

Paper on Revenue’s guidance on the taxation of Exchange Traded Funds (“ETF”) – update to Revenue Guidance TDM 27-01a-03

Contents

Executive Summary.....	2
Background	2
Detail on the history of guidance on ETFs	3
Review of TDM 27-01a-03	4
Application of updated guidance.....	4
Commencement of updated guidance	5
Next Steps	5
Appendix 1: Timeline of introduction of updated guidance.....	6

Executive Summary

The purpose of this paper is to provide additional background detail to the updated guidance as published in TDM Part 27-01a-03 on September 1st, 2021.

In addition, this paper seeks to address concerns raised by practitioners at the meeting of the TALC Direct & Capital Taxes Sub-Committee, which was held virtually on December 8th 2021, with respect to the practical application of the updated guidance and highlights resources that are currently available to assist with this application.

Finally, with a view to supplementing the updated guidance, Revenue actively encourages detailed submissions on this matter, in particular, around the proposed application of generic characteristics of ETFs that could assist in the determination of the tax treatment of an ETF.

Background

Investments in ETF are investments in funds.

The offshore funds regime (in Chapter 2 of Part 27 TCA 1997) was introduced in 1990. Prior to its introduction, an Irish resident investor could defer a liability to Income Tax by allowing an offshore investment to accumulate offshore over a period of years as profits were reinvested. When the investment was eventually realised, the profit element was a capital gain. Capital Gains Tax (“CGT”) treatment was more advantageous to the investor than Income Tax treatment as the payment of tax was deferred until the realisation of the investment and a lower rate of tax would often arise.

Chapter 4 of Part 27 TCA 1997 deals with the taxation of certain offshore funds, being those that are similar in all material respects to an Irish regulated fund and formed under the laws of an EU/EEA Member State or an OECD Member State with which Ireland has a double tax agreement. These provisions were introduced by section 72 Finance Act 2001, with the gross roll-up provisions for Irish regulated funds having been introduced by section 58 Finance Act 2000.

The first guidance provided by Revenue on the offshore funds regime was the note on the tax treatment of Exchange Traded Funds (“ETFs”) and Exchange Traded Commodities (“ETC”) in TDM 27-01A-03 in April 2015¹ on foot of requests from industry to provide clarity on the tax treatment of such investments. This was followed in September 2015 with TDM 27-02-01² and TDM 27-04-01³, which provided some additional high-level guidance on the regime more generally and the evolution of the legislation.

Significant work was then undertaken to develop more in-depth guidance on the offshore funds regime. As set out in eBrief 40 of 2017⁴, TDM 27-04-01⁵ was updated to focus on the taxation of

¹ <https://www.revenue.ie/en/tax-professionals/tdm/income-tax-capital-gains-tax-corporation-tax/part-27/27-01a-03-20171121165834.pdf>

² <https://www.revenue.ie/en/tax-professionals/tdm/income-tax-capital-gains-tax-corporation-tax/part-27/27-02-01-20150910075157.pdf>

³ <https://www.revenue.ie/en/tax-professionals/tdm/income-tax-capital-gains-tax-corporation-tax/part-27/27-04-01-20150910073552.pdf>

⁴ <https://www.revenue.ie/en/tax-professionals/ebrief/2017/no-402017.aspx>

⁵ <https://www.revenue.ie/en/tax-professionals/tdm/income-tax-capital-gains-tax-corporation-tax/part-27/27-04-01-20200316093307.pdf>

funds in EU/EEA/OECD territories while TDM 27-02-01⁶ was updated to provide more detailed guidance on the offshore funds regime in general, including practical guidance on applying the rules and a decision tree on how to identify if an offshore investment was potentially a material interest in an offshore fund. This work coincided with the introduction of section 1077E(15A) TCA 1997 by section 56 Finance Act 2016.

Detail on the history of guidance on ETFs

Revenue provided guidance, in April 2015, in a general context:

- In light of the commonality found between EU and Irish domiciled ETFs, as they are all governed by the UCITS Directive, Revenue confirmed that investment in an EU domiciled ETFs follows the treatment set out in Chapter 1A of Part 27 TCA 1997 for investments in Irish ETFs which are Investment Undertakings (IUs);
- However, as it was not possible to confirm that the reviewed US / EEA ETFs were similar to Irish ETFs, a general confirmation was given (with effect from 1 January 2014) that EEA / OECD ETFs should be taken as not being similar. As such, these investments are taxed in accordance with general tax principles. From 1 January 2020 this also includes UK ETFs which are likely to be identical, in the short term at least, to EU ETFs.
- ETCs were also reviewed and it was concluded that ETCs were generally debt instruments, and as such would not constitute a material interest in an offshore fund. A general confirmation was given that investments in ETCs would not be an investment in an offshore fund.

Table 1 Summary of current tax treatment

	ETFs domiciled in Ireland & EU	ETFs domiciled in EEA member States & OECD member state with DTA with Ireland
Tax Treatment Regime	Gross Roll Up Regime	General tax principles
Income	41% (PRSI/USC does not apply)	Marginal Rate of tax (20%/40%) (+ PRSI/ USC applies)
Gains	41%	33%
8-year deemed disposal	Yes	No
Remittance basis available	No	Yes

⁶ <https://www.revenue.ie/en/tax-professionals/t dm/income-tax-capital-gains-tax-corporation-tax/part-27/27-02-01-20171006092521.pdf>

Review of TDM 27-01a-03

As a result of the general confirmation provided in 2015, which does not have regard to whether or not an EEA / OECD ETF is similar to an Irish ETF, all EEA/OECD ETFs have been taxed as follows:

- Income (dividend payments) is potentially liable to a higher rate of tax than a dividend payment from an EU domiciled ETF, (depending on marginal rate of income tax and the inclusion of PRSI & USC),
- A gain is subject to a lower rate of CGT when compared to a gain on the disposal of EU domiciled ETF,
- The 8-year deemed disposal rule does not apply, meaning capital appreciation within the fund is not taxed until the investment is eventually disposed of, and
- The remittance basis of taxation is available to non-domiciled individuals on both income and gains, as dividends from EEA/OECD ETFs would be taxable under Case III.

Having regard to the changes in the market, both in the nature of the ETFs and the amendments to regulatory regimes, coupled with the impact of Brexit, it is no longer appropriate to provide a general confirmation in respect of a significant subset of investment products, namely ETFs.

It was therefore necessary to bring the guidance on the tax treatment of investments in EEA / OECD domiciled ETFs in line with that for other funds in those territories. As such, as with investments in other funds in EEA/OECD member states, the investor (or intermediary) must ascertain whether an investment in the ETF is a “material interest in an offshore fund”. In relation to requiring that this be done, regard was had to the fact that a significant amount of guidance on the operation of the offshore funds regime had been provided by Revenue in the period since the ETF guidance was first published in 2015.

Following a review of the products being sold in Ireland as ETCs, it has transpired that many of the products sold as ETCs are actually offshore funds which invest in commodities, which is different to the ETCs reviewed in 2015. It is true that a “pure” ETC is a debt instrument, but as the marketing nomenclature has moved on, the confirmation given in guidance is no longer appropriate.

Application of updated guidance

As advised by Revenue, the update to guidance⁷ with effect from 1 January 2022, is now that taxpayers who invest in ETFs domiciled in EEA or OCED Member States with whom we have a DTA, must carry out the same analysis as taxpayers who invest in any other offshore products in those territories in order to determine the appropriate Irish tax treatment.

As set out in eBrief 164/21⁸, three TDMS were updated to provide additional guidance with respect to ETFs, including on how investors in Irish ETFs should pay the tax arising. Paragraph 4 of TDM 27-02-01⁹ advises that where an intermediary has been used, the intermediary should be in a position to advise on the tax implications of the investment.

Where an intermediary is not used, careful examination of the terms of the investment is required to verify whether the investment falls to be an Offshore Fund or whether it should be taxed under general tax principles. Further guidance is provided within TDM 27-02-01 to assist with this analysis.

⁷ <https://www.revenue.ie/en/tax-professionals/tdm/income-tax-capital-gains-tax-corporation-tax/part-27/27-01a-03.pdf>

⁸ <https://www.revenue.ie/en/tax-professionals/ebrief/2021/no-1642021.aspx>

⁹ <https://www.revenue.ie/en/tax-professionals/tdm/income-tax-capital-gains-tax-corporation-tax/part-27/27-02-01.pdf>

The updated guidance realigns ETFs with other funds established in the same jurisdictions, and with the offshore fund legislation.

The timeline in relation to the introduction of the updated guidance is set out in Appendix 1.

Commencement of updated guidance

Taking into consideration the growing popularity of ETFs, the fast pace developments of the industry and the sophistication of the products themselves, it is no longer possible for Revenue to provide a general confirmation in this area.

Following a request by the ITI in their July submission, the draft guidance was updated before publication such that the change in guidance applied with effect from 1 January 2022.

There is no legislative basis to continue to treat one subset of funds in a jurisdiction differently to other funds in that jurisdiction, and the updated guidance is a realignment with relevant legislation. As such, it would not be appropriate to extend this updated guidance any further past 1 January 2022.

It is worth noting, that in general, the earliest return by which this analysis should be completed is, for individuals, the 2022 Form 11 filing in 2023 (generally in October with extension to November for online filing), and for companies (with a December year-end¹⁰), the 2022 Form CT1 is due for filing in September 2023.

Next Steps

Revenue always welcome submissions detailing where TDMs can be updated appropriately to further assist taxpayers and practitioners.

Following feedback on the September 2021 guidance, Revenue will update the TDM to confirm that the date from which the 8 years for the deemed disposal should be counted is 1 January 2022 meaning the earliest deemed disposal date is 1 January 2030 (albeit that when calculating the deemed disposal the acquisition cost will be the actual acquisition cost in an earlier year). Revenue will also update the guidance to highlight which Case is applicable for the various tax charges given the remittance basis of taxation does not apply to Case IV charges.

In relation to offshore funds, submissions relating to the application of generic characteristics of ETFs to assist determination of their tax treatment would be most helpful. Taxpayers and practitioners are best placed to assist Revenue in this respect, given their knowledge base and proximity to the products and the functioning of the markets. Such submissions should bear in mind that in general the key differentiating factor between an ETF and other funds in a jurisdiction is the way in which the shares / units are traded rather than the legal form, the objectives and purpose of the vehicle, or the local supervisory and regulatory arrangements. Therefore, the hallmarks or factors which advisors / intermediaries consider when determining if other funds in those jurisdictions are similar to an Irish fund may be a useful starting point.

¹⁰ There may be instances where due to the accounting period end, some companies may have a reporting obligation in 2022 (e.g. where a company prepares accounts to March 1st, the 2022 Form CT1 would be required to be filed on December 1st 2022) but the majority of companies have a December year end.

Appendix 1: Timeline of introduction of updated guidance

Date	Action
1 June 2021	<p>Draft TDMs provided¹¹ to TALC for review and discussion ahead of TALC June meeting</p> <p>TDM Part 27-01a-02 Investment Undertakings TDM Part 27-02-01 Offshore Funds TDM Part 27-01a-03 Exchange Traded Funds</p>
24 June 2021	<p><u>June TALC Meeting</u></p> <p>Revenue noted that an in depth review of TDM Part 27-01A-03 – “Exchange Traded Funds (ETFs)” which includes Exchange Traded Commodities (ETCs) has been completed, and that they were seeking feedback and comments on the draft manuals which had been circulated in advance of the meeting.</p> <p>From 1 January 2014, the TDM had provided a general confirmation in respect of the tax treatment of ETFs domiciled in the USA, EEA and other OECD countries, and ETC investments. Having reviewed changes in the ETF and ETC markets since 2014, including in light of the UK leaving the EU, Revenue proposes to withdraw these confirmations on the basis that it is no longer possible or appropriate to adopt a general tax treatment for a subset of exchange traded products.</p> <p>Revenue stated that they proposed to bring guidance on the tax treatment of EEA, US and other OECD member state domiciled ETFs in line with that of the Offshore Fund Legislation, and to confirm that ETCs can vary and may be debt instruments. It was confirmed that the onus is on the investor / intermediary (where appropriate) to ensure that the correct tax treatment is applied.</p> <p>Practitioners noted the difficulties which may exist in determining the status of a fund and requested that a pragmatic approach be taken by Revenue. Practitioners queried how the updates would affect taxpayers filing returns for 2020 or 2021, and Revenue stated that the previous guidance wasn’t intended to cover any products introduced to the market since 2014.</p> <p>Practitioners also queried whether it would be possible for Revenue to provide further guidance on whether there is an ETF, or what a reasonable approach may be in a given situation. Revenue noted that there are decision trees and guidance in the offshore fund TDM on this point.</p> <p>Revenue agreed to extension of deadline for submissions on the matter to 1 July 2021</p>
6 July 2021	Revenue received ITI submission
1 Sept 2021	<p>eBrief 164/21 issued detailed updates to various TDMs¹²</p> <p>As requested by the ITI, the TDM notes that the previous confirmation will remain valid until 1 January 2022.</p>

¹¹ We understand that the TDMs may not have been circulated to all TALC members until 10 June.

¹² <https://www.revenue.ie/en/tax-professionals/ebrief/2021/no-1642021.aspx>

2 Sept 2021	<p><u>September TALC Meeting</u></p> <p>Practitioners queried how the updated guidance, which stated that previous Revenue confirmations in respect of the treatment of ETFs would no longer apply from 1 January 2022, would impact someone acquiring an interest in an ETF in 2020 or 2021. Revenue noted that the updated guidance will only apply as of 1 January 2022.</p> <p>Practitioners further queried whether there had been any updates to the guidance to assist advisors in determining which treatment would apply to investment products. Revenue confirmed that the recently published TDMs had been updated to provide general guidance on ETFs and ETCs in as far as possible, noting that each product is unique and needs to be considered on its own merits.</p> <p>Practitioners referred to the submission made in July, and Revenue noted that the suggestions therein didn't have general applicability and that absent a complete overhaul of the offshore funds regime, there was no way of simplifying the tax treatment for investors or advisors. Revenue further noted that the manual is intended to be a general guide, and that the submissions in respect of the remittance basis and how it could apply to offshore funds would not be addressed in this TDM.</p> <p>It was agreed that this item would remain on the agenda and Revenue encouraged submissions relating to areas where TDMs could be updated to provide additional general guidance.</p>
5 Oct 2021	<p>ITI submitted 4 high level queries regarding;</p> <ul style="list-style-type: none"> • timing of the application of new guidance; • application of 8 year deemed disposal rule; • scenario involving CGT losses carried forward; and • remittance basis of taxation for non-domiciled individuals.
23 Nov 2021	<p>ITI submitted 4 high level queries regarding:</p> <ul style="list-style-type: none"> • Request for 2014 Revenue analysis • Provision of a non-exhaustive list, to consider in determining whether a fund is similar in all material respects to an Irish regulated fund; • application of 8 year deemed disposal rule; and • scenario involving CGT losses carried forward.
8 Dec 2021	<p><u>December TALC Meeting</u></p> <p>Revenue provided responses to queries (from the ITI and as part of the agenda for the meeting) and confirmed that the relevant TDMs will be updated to further clarify;</p> <ul style="list-style-type: none"> • the interaction of the 8 year "deemed" disposal rule with the new ETF/ETC guidance; and • the appropriate Case/Schedule for Offshore Funds where required. <p>Practitioners expressed concern that there had not been sufficient time to discuss and consider the updated guidance and refer to extensive analysis that is now required.</p>

	<p>Practitioners requested a review of the 1 January 2022 implementation date and requested a further extension.</p> <p>Revenue reiterated the extensive engagement thus far on the matter and noted that Revenue had requested proposals for updates to TDMs at September TALC. Revenue confirmed that there is no legislative basis to extend the current guidance but agree to take away the points raised and consider them further.</p>
--	--