

Ireland as an onshore investment platform



Introduction

Ireland has become an increasingly attractive location for establishing investment platforms over the last number of years due to its flexible legal, regulatory and tax environment. From a tax perspective, Ireland provides a number of benefits including:

- flexible and favourable domestic tax law reliefs,
- access to a wide and expanding tax treaty network,
- the absence of controlled foreign corporation legislation, and
- a regulated framework in a well established international financial centre.

Ireland's vehicles include Section 110 companies, Qualifying Investor Funds (QIFs) and "Super QIF" structures.

In this context, the recently enacted Irish Finance Act 2011 made a number of amendments to the Section 110 regime. These changes, arrived at following extensive industry consultation have significantly expanded the range of assets a Section 110 company can invest in, whilst also seeking to restrict the use of Section 110 in specific targeted circumstances in order to bring Irish legislation in line with recent EU developments.

Section 110 company

Ireland has a favourable tax regime for entities known as Section 110 companies. A Section 110 company is an Irish resident special purpose company which holds and/or manages "qualifying assets" and provides for an onshore investment platform in an environment of increased international focus on tax havens and transparency.

The Section 110 regime has been in existence since 1991 and effectively allows for corporation tax neutral treatment provided certain conditions are met.

With appropriate planning, there should be no Irish withholding taxes on interest or dividend payments by the Section 110 company. In addition, the Section 110 company qualifies for the benefits of Ireland's double tax treaty network which should reduce or eliminate withholding taxes on income flows and capital gains in treaty jurisdictions.

The Section 110 regime is widely used by international banks, asset managers and investment funds in the context of securitisations, investment platforms, Collateralised Debt Obligations (CDOs) and capital markets bond issuances.



Favourable grandfathering provisions

The amendments included in Finance Act 2011 contain a favourable grandfathering provision which protects the deductibility of payments which would otherwise be impacted. Under this provision, payments will continue to be deductible where they are made under a binding written agreement made before 21 January 2011.

Extension of scope of assets in which a Section 110 company can invest

Prior to the publication of the Finance Act 2011, Section 110 companies were limited to investing in financial assets. The term “financial asset” is widely defined and includes both mainstream financial assets such as shares, loans, leases, lease portfolios, bonds, debt and derivatives, as well as assets such as greenhouse gas emissions allowance, all types of receivables, etc.

The range of investments in which a Section 110 company can invest has been significantly extended to investments in commodities and plant and machinery. In addition, greenhouse gas emissions allowance has been redefined to include “Carbon Offsets” and broadened significantly. These are very welcome changes, particularly in the context of recent market interest in commodity transactions and the launch of the Irish Government’s “Green IFSC” (International Financial Services Centre) initiative.

In addition, the extension of the Section 110 regime to include plant and machinery will benefit Ireland’s position as the preferred destination for aircraft financing and leasing activities and will give an added boost to Ireland’s position as the centre of excellence for lease financing transactions.

Amendments to target specific arrangements

Finance Act 2011 contains provisions which seek to restrict the tax deductibility of specific payments for Section 110 companies in certain scenarios. These changes are designed primarily to counteract the use of “double non taxation” structures. A “double non taxation” structure is essentially where a company makes a payment which is fully tax deductible and the recipient, typically resident in another country, is not subject to tax on the income (example hybrid investments). Such structures were identified as part of a review by the Code of Conduct for Business Taxation group of the Council of Economics and Finance Ministers (ECOFIN). In order to further illustrate the wider EU approach in this area, it should be noted that since the publication of the Finance Act, the Austrian and Danish authorities have also introduced legislation to specifically target such structures.

The provisions introduced seek to restrict in specific circumstances the deductibility of payments made by a Section 110 company under a profit participating loan or total return swap agreement entered into on or after 21 January 2011. Going forward, payments made under such agreements will only be tax deductible if paid:

- to an Irish resident tax person,
- to a pension fund, government body or other specifically tax exempt person in a treaty country (e.g. US tax exempt investors), provided certain conditions are met,
- to a non-resident recipient in a treaty country which generally applies tax on foreign source income, provided a deduction is not available by reference to the amount of interest received, and
- under a quoted Eurobond or wholesale debt instrument, provided that the recipient does not “control” the Section 110 Company or that the Section 110 Company has not entered into transactions with the recipient which amount to 75% or more of the value of assets held by the Section 110 company.

In context of the 3rd bullet above, this test is by reference to the ultimate recipient of the interest or swap payment so that where a payment is made via a flow through entity, it is necessary to look through to the ultimate recipient.

In summary, these amendments are likely to impact specific structures used in limited situations on a going forward basis. However, it is clear that the Section 110 regime will continue to provide banks, asset managers and investment funds with a tax efficient platform through which it can structure a wider range of investments.

New categories of eligible assets

The legislation has outlined the addition of two new categories of eligible assets which can be securitised using a Section 110 vehicle. The eligible assets now include (i) commodities which are dealt in, on a recognised commodity exchange and (ii) plant and machinery. The expansion of the definition to include commodities is extremely positive in particular for assets such as base and precious metals, while the inclusion of plant and machinery should facilitate the leasing of that plant and machinery.

This expansion of the definition of the asset class is very welcome and will open up significant opportunities to the securitisation industry in Ireland and will assist in ensuring that Ireland remains at the forefront of this industry in the global marketplace.

Super QIF structures

The QIF is one of Ireland's most successful fund structures (as of December 2010 there were over 1,200 Irish domiciled QIFs). Given their flexibility, QIFs are the Irish vehicles most frequently used for alternative investment funds including hedge funds, funds of hedge funds, venture capital/private equity funds and real estate funds, as well as for holding investments directly in their own right. A QIF can offer a tax-exempt, regulated entity in an environment where increased supervision and regulation are required.

Investors increasingly use a "Super QIF" structure as their investment platform. The "Super QIF" structure, in which a QIF holds investments through a Section 110 company, allows investors to optimise the tax treatment of managing assets by providing;

- a tax neutral structure,
- no withholding taxes on outbound payments from Ireland,
- elimination/ mitigation of withholding taxes on inbound payments to Ireland, and
- elimination of investment country capital gains tax exposures.

The QIF can also hold assets directly itself. Therefore if the investment manager wants to invest in certain non "qualifying assets", such as real estate, this can be achieved through the QIF.

The Finance Act changes outlined above targeting specific arrangements will not impact on the tax deductibility of any payments made by a Section 110 company within the "Super QIF" structure because the QIF is an Irish resident. Accordingly, the "Super QIF" continues to provide offshore investors with a flexible and efficient onshore investment platform, particularly in light of the extended range of investments that the Section 110 Company can make by virtue of the Finance Act 2011 changes.



Significant enhancements to Ireland's aircraft finance offering

Finance Act 2011, also introduced a number of amendments which will enhance Ireland's status as the location of choice for aircraft leasing companies. These include welcome changes to Ireland's securitisation framework or "Section 110" offering.

While Section 110 companies are subject to tax at a rate of 25%, they are entitled to a deduction for interest on qualifying profit participating loans and it should be possible to structure a vehicle on a tax neutral basis. These entities are tax resident in Ireland and are entitled to avail of the terms of Ireland's treaty network. As mentioned, the definition of "qualifying assets" has now been expanded to include plant and machinery (which would include aircraft and ships).

The enhanced definition of "qualifying assets" will now offer investors a further avenue or option in which to structure leasing transactions in Ireland.

Amending the legislation to enable Section 110 companies hold aircraft should enhance Ireland's offering in this industry and may provide solutions to a number of commercial barriers which existed previously, particularly for less established lessors that do not have the necessary trading substance in Ireland.

The use of a Section 110 company may solve potential CFC issues in certain jurisdictions. Combining the offering of a Section 110 structure with an onshore regulated fund ("Super QIF") could enhance the Irish offering to private equity investors in particular.

US tax considerations

A Section 110 company can be formed as a public or private company. However, a QIF can be formed as a public company, unit trust or a partnership, but not as a private company. There is flexibility to set up the entity as an "eligible entity" under the US check-the-box rules and an election can be made to treat the entity as a fiscally transparent entity from a US tax perspective. The decision to make a check-the-box election may depend on a number of considerations. In order to get the benefit of direct foreign tax credits for taxes paid in Ireland or the source country, a check-the-box election should be made. The source and character of income can also be preserved.

Why choose Ireland?

- Ireland's tax regime is transparent and is approved by the EU and the OECD. The OECD has measured Ireland in the highest tier of conformance possible with regard to standards of openness, compliance and accountability of the taxation regime.
- Certainty of tax treatment and tax neutrality possible with appropriate planning.
- Ireland has extensive experience in attracting inward investment to the country with a globally recognised pro-active approach to business
- Ireland has a growing and expanding double tax treaty network with 62 treaties signed to date.
- Ireland's domestic infrastructure (tax, legal, regulatory and administrative environment) is highly experienced and globally recognised in implementing complex structured finance transactions in a cost effective manner
- No tax ruling is required on the setup of a Section 110 company.
- Ireland does not have any controlled foreign corporation (CFC) rules or thin capitalisation requirements.
- The use of profit participating loans to extract profit is specifically legislated for in the case of Section 110 companies.
- No withholding taxes on swap payments or with appropriate planning, on interest payments to non Irish resident investors.
- Ireland does not impose any net wealth taxes.
- It is not necessary for a Section 110 company to have employees. There are a number of multinational financial institutions in Ireland which can look after the day to day running of the company.

Conclusion

Ireland has an internationally regarded structured finance and securitisation regime. This regime, as reflected in the recent Finance Act 2011, consistently introduces and refines legislation to reflect the developments in the global marketplace. The expansion of the definition of assets to which a Section 110 company can invest is very welcome as are the additional opportunities which now exist for Section 110 companies in terms of leasing activities.

Ireland has a transparent onshore tax regime which is subject to EU approval. With effective planning it ought to be possible to establish an Irish structure on a tax neutral basis. The ability to operate within a regulated onshore regime is attractive to many investors in these uncertain times as is the ability to establish in Ireland in a cost effective manner.

Recent legislative changes combined with the track record that Ireland has as a tried and tested investment platform location, make a compelling case in attracting further investment into Ireland and using it as a location for global investment.

How can PwC help?

Tax Services

Our tax team formulates effective strategies for optimising taxes, implementing innovative tax planning and effectively maintaining compliance. In recognition of the international tax issues to be considered in structuring funds, our specialised tax team works extensively with our global international tax teams on an ongoing basis.

Audit Services

Our audit approach is tailored to suit the size and nature of your organisation and draws upon our extensive industry knowledge. In addition to the independent audit, we offer advisory services in the areas of financial reporting, corporate governance, regulatory compliance, independent controls and risk assessment.

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