Evolving Section 110 regime needs to retain its clarity for investors

Ireland's structured finance regime, Section 110, has put simplicity and clarity at the centre of a piece of legislation which is seen by many as a catalyst for significant growth in Ireland's financial service industry writes PATRICK MCCLAFFERTY. He looks at the evolution of the Section 110 regime and the risks caused by changes to the legislation.

Over the past decade Ireland has become one of the world's leading onshore locations for special purpose vehicles (SPVs). Central to this success has been the bespoke tax regime which operates under Section 110 of the Taxes Consolidation Act, 1997 (Section 110). Where structured correctly, SPVs operating under this special tax regime (Section 110 companies) can now engage in a wide range of global financial and leasing transactions on a tax neutral basis.

Introduced in the early 90s, the original legislation was designed to allow for traditional bank loan and receivables securitisations as part of initiatives designed to attract business to the fledgling IFSC. Upon the consolidation of the Taxes Acts in 1997, Section 110 was born and since then the regime has been amended at fairly regular intervals. These changes have largely been positive, with Revenue and the Department of Finance recognising the emergence of new products and instruments in the financial services sector and amending the legislation to keep pace. In particular, the regime's momentum and relevance has been maintained by the continued expansion of the types of assets which a Section 110 company can hold or manage.

In 2003 the legislation was significantly expanded for the first time with the inclusion of an extensive range of financial assets.

This development created a vibrant structured finance regime and is regarded by many as the catalyst for significant growth in the financial services industry in Ireland. The next big step forward was seen in 2011 when physical assets (plant and machinery) were added to the regime. This brought a new dimension to Ireland's asset financing and leasing sector; adding another string to the bow of the already powerful aircraft leasing empire. The inclusion of a range of traded commodities in the regime is also to be welcomed and extends the reach of the SPV. With additional building blocks now in place it is hoped that a broader range of global transactions can be attracted to Ireland.

Where are we now?

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The regime now allows for a comprehensive array of transactions to be carried on in a tax efficient manner from Ireland. A Section 110 company can now hold or manage: financial assets - widely defined and include shares, bonds, derivatives, receivables, deposits, leases, insurance/reinsurance contracts; carbon offsets - including allowances, permits and licenses issued under government sponsored or regulated commercial schemes; commodities - of a kind normally traded on a commodities exchange; and plants and machinery - such as aircraft, ships, rolling stock, heavy duty equipment.

During its evolution, the regime largely retained one of its key selling points - its simplicity. Section 110 was easily explained to promoters and, more importantly, easily understood by them. This gave Ireland a significant competitive advantage over other onshore locations in the drive to attract this high value business. In recent times the regime has taken on an element of sophistication in terms of its potential application but also a level of complexity with the introduction and tightening of certain anti-avoidance measures.

Anti-avoidance considerations

The most significant changes from an anti-avoidance perspective were introduced in 2011. Briefly, new measures were introduced to deny a tax deduction for certain profit participating interest or swap payments where the payments are not 'subject to tax' in an EU or tax treaty partner country. In general however, the measures do not apply in the context of payments on quoted Eurobonds or wholesale debt instruments. So why were these changes introduced? There was a level of discomfort in Revenue and the Department of Finance regarding the use of Section 110 companies in hybrid debt transactions (particularly in a 'group' context) involving EU and tax treaty partner countries and also where payments were being made to non-tax treaty haven countries, such as Cayman or Bermuda. In certain circumstances this enabled a tax deduction in the Section 110 company with no taxable 'pick up' in the lenders' home jurisdiction.

The changes to the legislation were long, complex and difficult to interpret even for experienced professionals. The resulting uncertainty was undesirable for all involved as transactions can only thrive in an environment of clarity. Following many queries from tax professionals, industry bodies and taxpayers, Revenue issued a tax briefing on the topic in April of this year (Tax Briefing 02/12 - Securitisation Transactions). Although the briefing was undoubtedly helpful in allying some fears as to the impact of the new rules, the fact that it was required at all could lead one to question the original intentions of the legislative changes or whether they were drafted in haste.

One hopes that we are not seeing the beginning of a trend where detailed and complex legislation is enacted only to be followed by a lengthy tax briefing with Revenue's 'view'. With such an approach, there is always the risk that a Revenue pronouncement adds to confusion, or is silent on important areas, rather than providing the desired clarity. It is always important to remember that Revenue pronouncements are their view, they are not law and are subject to change by them as opposed to the legislators.

Section 110 remains an important part of the armoury for attracting financial services business to Ireland. However, promoters need to be mindful of the limitations on interest deductibility which can now apply in certain circumstances. The need for thorough tax and legal advice in advance of any transaction is now more important than ever to ensure the detailed legislative requirements are met and Revenue's interpretation of same are taken into 'consideration'.

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