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Minister Paschal Donohoe TD
Department of Finance
Government Buildings
Upper Merrion Street
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2 July 2020

Pre-Finance Bill 2020 Submission

Dear Minister

We set out in this submission a number of legislative changes for consideration in drafting Finance Bill 2020. We have outlined in the body of this letter, various technical amendments to tax legislation, which we believe are required to mitigate certain 'unintended consequences' arising from recent legislative changes. Our recommendations are grouped under the following three broad policy areas:

1. Measures to support Irish SMEs
2. Measures to provide tax certainty for business (both international and domestic)
3. Business succession measures

We warmly welcome the central focus on SMEs in the Programme for Government and the strong commitment to a pro-enterprise policy framework. We also agree, as stated in the Programme that such a policy framework must be underpinned by a sustainable and stable tax environment. In our Submission to the three political parties during the government formation process (copy attached), we set out a number of broad principles on tax policy as well as some practical ideas to support businesses and protect jobs in the sectors worst hit by the Covid-19 restrictions.

The Programme for Government commits to enacting legislation for the warehousing of tax liabilities. Under the tax debt warehousing arrangement announced in early May, Revenue will ringfence VAT and PAYE (Employer) tax debts deferred while a business was unable to trade or was subject to restricted trading due to the Covid-19 related health restrictions, as well as debts for an additional two months after the business resumes “normal” trading. SMEs, which Revenue define as businesses with a turnover of less than €3 million, will automatically qualify for the warehousing arrangement.

However, businesses with higher turnovers have also been seriously affected by the Covid-19 restrictions and it is essential that they are provided for in the legislation for warehousing tax liabilities to reflect the administrative flexibility currently operated by Revenue for them on a case by case basis.

We would be very glad to meet you to discuss these ideas though we appreciate the time pressure on the government to bring forward the Jobs Stimulus Package in the coming weeks.

Yours sincerely

Frank Mitchell

Frank Mitchell
Institute President

Institute Recommendations for Finance Bill 2020

Our recommendations for Finance Bill 2020 are grouped into three areas below. We have provided further detailed analysis of each technical matter in the Appendix to this submission (pages 9 – 25).

1. Measures to support Irish SMEs

1.1 Enhancements to the Key Employee Engagement Programme (KEEP)

A number of amendments have been made to KEEP since it was first introduced in Finance Act 2017 to help improve the limited take up of the scheme by SMEs. However, we believe that further legislative steps are necessary, as several factors continue to significantly affect the feasibility of the scheme. In our view, the policy intention of KEEP, which is to help SMEs attract and retain key employees, can only be achieved if the following legislative provisions are addressed:

- Further amend the definition of a 'qualifying holding company'.
- Develop an agreed 'safe harbour' approach to share valuation and impose an appropriate sanction where there is an undervalue.
- Amend the conditions regarding remuneration, in particular for 2020 and 2021, to take account of situations where employees' hours may have been reduced or temporarily laid off because of the Covid-19 restrictions.
- Create liquidity in KEEP shares by allowing a company to buy-back KEEP shares.
- Amend the employment conditions for a 'qualifying individual', in particular for 2020 and 2021, to take account of situations where employee hours may have been reduced or temporarily laid off because of the Covid-19 restrictions.
- Allow the continuing availability of the relief should the SME (e.g. holding company and its subsidiaries) undergo a corporate reorganisation during the period in which the KEEP share option rights are outstanding.

1.2 Enhancements to the Employment and Investment Incentive (EII) Scheme

In the current economic environment, many businesses will need to diversify into new markets and expand existing ones. Changes to logistics to accommodate social distancing may be needed in certain sectors, such as the hospitality and food industry. Some businesses are thriving due to Covid-19 related demand for their products or services and need investment to expand. This investment will require financial support and funding from a range of external sources and will be critical to the survival of many businesses. The EII scheme is a vital tool that allows many viable and fundamentally sound Irish SMEs and start-up businesses to raise short-term financing at a reasonable rate of return to enable them to diversify and grow.

However, we believe further legislative and administrative steps are necessary to ensure the relief is working effectively and in line with its stated policy intention, such as:

- Capital losses realised on EII investments should be available for offset, as recommended by Indecon in their evaluation of the scheme.
- The rules governing EII could be broadened to cater for institutional investors pooled in vehicles which mirror the operation of an alternative investment fund established to invest in "qualifying companies" for the purposes of EII.
- A monetary penalty would be a more proportionate sanction for administrative errors or the late filing of a return, rather than the claw back of the entire relief, which can act as a disincentive for companies considering using EII.
- Appropriate and adequate resourcing should be committed by Revenue to processing EII applications to ensure consistency in dealing with applications and to provide pre-clearance on General Block Exemption Regulations (GBER)[1] requirements (where applied for) in a timely manner.
- Revenue guidance should be further enhanced on their interpretation of key GBER concepts to provide taxpayers with the necessary tax certainty regarding their EII applications.

2. Measures to support tax certainty for business

The ongoing impact of the Covid-19 crisis is causing significant uncertainty in the business environment. Now more than ever businesses need certainty over their tax affairs. We have outlined below six international measures and seven domestic measures where we believe amendments are required to existing legislation to provide the necessary certainty for business in applying tax rules.

International Measures

2.1. Implementation of ATAD interest limitation rules

The Anti-Tax Avoidance Directive[2] (ATAD) requires EU Member States to introduce ratio-based interest limitation rules, designed to limit the ability to deduct borrowing costs when calculating taxable profits. In implementing the ATAD compliant interest limitation rules, we believe that policymakers should avoid going beyond what is required under ATAD unless there is a clear domestic policy reason for doing so. In view of the very technical nature of the interest limitation rules, it is important that stakeholders are provided with an opportunity for proper consultation on draft legislation, to ensure the new rules do not give rise to any unintended consequences within the tax code.

If it is not possible to implement a complete reform of Ireland's interest deductibility rules in Finance Bill 2020, but rather over subsequent Finance Bills, provisions which are clearly incompatible with the operation of the new ATAD rules, such as, section 840A TCA 1997, should be removed this year at the very minimum.

The exemption for long-term infrastructure projects under ATAD should be adopted in Ireland with a wide definition of long-term infrastructure and not just confined to public private partnership projects. Projects should be considered for the general public interest,

[1] Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible internal market in application of Articles 107 and 108 of the Treaty.
[2] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market

irrespective of whether they are privately owned or whether a fee is charged to the public for their use.

2.2. Introduction of a participation exemption for dividends and foreign branches

The introduction of controlled foreign company (CFC) rules in Finance Act 2018 ensures that profits are properly aligned with substance and prevent any profit shifting risks to the Irish tax base. The administrative burden and compliance costs associated with Irish CFC rules, in addition to the operation of a worldwide tax system, can act as a barrier to Ireland being a location of choice for regional headquarters of multinational groups. We believe that it is now time for Ireland to introduce a participation exemption for dividends and foreign branches to ensure that Ireland remains an attractive location for foreign direct investment.

2.3. Measures to alleviate the impact of Brexit

The UK has confirmed it will not consider an extension to the Brexit transition period beyond 31 December 2020, even though many aspects of the future EU/UK relationship remain uncertain. In light of this, taxpayers now need clarity as to whether the taxation provisions contained in Part 6 of the Withdrawal of the United Kingdom from the European Union (Consequential Provisions) Act 2019 (the Withdrawal Act) will be commenced or indeed, whether policymakers intend to enact similar legislative provisions, given the Withdrawal Act was meant to apply in the event of a “no-deal” Brexit.

In addition, we identified in our Pre-Finance Bill 2019 submission[3] several circumstances that were not covered by the Withdrawal Act, which we believe should be legislated for to ensure that the status quo will be maintained for taxpayers post 31 December 2020.

2.4. Implementation of agreements reached under MAP and the Arbitration Convention

Section 959AA (2A) TCA 1997 allows Revenue to make or amend an assessment for the purpose of giving effect to an agreement reached with the competent authority of another jurisdiction under the Mutual Agreement Procedure (MAP) or the Arbitration Convention. We recommend that section 959AA is amended to ensure, that in giving effect to such an agreement, any relevant time limits may be disregarded so that a taxpayer can be put in the same position as they would have been, had the original return filed reflected the outcome of the agreement reached.

2.5. Determination of company residence for tax purposes

Section 626B TCA 1997 provides for an exemption from tax on certain capital gains from the disposal of holdings in subsidiaries. Section 626B TCA 1997 requires consideration of whether a company is *"by virtue of the law of a relevant territory, resident for the purposes of tax in the relevant territory”.* We recommend that wording be introduced into section 626B to clarify that a company which is resident in a territory for the purposes of a double tax treaty with Ireland shall be considered to be resident *"by virtue of the law of"* that territory.

2.6. Extend relief from Encashment Tax

Feedback from our members suggests that technical uncertainties regarding the scope of Encashment Tax to foreign branches of Irish entities operating as collecting agents and its application to payments under derivatives, together with the compliance and cash flow burden associated with the tax, is impacting on Ireland’s competitiveness with other jurisdictions, such as the UK, for custodial operations and retail wealth management. The

[3] https://taxinstitute.ie/wp-content/uploads/2019/07/2019-06-21-ITI-Finance-Bill-2019-Submision-FINAL.pdf

UK abolished Encashment Tax in 2001. In order to strengthen Ireland's competitive position in the financial services sector post-Brexit, we recommend extending relief from operating Encashment Tax to all companies, to reduce the compliance burden for custodians and alleviate the cash flow mismatch issue for financial traders.

Domestic Measures

2.7. Tax exemption for the Restart Grant

The Restart Grant is available to small businesses[4] to help them with the costs associated with reopening and re-employing workers following Covid-19 closures. However, without a legislative provision confirming otherwise, the grant will be taxable, effectively halving its value for sole traders. We recommend that Finance Bill 2020 includes a provision to exempt the Restart Grant from tax to ensure the benefit of the Grant for impacted businesses is maximised.

2.8. Streamlining the tax reporting and collection process for non-resident landlords

Where a collection agent (such as a property management company, letting agent or family friend) collects rents on behalf of a non-resident landlord, the landlord is chargeable to income tax in the name of that collection agent under section 1034 TCA 1997. This means that if a non-resident landlord has properties in different parts of the country managed by different agents, each agent is obliged to submit a tax return in respect of the rent they collect from the property that they manage on the client's behalf and calculate and pay the tax due (including preliminary tax) on rental income as if the non-resident landlord were assessed in his or her own right. This reporting process can be cumbersome and adds unwarranted costs and complexity to the tax compliance process.

In our view, a more streamlined approach to collecting information and tax relating to non-resident landlords should be adopted. The current Third-Party Return for letting agents/property managers could be adapted to capture information relating to non-resident landlords, perhaps, through a non-resident landlord version of the form. The collection agent could submit a report to Revenue electronically at set intervals, providing details of the non-resident landlords for whom they have collected rents. Tax at the standard rate of 20% could be withheld on the rent after expenses and paid over to Revenue with the return.

2.9. Extension of the Knowledge Development Box beyond 2020

The Knowledge Development Box[5] (KDB) offers companies an effective corporation tax rate of 6.25% on profits arising from "qualifying assets" such as patents, copyrighted software and certain other assets where some or all of the related research and development is undertaken by the Irish company. The KDB is due to end on 31 December 2020 and a public consultation was expected to take place in advance of the year end. We recommend that the KDB is extended and that a public consultation is undertaken in the short term to identify any limitations with the relief and to ensure that any necessary amendments can be made to encourage further uptake of the scheme.

2.10. Enhancement of the Residential Development Stamp Duty Refund Scheme

The Residential Development Stamp Duty Refund Scheme (SDRS) is an important relief which encourages the building of housing available for rental and reduces the cost of

[4] The scheme applies to small businesses with a turnover of under €5 million and employing 50 people or less.
[5] Part 29, Chapter 5 TCA 1997

certain homes for buyers. However, certain legislative changes are necessary to ensure there is certainty regarding the availability of the SDRS for residential developments.

In our view, the 75% test should be applied after green areas, footpaths, roads, and other common areas on the site have been excluded given that they are for the purposes of the housing units being built. The timeline for completion of ongoing developments should be extended to proportionately take account of restrictions imposed because of the Covid-19 pandemic, including limitations resulting from the ongoing social distancing requirements.

We would also recommend that the relief be extended now beyond its current end date of 31 December 2021 to ensure that it can continue to be an influencing factor to encourage the development of residential construction projects.

2.11. Roll forward the regional uplift for film relief beyond 2020

Finance Act 2018 provided for an increased rate of film relief for films substantially produced in an "assisted region", known as the "Regional Film Development Uplift"[6]. Given the impact of the restrictions imposed because of the Covid-19 pandemic on all stages of the film production process, we would recommend that the Regional Film Development Uplift of 5% for 2020 and the reduced rates for subsequent years are rolled forward for at least an extra year.

2.12. Technical amendments to domestic mergers by absorption

We recommend that section 633D TCA 1997 is amended to clarify that the provisions for cross border mergers apply equally to mergers by absorption under Irish law and that the meaning of "transfer" for the purposes of a merger under section 633D, includes both trading and non-trading assets and liabilities.

2.13. Legislative amendments for stock lending and repo transactions

Stock lending and sale and repurchase (repo) transactions are important sources of liquidity in properly functioning financial markets. Legislative provisions were introduced in Finance Act 2019 which sought to put Revenue guidance[7] dealing with such transactions on a legislative footing. However, the enacted legislation does not address the application of the rules to companies entering stock lending and repo transactions as part of their Schedule D Case I activities nor to pension funds. If it is not intended for the rules to apply to such activities, then it is important for this to be clearly stated in legislation.

In addition, there are a number of issues with the existing legislation which can result in relief for genuine costs incurred being disallowed. The definitions of 'financial transaction', 'manufactured payment' and 'equivalent stock' and the tax treatment of a 'manufactured payment' needs to be addressed and the record keeping requirements with existing regulatory obligations need to be aligned. Given the technical nature of these provisions, it would be beneficial for stakeholders to be provided with an opportunity for consultation on draft legislation to ensure that any proposed amendments do not give rise to any further unintended consequences.

[6] Section 481 TCA 1997
[7] Tax and Duty Manual Part 04-06-13

3. Business succession measures

3.1. Impact of section 135 TCA 1997 on the sale of a family business/SMEs

Considerable concern continues to exist regarding the effect of the anti-avoidance provision contained in section 135 (3A) TCA 1997 on scaling up and passing on of businesses in the SME sector. Subsection 3A imposes income tax treatment on selling shareholders in any situation where Revenue take the view that a company has retained profits in excess of the company's commercial needs, rather than allowing those shareholders to obtain capital gains tax (CGT) treatment.

Unlike other anti-avoidance provisions in Irish tax legislation, section 135 TCA 1997 does not include a *bona fide* test to exclude transactions effected for *bona fide* commercial reasons. In our view, inserting an exclusion for *bona fide* commercial transactions into section 135 TCA 1997 is essential to provide the necessary level of certainty to taxpayers and their advisers, when implementing transactions involving the disposal of shares in a company with cash on its balance sheet.

3.2 Availability of Young Trained Farmer Stamp Duty Exemption where the farmer is an employee or shareholder of a farming company

Section 81AA SDCA 1999 provides for an exemption from stamp duty on transfers of farmland and buildings to young trained farmers.[8] Some farm businesses are carried out by companies that farm land owned by a shareholder. The farmers in question spend the majority of their time engaged in the farming activities as employees of the company. The availability of young trained farmers stamp duty relief in such circumstances is not certain in legislation and clarification would be welcome on the matter.

3.3 Impact of increase in CAT group thresholds

Where there is an increase in a capital acquisitions tax (CAT) group threshold, whilst the general perception may be that a person can avail of the increased tax free amount for any subsequent gifts or inheritances, this is not possible for a beneficiary who has previously received benefits exceeding the new threshold amount, irrespective of the fact that they would have paid CAT on the increased amount now available to others. We recommend that the legislation is amended to ensure that where there is an increase in a CAT group threshold, a person is able to avail of the increased tax-free amount for any subsequent gift or inheritance.

[8] Section 81AA Stamp Duty Consolidation Act 1999

APPENDIX - FURTHER DETAILED ANALYSIS

1. Measures to support Irish SMEs

1.1. Enhancements to the Key Employee Engagement Programme (KEEP)

KEEP[9] was introduced by Finance Act 2017 to assist SMEs[10] to attract and retain skilled workers through the provision of share-based awards. It provides for an exemption from income tax, USC and PRSI for any gain arising on the exercise of a share option by a qualifying individual in a qualifying company. However, there has been a relatively low uptake of the scheme.[11] Several amendments were made to KEEP in Finance Act 2019, following the public consultation undertaken by the Department of Finance in 2019. These changes are subject to a Ministerial commencement order as State aid approval is required.

We believe further legislative amendments are needed to improve the feasibility of the scheme. In our view, the policy intention of KEEP, which is to help SMEs attract and retain key employees, can only be achieved if these limitations are addressed. We have outlined the limitations below together with our recommendations for reforms to the existing legislation. A number of these recommendations were also included in our response[12] to the 2019 public consultation on KEEP.

Amend the definition of a 'qualifying holding company'

While the amendments introduced by Finance Act 2019 are welcome and are likely to go some way to increasing the number of groups that can now qualify for KEEP, there are certain conditions attaching to the new definitions of 'qualifying holding company' and 'qualifying group' that will also hinder certain groups availing of the scheme.

For example, it is common for a new business to start up as a single trading entity, then, as the business grows and expands into new territories or delivers new products, it can become necessary for commercial reasons to incorporate another entity. Often, such new entities are established as subsidiaries of the original trading company. As the business activities expand, the original company often continues to carry on the existing trade but also evolves into a holder of the shares in the new trading subsidiary.

Generally, such businesses would not put a company in place whose sole or main business is that of holding shares, as the stage of development of the business may not warrant it or it may not be commercially necessary to do so, particularly given the complexity and cost that can be involved in undertaking a group restructure to put a holding company in place.

Many businesses that wish to set up a KEEP scheme are prevented from doing so because of the restrictive definition of a 'qualifying holding company' under the rules of the scheme.

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[9] Section 128F TCA 1997

[10] A company will be considered a micro, small or medium sized enterprise (SME) where the company employs fewer than 250 employees and its annual turnover/ annual balance sheet does not exceed €50 million and €43 million respectively.

[11] The latest available data is that 10 companies granted share options qualifying for the Key Employee Engagement Programme (KEEP) to 87 key employees during 2018 – Response to Parliamentary Question, 5 December 2019https://www.oireachtas.ie/en/debates/question/2019-12-05/82/

[12] https://taxinstitute.ie/wp-content/uploads/2019/06/2019-05-24-FInal-ITI-response-to-KEEP-consultation-May-2019.pdf

The following conditions for a 'qualifying holding company' are particularly problematic:

- A qualifying holding company for KEEP purposes cannot be a trading company. If it is trading, it is not a qualifying holding company, even if it is wholly or mainly holding shares in trading subsidiaries.
- Company structures with an intermediate holding company may not be regarded as a qualifying company if there is no qualifying subsidiary held directly by the ultimate holding company. By way of comparison, Revenue guidance[13] for Revised Entrepreneur Relief (section 597AA TCA 1997) acknowledges that structures with a double holding company are not precluded from that relief.
- A holding company can only hold shares in a qualifying subsidiary and a "relevant subsidiary" and no other companies. A "relevant subsidiary" is one in which the qualifying holding company holds more than a 50% interest in the ordinary share capital. Therefore, if the holding company had a 50% joint venture interest in another company it cannot be a qualifying holding company, even if it had a qualifying subsidiary that was a qualifying company.

We believe that the definition of qualifying holding company should be amended to permit the group as a whole to be considered, rather than simply considering the holding company in isolation. This could be achieved by amending the wording of the definition of a "qualifying holding company" at subsection (c) to state that it means a company where "*the business of the company, its qualifying subsidiary or subsidiaries, and as the case may be, its relevant subsidiary or subsidiaries, taken together consists wholly or mainly of the carrying on of a trade or trades."* This approach would be similar to the approach taken for the capital gains tax holding company exemption in section 626B TCA 1997.

In addition, the legislation is unclear as to whether it is possible to issue KEEP options in a single company within a group that meets the "qualifying company" tests or whether it is necessary for the group, of which the qualifying company is part, to be a "qualifying group". This should be clarified in the legislation.

<u>*Develop an agreed 'safe harbour' approach to share valuation and impose an appropriate sanction where there is an undervalue*</u>

In our response to the 2019 public consultation on KEEP[14] we highlighted that one of the most significant practical issues that SMEs face when implementing KEEP is the ability to achieve as much certainty as possible that the valuation conditions have been met. For example, that the share option price is not less than the market value of the shares at the date of grant.

Currently there is no guidance on how to determine what market value is for the purposes of KEEP. If qualifying options are not granted for market value or the market value is subsequently determined by Revenue to be higher than originally projected, the options would not qualify as KEEP options under section 128F TCA 1997, resulting in no exemption from income tax, USC and PRSI on exercise.

Comprehensive guidance on share valuations is required to support companies adopting the scheme. This would make the process more accessible, easily understood, and capable

[13] Tax and Duty Manual Part 19-06-02b - Revised entrepreneur relief
[14] https://taxinstitute.ie/wp-content/uploads/2019/06/2019-05-24-FInal-ITI-response-to-KEEP-consultation-May-2019.pdf

of implementation without undue duplication of effort and cost. We outlined several ways of achieving this in our response to the public consultation on KEEP.[15]

In addition, where options are granted at an undervalue, we believe that a more proportionate sanction would be for a charge to income tax to arise on the exercise of the options on the difference between the market value at the date of grant and the option price. This would allow the options to remain qualifying share options, but it would also enable Revenue to collect income tax on the portion of the gain attributable to the undervalue.

The income tax arising on exercise could be collected under the same mechanism as section 128 TCA 1997 (i.e. a charge to income tax under Schedule E is imposed on any gain realised by a director or employee from a right granted to him/her, by reason of his/her office or employment, to acquire shares or other assets in a company).

Amend the conditions regarding remuneration

Currently, the total market value of all shares, in respect of which qualifying share options have been granted by the qualifying company to an employee or director, must not exceed €100,000 in any one year of assessment, €300,000 in all three years of assessment or 100% of the annual emoluments of the qualifying individual in the year of assessment in which the qualifying share option is granted.

In our response to the 2019 public consultation on KEEP[16] we outlined that linking the amount of share options that can be awarded under KEEP to the employee's annual emoluments restricts high growth companies in start-up mode availing of the scheme. Often in start-up businesses employees and directors would have lower salaries, compared with larger multinationals, which can prohibit such companies under KEEP offering equity as an incentive for these individuals to stay in the business.

We suggest that rather than discriminating in practice against the remuneration strategies of these companies and the mix of cash-based and equity-based remuneration that they offer employees, the KEEP measures should simply set absolute values, such as those included in subparagraph (i) and (ii) of part (d) of section 128F (1) TCA 1997.

We believe that such an amendment to the qualifying limit of 100% of the annual emoluments of the qualifying individual is particularly needed in 2020 and 2021 to ensure that employees are not adversely affected by receiving a lower salary because of the Covid-19 restrictions on our economy.

This would take account of situations where an employee's salary has reduced because of reduced working hours or a temporary layoff. It would also address situations where employees, who are temporarily absent from work due to maternity or paternity leave, are limited in terms of the relief which may apply, as often their salary levels would be reduced during this time.

Creating liquidity in KEEP shares by allowing a company buy-back of shares

A substantial challenge for SMEs wishing to operate a KEEP scheme is to provide assured liquidity for their shares, as not all such companies are likely to be sold or listed on a stock

[15] https://taxinstitute.ie/wp-content/uploads/2019/06/2019-05-24-FInal-ITI-response-to-KEEP-consultation-May-2019.pdf
[16] https://taxinstitute.ie/wp-content/uploads/2019/06/2019-05-24-FInal-ITI-response-to-KEEP-consultation-May-2019.pdf

exchange. SMEs may need to consider how to create a market in the absence of a third-party exit, such as the owner, other employees, or the company itself buying back the shares from an employee.

In general, a company buyback of shares is treated as income rather than capital. However, section 176 TCA 1997 provides that CGT treatment can apply to a buyback or redemption of shares if it is for the benefit of the trade. The KEEP provisions include a *bona fide* commercial reason test[17] to be met as part of the scheme's requirements. In our response to the public consultation we recommended that section 176 TCA 1997 should be amended to reflect that a buyback of shares acquired under KEEP can be expected to meet the conditions for the benefit of the trade test in that section.

A full list of our recommendations in relation to a company buyback of shares and the amendments required to be made to the rules on buybacks in sections 176, 177 and 178 TCA are outlined in our response to the public consultation on KEEP.[18] An alternative approach would be for the KEEP legislation to be amended to permit CGT treatment to apply to a buyback or redemption of shares in certain circumstances without meeting the conditions of Part 6, Chapter 9 TCA 1997.

Amend the employment conditions for the 'qualifying individual'
Changes introduced by Finance Act 2019 allow individuals working part-time or who have flexible working arrangements to be regarded as qualifying individuals.[19] The amendments also allow for the movement of qualifying individuals between qualifying companies within the group. While these changes are welcome, the amendments to the legislation would appear to preclude an employee who has been temporarily absent from work, for example, due to maternity or paternity leave, from qualifying for the relief.

Many employees have been put on part-time or reduced hours or temporarily laid off because of the Covid-19 restrictions on our economy and the SME sector. Under section 128F TCA 1997, an employee is required to work at least 30 hours per week to be a qualifying individual for KEEP.[20] We believe this condition should be amended for 2020 and 2021 to take into account the impact of Covid-19 on these employees, so that they can remain within the scheme where their hours have been reduced or they have been temporarily laid off as a direct result of the Covid-19 restrictions.

Where a SME undergoes a reorganisation
The current KEEP legislation does not provide for the continuing availability of the relief in the event of the SME (e.g. holding company and its subsidiaries) undergoing a corporate reorganisation during the period in which the KEEP share option rights are outstanding. We would suggest amending the KEEP legislation to include similar provisions to those contained within the Revised Entrepreneur Relief legislation,[21] which seeks to address reorganisations[22] that might affect the entitlement of a qualifying individual and a qualifying company to meet the scheme requirements.

[17] Section 128F (11) TCA 1997
[18] https://taxinstitute.ie/wp-content/uploads/2019/06/2019-05-24-FInal-ITI-response-to-KEEP-consultation-May-2019.pdf
[19] This amendment is subject to a Ministerial Order.
[20] Finance Act 2019 amendments, subject to Ministerial Order, changed this to 20 hours per week with the employee and/or director dedicating not less than 75% of their work time to the qualifying company.
21 Section 597AA (1) (b) (i) and (ii) TCA 1997
[22] Corporate reorganisations under section 586 and 587 TCA 1997

1.2. Enhancements to the Employment and Investment Incentive (EII) Scheme

Rather than having to rely solely on government to inject cash into the economy, the EII could be encouraged as a way for the private sector to support the return to business following the Covid-19 restrictions and to boost the creation of new jobs.

In the current economic environment, many businesses will need to diversify into new markets and expand existing ones. Changes to logistics to accommodate social distancing may be needed in certain sectors, such as the hospitality and food industry.

Some businesses are thriving due to Covid-19-related demand for their products or services and need investment to expand. This investment will require financial support and funding from a range of external sources and it will be critical to the survival of many businesses. The EII scheme is a vital tool that allows many viable and fundamentally sound Irish SMEs and start-up businesses to raise short-term financing at a reasonable rate of return to enable them to diversify and grow.

Allow the offset of capital losses

The Institute welcomed the implementation of the recommendations of the Indecon Evaluation of the EII and SURE in Finance Act 2018 and Finance Act 2019. However, Indecon's recommendation for capital losses realised on EII investments to be available for offset has not yet been implemented. Given the high-risk nature of investments in EII companies, the non-availability of capital losses for a business venture which is ultimately unsuccessful, is an additional cost factor that must be considered by potential investors. Losses, net of tax relief already received, incurred on EII investments should be allowable. This would bring EII in line with the equivalent Enterprise Investment Scheme in the UK.

Allow investors to access EII through a broader the range of investment vehicles

Currently, institutional investors can access the EII scheme using a "designated investment fund". A designated investment fund must be established under an irrevocable trust with investors subscribing to such a fund and the subscription monies invested held by a trustee, as nominee[23].

However, this mechanism does not cater for the full range of investors who may be interested in investing in Irish SMEs. For example, certain investors may be pooled in limited partnership funds or structures not established under an irrevocable trust, where capital is committed by means of a mixture of debt and equity. To increase the attractiveness of the EII for institutional investors, the rules governing EII could be broadened to cater for investors pooled in vehicles which mirror the operation of an alternative investment fund established to invest in "qualifying companies" for the purposes of EII.

Proportionate penalties should apply for administrative errors or delays

Under the current rules, administrative errors or delays in the certification and reporting process can result in a full clawback of the relief on the fundraising company,[24] which in our

[23] Section 508I TCA 1997

[24] For example, where eligible shares are held by a nominee, a failure to file a nominee return (Form 21R) may result in such shares ceasing to be eligible shares and therefore there will no longer be a qualifying investment for the purposes of the relief (see sections 494(2) and section 496 Taxes Consolidation Act 1997). This means that there is a clawback of the relief on the company under section 508U Taxes Consolidation Act 1997.

view is disproportionate to the mistake made. These penal sanctions can act as a disincentive for companies considering using the EII. We believe it would be more proportionate for a monetary penalty to be imposed, rather than a claw back of the entire EII relief, as a sanction for an administrative error or the late filing of a return.

Administrative improvements

Whilst the changes introduced in Finance Act 2018 and Finance Act 2019 are welcome, further administrative improvements are necessary to ensure the effectiveness of the EII scheme. The uncertainty which exists regarding the interpretation of the General Block Exemption Regulations (GBER)[25], under which the EII operates, is continuing to result in delays where pre-clearance on GBER requirements are requested.

Member feedback suggests that considerable delays continue to be experienced in dealing with legacy cases. Such delays are creating uncertainty for taxpayers surrounding the availability of tax relief on their investments and in some cases, compromising the ability of businesses to raise EII funds. Appropriate and adequate resourcing should be committed to processing EII applications, as a matter of priority. Dedicated full-time staff, with the required technical knowledge to understand the complicated rules of the scheme, within the parameters of GBER, are necessary to ensure consistency in dealing with applications and to provide pre-clearance on GBER requirements (where applied for) in a timely manner.

We continue to work with Revenue through the Tax Administration Liaison Committee (TALC) to identify areas where additional guidance is required. We believe that Revenue guidance could be further enhanced with practical examples on their interpretation of key GBER concepts, such as, 'linked/partner businesses', 'new product' and 'new geographical market'. This would provide taxpayers with the necessary tax certainty regarding their EII applications and reduce the need for pre-clearance from Revenue.

2. Measures to support tax certainty for business

International Measures

2.1 Implementation of ATAD interest limitation rules

The Anti-Tax Avoidance Directive[26] (ATAD) requires EU Member States to introduce ratio-based interest limitation rules, designed to limit the ability to deduct borrowing costs when calculating taxable profits. We outlined the Institute's recommendations on the reform of Ireland's interest limitation rules in our response to the Department of Finance public consultation held in early 2019.[27]

In implementing the ATAD compliant interest limitation rules, we believe that policymakers should avoid going beyond what is required under ATAD unless there is a clear domestic policy reason for doing so. In light of the very technical nature of these provisions, it is important that stakeholders are provided with an opportunity for consultation on the draft legislation to ensure the new rules do not give rise to any unintended consequences within the tax code.

[25] Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible internal market in application of Articles 107 and 108 of the Treaty.
[26] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market
[27] https://taxinstitute.ie/wp-content/uploads/2019/06/ITI-Submission-18-January-2019.pdf

In our view, there should be a reconstruction of Ireland's existing rules on interest deductibility in parallel with the implementation of the new ATAD compliant interest limitation rules in Irish law. The updated provisions should reflect a broad base for interest deduction against both trading and non-trading income, using the protection of the new 30% EBITDA ratio rule against base erosion risks and removing the existing interest restrictions within the TCA 1997. Retaining two separate interest limitation regimes would make Ireland very uncompetitive for inward investment, compared with other jurisdictions and would likely increase the cost of borrowing for Irish businesses.

If it is not possible to implement a complete reform of Ireland's interest deductibility rules in Finance Bill 2020, as a starting point, provisions which are clearly incompatible with the operation of the new rules should be removed. For example, section 840A TCA 1997, which narrows the scope for deduction of interest on group borrowings used to acquire certain types of assets already held by the group, should be removed at a minimum.

EU Member States can decide not to apply the interest restriction rules to certain loans used to fund long-term infrastructure projects, which include projects to provide, upgrade, operate and/or maintain a large-scale asset, that are considered in the general public interest. Generally, long-term infrastructure investment by companies can result in increased growth and employment and the interest costs associated with that investment are often simply costs incurred for expanding a business and are not tax motivated.

As outlined in our response to the 2019 public consultation, in adopting such an exemption it is important that a wide definition of long-term infrastructure is applied and that it is not confined to public private partnership projects. Projects should be considered for the general public interest irrespective of whether they are privately owned or whether a fee is charged to the public for their use.

2.2 Introduction of a participation exemption for dividends and foreign branches

The introduction of Irish controlled foreign company (CFC) rules in Finance Act 2018 ensures that profits are properly aligned with substance and act to prevent profit shifting risks to the Irish tax base. The Irish CFC rules apply alongside the operation of Ireland's worldwide tax regime.

In determining where to invest, international investors consider how dividends, branches and capital gains on share disposals relating to that investment will be taxed. The operation of a worldwide regime requires foreign dividends to be taxed at the domestic rate, with credit for foreign tax incurred.

With the trend of decreasing corporate tax rates globally, the level of tax collected from worldwide regimes has diminished, even though the administration remains. The majority of the largest 50 economies by GDP now operate a territorial system, delivered through a range of options, including participation exemptions for dividends and exemptions for foreign branches. The trend in tax policy in recent times has been to move towards territorial systems, for example in Japan, the UK and in the US.

As domestic tax laws have been strengthened globally through the implementation of the BEPS Actions and the Inclusive Framework, including CFC rules, the need to have a worldwide tax regime to address foreign base erosion concerns has diminished. Any extension beyond protecting the domestic tax base can render a host country less competitive, given the additional administration created by a worldwide regime. In our view, the administrative burden and compliance costs associated with the Irish CFC rules, in addition to the operation of a worldwide tax system, can act as a barrier to Ireland being a location of choice for regional headquarters of multinational groups.

We believe that it is now time for Ireland to introduce a participation exemption for dividends and foreign branches to ensure that Ireland remains an attractive location for foreign direct investment.

2.3 Measures to alleviate the impact of Brexit

The UK has confirmed it will not consider an extension to the transition period created by the Withdrawal Agreement under Article 50 of the Treaty on European Union on 31 December 2020,[28] even though many aspects of the future EU/UK relationship remain uncertain. In light of this, taxpayers now need clarity as to whether the taxation provisions contained in Part 6 of the Withdrawal of the United Kingdom from the European Union (Consequential Provisions) Act 2019 (the Withdrawal Act) will be commenced or indeed, whether policymakers intend to enact similar legislative provisions, given the Withdrawal Act was intended to apply in the event of a “no-deal” Brexit.

Many of the provisions contained in the Withdrawal Act propose to extend tax legislative definitions to include the UK, allowing for the continuation of existing arrangements for the immediate future. For example, the provisions propose extending existing legislative definitions for group relief (sections 410 and 411 TCA 1997) company reconstructions and amalgamations (section 615 TCA 1997) and agricultural relief (section 89 CATCA 2003) to include the UK notwithstanding that the country is no longer a member of the EU/EEA.

In addition, we identified in our Pre-Finance Bill 2019 submission[29] several circumstances that are not covered by the Withdrawal Act, which we believe should be legislated for in order to ensure that the status quo will be maintained for taxpayers post 31 December 2020.

2.4 Implementation of agreements reached under MAP and the Arbitration Convention

Section 959AA (2A) TCA 1997 allows a Revenue officer to make or amend an assessment for a chargeable period to give effect to an agreement reached between Revenue and the competent authority of another jurisdiction under the Mutual Agreement Procedure (MAP) or the Arbitration Convention. However, we understand that it is Revenue’s view that this does not permit the amending of an assessment to allow claims for reliefs that would have been available at the time the return was originally filed where the deadline for claiming the relief has expired. This does not appear to align with the policy intention that section 959AA seeks to achieve.

It is worth noting that a similar provision exists in the UK under section 124(4) Taxation (International and Other Provisions) Act 2010 which provides that a claim for relief under the UK’s taxes acts may be made in pursuance of a mutual agreement at any time within 12

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[28] Part 15 of the *Withdrawal of the United Kingdom from the European Union (Consequential Provisions) Act 2019*, which came into operation with effect from 31 January 2020, means that where the term ‘Member State’ is used in any enactment it should be interpreted as including the UK for the duration of the transition period created by the Withdrawal Agreement under Article 50 of the Treaty on European Union i.e. up to 31 December 2020.

[29] https://taxinstitute.ie/wp-content/uploads/2019/07/2019-06-21-ITI-Finance-Bill-2019-Submision-FINAL.pdf

months of notification of the mutual agreement to the person affected, even if that involves making the claim after a deadline imposed by another enactment.

We recommend that section 959AA is amended to ensure, in giving effect to an agreement, that any relevant time limits may be disregarded so that a taxpayer can be put in the same position as they would have been, had the original filed return reflected the outcome of the agreement reached.

2.5 Determination of residence for tax purposes

Section 626B TCA 1997 provides for an exemption from tax on certain capital gains from the disposal of holdings in subsidiaries. One of the conditions of section 626B requires consideration of whether a company is *"by virtue of the law of a relevant territory, resident for the purposes of tax in the relevant territory*". However, this condition can give rise to uncertainty as some countries do not have a domestic concept of tax residence.

One such country is Hong Kong. Notwithstanding the absence of a domestic concept of tax residence for the purposes of the Ireland-Hong Kong Double Taxation Agreement (DTA), a resident of Hong Kong is defined as: *"A company incorporated in the Hong Kong Special Administrative Region or, if incorporated outside the Hong Kong Special Administrative Region, being centrally managed and controlled in the Hong Kong Special Administrative Region".*

It would seem appropriate that an entity meeting the definition of a "resident of Hong Kong" for that DTA should be regarded as resident in Hong Kong by virtue of the law of Hong Kong and should therefore satisfy the requirements of section 626B TCA 1997. This approach would appear to be in line with published Revenue guidance.[30]

For example, Revenue's guidance on CFC rules states: *"Hong Kong does not have a general concept of residence. There is no need to go through the various steps, however, as it has a double tax treaty with Ireland which will assist in determining residence. If, under the double tax treaty, a Hong Kong incorporated company is considered to be a resident of Hong Kong, then the company will be considered resident in Hong Kong for the purposes of the CFC legislation."*

We would welcome legislative confirmation that for the purposes of section 626B (2)(b) TCA 1997, if a company is resident in a territory under the terms of a DTA it shall be considered resident *"by virtue of the law of"* that territory.

2.6 Extend relief from Encashment Tax

Encashment Tax is a withholding tax at the standard rate of income tax made by collecting agents, such as, stockbroking firms, when they make or receive certain foreign interest and dividend payments. Revenue can relieve a chargeable person of the obligation to deduct Encashment Tax on foreign dividends payable to Irish residents.[31] Such relief has been granted to charities, pension schemes, investment undertakings, section 110 companies, banks, building societies and life assurance companies.[32] However, most Irish corporates are not exempt from Encashment Tax.

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[30] See Revenue's Tax and Duty Manual Part 35b-01-01 Controlled Foreign Companies, July 2019 & Revenue's Tax and Duty Manual Part 08-03-06, Payment and receipt of interest without deduction of income tax, December 2018.
[31] Schedule 2 Part 5 TCA 1997
[32] https://www.revenue.ie/en/tax-professionals/tdm/income-tax-capital-gains-tax-corporation-tax/sch-2/sch2-1.pdf

Feedback from our members suggests that technical uncertainties regarding the scope of Encashment Tax to foreign branches of Irish entities operating as collecting agents and its application to payments under derivatives, together with the compliance and cash flow burden associated with the tax, is impacting on Ireland's competitiveness with other jurisdictions, such as the UK, for custodial operations and retail wealth management.

For financial traders who generally hedge most, if not all, positions, Encashment Tax means discontinuity in income flows between the dividend/interest and the manufactured payment. In contrast, the UK abolished Encashment Tax in 2001.

In order to strengthen Ireland's competitive position in the financial services sector post-Brexit, we recommend extending relief from operating Encashment Tax to all companies, to reduce the compliance burden for custodians and alleviate the cash flow mismatch issue for financial traders. In our view, the risk of non-disclosure of such income is low.

Domestic Measures

2.7 Tax exemption for the Restart Grant

The Restart Grant is available to small businesses[33] to help them with the costs associated with reopening and re-employing workers following Covid-19 closures. The grants will be equivalent to the rates bill of the business in 2019, with a minimum payment of €2,000 and a maximum payment of €10,000. However, without a legislative provision confirming otherwise, the grant will be taxable, halving its value for sole traders. We recommend that the Restart Grant is exempt from tax to ensure that the benefit of the Grant for impacted businesses is maximised.

2.8 Streamlining the tax reporting and collection process for non-resident landlords

If a non-resident landlord appoints a collection agent (such as, a property management company, letting agent or even a family friend), to collect rents on his/her behalf under section 1034 TCA 1997, the non-resident landlord is chargeable to income tax in the name of that collection agent. Revenue has confirmed[34] that where a non-resident landlord has properties in different parts of the country managed by different agents, section 1034 requires each agent to submit a tax return in respect of the rent they collect from the properties that they manage on the client's behalf.

Therefore, each agent must:

- Submit an income tax return for each non-resident landlord for whom they collect rent and withhold a portion of the rent to pay the tax liability.
- Not only should the tax return take account of expenses in calculating the rental profit, but it should also include relief for any personal tax credits to which the landlord is entitled.
- Preliminary tax obligations must be met by each agent.
- Penalties can apply if the agent fails to submit the return.
- In addition, the agent's own tax clearance can be impacted if the obligations are not met.

[33] The scheme applies to small businesses with a turnover of under €5 million and employing 50 people or less.
[34] Minutes of TALC Collections sub-committee meeting, 28 November 2019 https://taxinstitute.ie/wp-content/uploads/2020/03/Minutes-of-TALC-Sub-Committee-on-Collections-28-November-2019.pdf

The requirements of section 1034 present a range of practical issues, such as:

- Difficulties in completing the return. For example, the agent needs to know information on the landlord's worldwide income and Irish income to determine to what extent personal tax credits may be claimed on the return. Agents merely appointed to manage a property for a landlord would not typically be privy to such information.
- Duplicate claims for personal credits if each agent is claiming these on the return they submit on behalf of the landlord.
- The submission of information on multiple income tax returns relating to a single taxpayer, which needs to be amalgamated by Revenue and compared to the landlord's own return.
- Increased compliance costs for taxpayers arising from the completion of multiple returns.
- Lack of clarity that compliance by the agents with these obligations removes the landlord's obligation to submit a return. Equally, the fact that the landlord is a chargeable person submitting their own return does not remove the obligation on the collection agent to also submit a return relating to the rental income they receive.

In addition, under section 888 TCA 1997 letting agents and managers of premises are obliged to submit a Third-Party Return of information (Form 8-3) to Revenue annually on rental payments to landlords. This includes information on details of the property address, property owner, and details of the rent paid to landlords. This filing obligation applies whether or not the owner of the premises is resident in Ireland.

Overall, this reporting process is cumbersome and adds unwarranted costs and complexity to the tax compliance process. In our view, a more streamlined approach to collecting information and tax relating to non-resident landlords should be adopted. Revenue has advised that such a change would require a change to the legislation.

The current Third-Party Return for letting agents/property managers could be reviewed and adapted to capture information relating to non-resident landlords, perhaps, through a non-resident landlord version of the form. The collection agent could submit a report to Revenue electronically at set intervals, providing details of the non-resident landlords for whom they have collected rents. Tax at the standard rate of 20% could be withheld on the rent after expenses and paid over to Revenue with the return.

Providing the information in electronic format should aid Revenue's analysis and interrogation of the data and provide more accurate information on the taxpayer's position, than can be ascertained from amalgamating information from multiple income tax returns. This system would also allow for the pre-population of information regarding such rents on the tax returns of the non-resident landlords which is a process Revenue increasingly use to improve the accuracy of tax returns.

2.9 Extension of the Knowledge Development Box beyond 2020

The Knowledge Development Box[35] (KDB) was introduced by Finance Act 2015, following a public consultation. The general aim was to ensure that Ireland provided a KDB offering which was the "most competitive in class" within the parameters set by the OECD's "modified nexus" approach. The KDB offers companies an effective corporation tax rate of

[35] Part 29, Chapter 5 TCA 1997

6.25% on profits arising from "qualifying assets" such as patents, copyrighted software, and certain other assets where some or all of the related research and development is undertaken by the Irish company. To date the uptake of companies claiming the KDB has been slow. The latest available information indicates 12 companies claimed the KDB in 2016 and 10 companies claimed it in 2017[36].

The KDB is due to end at the end of 2020 and a public consultation was expected to take place in advance of the end of the year. We recommend that the KDB is extended and that a public consultation is undertaken in the short term to identify any limitations with the relief and to ensure that any necessary amendments can be made to encourage further uptake of the scheme.

2.10 Enhancement of the Residential Development Stamp Duty Refund Scheme

The Residential Development Stamp Duty Refund Scheme (SDRS) is an important relief which encourages the building of housing available for rental and reduces the cost of certain homes for buyers. However, a number of legislative changes are necessary to ensure there is certainty regarding the availability of the SDRS for relevant developments.

The SDRS provides for a 4% stamp duty refund for land that is subsequently developed for residential purposes. One of the conditions to qualify for the refund is that housing units must account for at least 75% of the total surface area of the land. In less urbanised areas, it may not be possible to meet the 75% test due to the requirement to include green areas, footpaths, roads, and other common areas in the site area. In our view, the 75% test should be applied after such areas are excluded given that they are for the purposes of the housing units being built.

The restrictions imposed because of the Covid-19 pandemic, including limitations as a result of ongoing social distancing requirements, has resulted in delays in developments. We would suggest that the timeline for completion of ongoing developments should be extended to proportionately take account of such restrictions.

The SDRS is due to end for developments commencing after 31 December 2021. Given the considerable time involved in taking a site to the point of commencement of development, we would recommend that the relief is extended now to ensure that it can continue to be an influencing factor to encourage the development of residential construction projects.

2.11 Roll forward the regional uplift for film relief beyond 2020

Film relief[37] plays an important role in attracting international talent and significant inward investment for the Irish television and film industry. Finance Act 2018 provided for increased relief for films substantially produced in an "assisted region", which is known as the "Regional Film Development Uplift". For claims made on or before 31 December 2020, the Regional Film Development Uplift operates to increase the rate of the credit by 5% to 37%. A reduced uplift applies for claims made in 2021 and 2022.

Given the impact of the restrictions imposed because of the Covid-19 pandemic on all stages of the film production process, we would recommend that the Regional Film Development Uplift of 5% for 2020 and the reduced rates for subsequent years should be

[36] Revenue's paper on 2018 Corporation Tax payments and 2017 Corporation Tax returns (page 18) https://www.revenue.ie/en/corporate/documents/research/ct-analysis-2019.pdf
[37] Section 481 TCA 1997

rolled forward for at least an extra year.

2.12 Technical amendments to domestic mergers by absorption

Equal treatment for EU and domestic mergers by absorption

Groups of companies may seek to restructure by means of a merger by absorption for a number of commercial reasons. The Mergers Directive (Council Directive 2009/133/EC) provides that cross border mergers by absorption should be tax neutral. Section 633D TCA 1997 sought to transpose the requirements of the Merger Directive into Irish law. At the time of the introduction of section 633D, mergers by absorption was not a concept which existed in Irish law. The Companies Act 2014 subsequently introduced domestic mergers by absorption into Irish law, however, clarification in legislation is required to ensure that the tax treatment available under section 633D for cross border mergers applies equally to mergers by absorption under Irish law.

Meaning of "transfer" for the purposes of section 633D

To meet the conditions of section 633D, a wholly owned subsidiary must transfer all of its assets and liabilities to its parent company in the course of the merger. However, "transfer" is defined in section 630 for the purposes of Part 21 Chapter 1 TCA 1997, (which incorporates section 633D) by reference to a transfer by a company of the whole or part of its trade. This requirement does not align with the Mergers Directive which refers to the transfer of a company's "assets and liabilities" without distinguishing between trading and non-trading assets. A legislative amendment is required to section 633D to clarify that a "transfer" includes both trading and non-trading assets and liabilities.

We recommend that section 633D TCA 1997 is amended to clarify that the provisions for cross border mergers apply equally to mergers by absorption under Irish law and that the meaning of "transfer" for the purposes of a merger under section 633D, includes both trading and non-trading assets and liabilities.

2.13 Legislative amendments for stock lending and repo transactions

Stock lending and sale and repurchase (repo) transactions are important sources of liquidity in properly functioning financial markets. Legislative provisions were introduced in Finance Act 2019 which sought to put Revenue's guidance[38] dealing with such transactions on a legislative footing. However, the legislation[39] does not address the application of the rules to companies entering stock lending and repo transactions, as part of their Schedule D Case I activities nor to pension funds. If it is not intended for the rules to apply to such activities, then it is important for this to be clearly stated in legislation

In addition, there are a number of issues with the existing legislation which can result in relief for genuine costs incurred being disallowed. We have outlined below the key legislative provisions which need to be addressed. Given the technical nature of these provisions, it would be beneficial for stakeholders to be provided with an opportunity for consultation on draft legislation to ensure that any proposed amendments do not give rise to any further unintended consequences.

Definition of 'financial transaction' (section 753A TCA 1997)

The legislation does not cater for the differences between stock lending and repo

[38] Tax and Duty Manual Part 04-06-13
[39] Sections 753A to 753F TCA 1997

transactions. Repo transactions are generally entered into by persons seeking to raise finance, such as, banks effectively using large portfolios of securities as collateral when borrowing funds from a counterparty bank, including the Central Bank of Ireland.

In contrast, stock lending transactions are generally undertaken for the purposes of market making or providing liquidity in the securities market by institutional investors, such as, life assurance companies and pension funds. These investors do not seek to raise finance and may even be precluded from borrowing money.

Revenue guidance[40] which was in place prior to Finance Act 2019 stated that the substance of stock lending and repo transactions "*is essentially one of lending*". However, section 753A TCA 1997 goes further and defines financial transactions as *"equivalent to a transaction or agreement for the lending of money, or money's worth at interest*".

Although stock lending may be a form of lending, in many cases it is the lending of securities rather than money. By defining a relevant financial transaction in this way, many stock lending transactions are excluded from the rules, with the consequence of potential negative implications for those who have historically relied on Revenue's guidance.

In addition, a strict application of the provision would pose difficulties for most pension funds that are generally prohibited from borrowing or incurring any indebtedness. If pension funds cannot rely on Revenue's previous guidance or the new legislation to deem the substitute payments to have the same character as the related securities income, they may not be able to satisfy the requirements of the exemption under section 774(3) TCA 1997 in respect of *"income derived from investments or deposits of a scheme".*

This is a significant issue which needs to be addressed in the legislation. We would recommend that the definition of "financial transaction" is amended to remove the requirement that the transaction be *"equivalent to a transaction or agreement for the lending of money, or money's worth at interest*".

<u>Definition of 'manufactured payment' (section 753A TCA 1997)</u>
In commercial terms, a manufactured payment or substitute payment is made to compensate the original holder of the securities for any dividend or interest which is payable on the securities during the currency of the stock loan or repo.

Section 753A TCA 1997 introduced a new requirement that a manufactured payment be in return for "*any distribution or interest arising or accruing to the stock buyer".* As a result, relief may be denied for manufactured payments in many common *bona fide* commercial stock lending and repo transactions where the stock buyer is not in receipt of the distribution or interest on the stock. For example, where the stock buyer has shorted the stock and as a result is liable to make a manufactured payment but is not in receipt of real interest or distribution.

To address these concerns, we would suggest an alternative definition of a 'manufactured payment' as: *"a payment by a stock buyer to a stock seller made pursuant to a financial transaction to compensate the stock seller for any distribution or interest payable on the*

[40] Tax and Duty Manual Part 04-06-13

stock which, as a consequence of the financial transaction, is receivable otherwise than by the stock seller."

Tax treatment of 'manufactured payment' (sections 753B & 753C TCA 1997)
The deductibility of a 'manufactured payment' where the payer is not in receipt of the corresponding 'real' dividend or interest in respect of the underlying securities (referred to as the "specified amount") is unclear. This issue arises where the securities have been used in successive stock lending/repo transactions or where the stock has been sold 'short'.

In the former case, the payer will be in receipt of a 'manufactured payment' against which the obligation to make a 'manufactured payment' would be expected to be offset. This issue could be resolved by deeming any 'manufactured payment' received to constitute a 'specified amount' in section 753C (1) TCA 1997.

In the latter case, there is no income, merely an expense of making the manufactured payment. This is a natural feature of 'shorting' securities. To facilitate the stated aim of achieving a tax treatment consistent with the substance of the transaction,[41] we believe that the following wording could be inserted at section 753B(2)(c) TCA 1997: *(iii) in circumstances where the stock buyer is in receipt of neither the corresponding specified amount nor any manufactured payment representative thereof, any manufactured payment paid by the stock buyer shall be taken into account in the computation of any income, profits or gains as is referred to in subsection (b) above.*

Definition of 'equivalent stock' (section 753A TCA 1997)
The definition of 'equivalent stock'[42] for the purposes of a repo transaction is the definition set out in section 87A Stamp Duties Consolidation Act 1999 (SDCA 1999). However, it is not uncommon for parties to a repo transaction to settle by a transfer of similar debt securities. For example, for 'general collateral' repo transactions, the parties are concerned with the value and issuer type, rather than the specific type of the securities. The definition of 'equivalent stock' in section 87A SDCA 1999 does not align with the nature of such transactions. In our view, the definition of 'equivalent stock' should be extended to include securities of a type, nominal value, description and amount as might be agreed in substitution for the original securities.

Align record keeping requirements with existing obligations (section 753F TCA 1997)
The record keeping requirements set out in legislation are onerous and for many businesses their existing record keeping systems may not be able produce the information in the manner envisaged by the legislation. The provisions do not consider the existing requirements under the Companies Acts to maintain proper books of account and to meet regulatory oversight requirements. Furthermore, in the case of pension funds and investment funds, the responsibility for maintaining this information typically lies with a custodian or prime broker.

In our view, the record keeping requirements contained in section 753F could be aligned with existing regulatory oversight requirements, which would remove the need to redesign existing systems and, in many cases, to modify contractual agreements with the pension fund or investment fund. Alternatively, the record-keeping requirement could be restricted

[41] Section 33, Explanatory Memorandum to Finance Bill 2019.
[42] Section 753A TCA 1997

to securities which are subject to Irish dividend withholding tax or deduction of income tax at source.

3. Business succession measures

3.1. The impact of section 135 TCA 1997 on the sale of a family business/SMEs

The passing on of family businesses and management buy-outs (MBOs) involving 'close companies' continue to be impacted by the anti-avoidance provision contained in section 135 (3A) TCA 1997, which was inserted by Finance Act 2017.[43]

Subsection 3A imposes income tax treatment on selling shareholders in any situation where Revenue take the view that a company has retained profits in excess of the company's commercial needs, rather than allowing those shareholders to obtain capital gains tax (CGT) treatment. Unlike other anti-avoidance provisions in Irish tax legislation, section 135 TCA 1997 does not include a *bona fide* test. It is usual for targeted anti-avoidance measures to exclude transactions effected for *bona fide* commercial reasons, to avoid any unintended consequences that could arise because of the legislation.

Considerable concern continues to exist regarding the potential effect of section 135 on scaling up and passing on of businesses in the SME sector, in the absence of a statutory *bona fide* test. Even though Revenue guidance[44] may contest that *bona-fide* financing arrangements entered into by a purchaser relating to the acquisition of shares are outside the scope of the provisions, this is not expressed in legislation. Therefore, it cannot be relied upon by taxpayers in the event of the matter being disputed and subject to an appeal.[45]

In our view, inserting an exclusion for *bona fide* commercial transactions into section 135 TCA 1997 is essential, to provide the necessary level of certainty to taxpayers and their advisers, when implementing transactions involving the disposal of shares in a company with cash on its balance sheet.

3.2. Availability of Young Trained Farmer Stamp Duty Exemption where the farmer is an employee or shareholder of a farming company

Section 81AA SDCA 1999 provides for an exemption from stamp duty on transfers of farmland and buildings to young trained farmers.[46] A young trained farmer is defined as a person under 35 years of age who has a relevant agricultural qualification. The farmer must subsequently spend more than 50% of his/her working time farming the land for the 5 years after the transfer, for the relief to apply.

Some farm businesses are carried out by companies that farm land owned by a shareholder. The farmers in question spend the majority of their time engaged in the farming activities as employees of the company. The availability of young trained farmers stamp duty relief in such circumstances is not certain and clarity is needed in legislation on this issue. Otherwise, the uncertainty could serve as a disincentive to making transfers of land to young trained farmers when the land is farmed by a young trained farmer as an

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[43] Section 430 TCA 1997 defines a close company as an Irish resident company that is under the control of 5 or fewer participators, or by participators who are directors, whatever the number.
[44] eBrief 03/18: Tax and Duty Manual 06.02.05 – Section 135 TCA – Anti-avoidance, Part 6/Chapter 2, January 2018
[45] The Appeal Commissioners have expressly stated that their jurisdiction does not extend to supervising the administrative actions or any purported inequity in the application of the tax code by Revenue. See Tax Appeals Commission determination 20TACD2018.
[46] Section 81AA Stamp Duty Consolidation Act 1999

employee or shareholder of the farming company.

3.3. Impact of increase in CAT group thresholds

Where there is an increase in a capital acquisitions tax (CAT) group threshold, whilst the general perception may be that a person can avail of the increased tax free amount for any subsequent gifts or inheritances, this is not possible for a beneficiary who has previously received benefits exceeding the new threshold amount, irrespective of the fact that they would have paid CAT on the increased amount now available to others.

Where the value of previous benefits do not exceed the current threshold, then CAT is payable on the excess over the current threshold.[47] We understand that the rationale behind the computational rules, as drafted, is to ensure that prior benefits which were previously taken account of are not brought back into a charge to CAT.

We recommend that the legislation is amended to ensure that where there is an increase in a CAT group threshold, a person can avail of the increased tax-free amount for any subsequent gift or inheritance.

[47] The CAT computational rules are set out in Schedule 2 of the Capital Acquisitions Tax Consolidation Act 2003