Finance Act 2011

Structured Finance (Section 110) Regime Amendments

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FINANCE ACT 2011 – STRUCTURED FINANCE (SECTION 110) REGIME AMENDMENTS

Introduction

Ireland is a favoured location for special purpose vehicles (commonly referred to as "SPVs" or "Section 110 Vehicles") that are used in many financial transactions. A wide diversity of transactions has contributed to Ireland's growing importance as an onshore SPV domicile.

The regime under which the Structured Finance Industry operates is governed by Section 110 of the Taxes Consolidation Act, 1997 ("**Section 110**") and following on from the publication of the initiated draft of the 2011 Finance Bill on 21st January 2011, on the 6th February 2011 the Finance Act 2011 was signed into law enacting the following changes to Section 110.

Qualifying Assets

The Act has extended the list of qualifying assets (in which Section 110 vehicles can invest) to include:-

i) ***Commodities*** - which in the context of Section 110 means tangible assets (other than currency, securities, debts or other assets of a financial nature) which are dealt with on a recognised commodity exchange;

ii) ***Plant & Machinery*** - which in the context of Section 110 would include aircraft, ships, motor vehicles, etc (including a business of leasing the plant and machinery); and

iii) ***Carbon Offsets*** – which in the context of Section 110 means:-

a. an allowance, permit, licence or right to emit during a specified period, a specified amount of carbon dioxide or any other greenhouse gas as defined in Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/ EC of 24 September 1996, where such allowance, permit, licence or right is issued by a state or by an intergovernmental or supra-national institution pursuant to a scheme which:

- imposes limitations on the emission of such greenhouse gases; and
- allows the transfer for value of such allowances, permits, licences or rights;

b. an allowance, permit, licence or right to emit during a specified period, a specified amount of carbon dioxide or any other recognised greenhouse gas under a voluntary scheme sponsored by a State or by an inter-governmental institution, or regulated commercial enterprise, where such allowance, permit, licence or right is subject to recognised independent periodic verification, monitoring and reporting; or

c. any right that is directly attributable to an allowance, permit, licence or right to emit within subparagraph (a) or (b).

The above amendments further enhance Ireland's excellent reputation as a top location for structured finance transactions and there is no doubt the new categories of assets will lead to further interest in Ireland from promoters, originators and investors.

Restrictions on Tax Deductibility of Certain Payments

The Act also contains certain (anti-avoidance) measures to deny a tax deduction for the Section 110 Vehicle in respect of:-

i) the payment of interest on profit participating debt to a non-Irish tax resident recipient other than:-

   a) a recipient which is resident in an EU or Irish tax treaty partner country ("relevant territory") and such country subjects the interest receipts to tax generally (this is to be applied on a "country basis" rather than by reference to the particular circumstances of the recipient); or
   b) the interest payment is subject to Irish withholding tax.

In applying the test in a) above, it is notable that the interest need only be subject to tax in a relevant territory and not necessarily in the country of the initial recipient of the interest. Furthermore, the above amendments will not apply to an interest payment in respect of a quoted Eurobond or a wholesale debt instrument except in certain "group" situations.

ii) The above restrictions will similarly apply to payments made to a non-Irish recipient under total return swaps ("TRS"). While the definition in the Act is drafted quite widely, the authors understand (having been actively involved in the consultation process with the Department of Finance and the Revenue Commissioners) that this should only apply to TRS (as opposed to other categories of swap or similar agreements which may be entered into by a Section 110 Vehicle).

There may also be cases were the tax deductibility of interest payments on profit participating debt which falls fouls of these new anti-avoidance provisions is still maintained because of the non-discrimination article in a particular treaty.

Arbitrage financing / "subject to tax"

It is useful to appreciate the background to the changes introduced in respect of interest deductibility and Section 110 companies. The Department of Finance & the Revenue Commissioners explained their sensitivity in certain cases to hybrid financial instruments ("HFI") which are treated for example as debt in one country and equity in another and thereby not be taxed in either. This type of tax arbitrage financing is a matter which has generally attracted the attention of the EU. Indeed some countries have already taken measures to deny the participation exemption for distributions arising from a HFI where the issuer of such HFI obtains a tax deduction for such distributions made. It was against this background that Ireland has introduced changes in the Act to deny in certain circumstances an interest deduction for the borrowing company (i.e. the Section 110 company). However, while this was the background to such changes, the Act has extended the ambit of the denial of such an interest deduction to circumstances were interest is not "subject to tax". The reason for this requirement was a desire not to treat differently debt reclassified as equity in the jurisdiction of a lender tax resident in a relevant territory than interest received by a lender tax resident in a non-relevant territory (such as Cayman). Obviously for many tax haven countries there is no need to structure the debt to be reclassified as equity in the lender's jurisdiction as the interest is simply not taxable in the first place. Therefore, the focus of the denial of an interest deduction moved away solely from debt which is reclassified as tax-exempt income in the hands of the lender (under for example some for of participation exemption) to scenarios where the interest is also not taxable in the hands of the lender (such as where the lender is tax resident in a jurisdiction which generally does not tax such interest income – e.g. Cayman).

For the avoidance of doubt the Act confirms that the measures in i) and ii) above will <u>not</u> apply in the context of interest or other distributions paid to:-

i) an Irish tax resident person;
ii) a pension fund, government body or other specifically tax exempt person provided they are resident in relevant territory and such country subjects the interest receipts to tax generally (unless broadly speaking the recipient controls the SPV or has originated 75% of the SPV assets).

Therefore, for example payments made by an SPV to an Irish regulated fund are not affected by these new measures.

Grandfathering Provisions

The Act also contains certain grandfathering provisions which confirm that the new limitations referred to above on deductibility of certain payments are dis-applied for interest or other distributions paid post 21st January 2011, in respect of securities issued before that date or in respect of securities which were entered into under a binding written agreement made before that date.

Actions to be taken

Consideration should be given to the impact of the aforementioned changes to your specific structures and in particular where it is proposed to issue new securities or refinance existing securities. If you require any further advice or assistance please contact your usual Dillon Eustace contact or the persons listed below.

Summary

The amendments are being undertaken to enhance Ireland's Structured Finance Industry by making it a more robust and sustainable industry. The expansion of the range of assets that can now be securitised is to be particularly welcomed and once again confirms that the Department of Finance and the Revenue Commissioners are committed to working with industry to maintain and further enhance Ireland as a location of choice for structured finance deals.

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This document is for information purposes only and does not purport to represent legal or tax advice. If you have any queries or would like further information relating to any of the above matters, please refer to the contacts above or your usual contact in Dillon Eustace.

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