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11 April 2023

Dear Niall,

Funds Sector 2030: A Framework for Open Resilient & Developing Markets

We are writing to you following the publication of Terms of Reference of the Governments Funds Sector 2030: A Framework for Open Resilient & Developing Markets review and our request to meet in relation to this review.

Irish Funds' more than 145 members service or manage in excess of 14,000 funds with a net asset value of €5.4 trillion. Irish Funds' objective is to support and complement the development of the international funds and asset management industry in Ireland, ensuring Ireland continues to be a location of choice for the domiciling and servicing of investment funds. Our vision is that Ireland will be the premier location to enable and support global investing through its reputation for trust, capability and innovation and our aim is to achieve this through collaboration, excellence and integrity amongst other values.

We welcome the proposed review of the sector as a keystone developmental step to the modernisation and simplification as proposed by the Commission; advancing potential for Ireland's financial services sector diversification through greater participation and regional equivalence in our support and supervision of real assets' investment. While it is important that the right safeguards against misuse and abuse are in place, it is important to bear in mind that such instances are rare and, consequently, counter-measures must be proportionate and respect the overall policy objectives underpinning these regimes as espoused by the Commission. The asset management and funds industry is a very important source of investment into the real economy and their efficient operation is important in this regard.

Following the publication of the Terms of Reference and in advance of the Department commencing it's work we thought it might be helpful and assist in that process if we set out our thoughts on a number of key matters of concern to our members and to outline our thoughts on improving and simplifying the tax regime applicable to funds and Section 110 alike and taking the opportunity to modernise elements of the rules. With this objective in mind, we have summarised below some initial considerations on the following matters:

- Simplification of the funds taxation regime.
- Withholding taxes and Investment Limited Partnerships (ILPs).
- Section 110 regime.
- Promoting ESG investment in Ireland and through Irish funds.

- IREF regime.
- Ireland's fund product mix.

We hope that the approach to this review will be framed as one of improvement and simplification with the objective of protecting and enhancing Ireland's position as a global centre for funds and investment management.

We remain at your disposal to discuss or provide additional detail.

Yours faithfully,

Declan Casey
Director Legal and Technical

1 Simplification and modernisation of Funds tax regime

Under the current funds regime, a regulated Irish corporate fund is obliged to collect and account for investment undertaking tax ("IUT") on the payment of any distributions, redemptions above par, or gains on disposal of its units unless it is holding a valid exemption declaration for those investors. In general, non-resident investors are exempt from IUT as are certain Irish domestic investors (e.g., pension funds). However, other investors (such as Irish resident individuals and ordinary corporate investors) are not exempt from this tax and the fund is obliged to operate and collect tax in respect of these investors.

Ireland is a major international hub for international regulated cross border funds the investors in which are predominately international. The IUT regime is quite complex and, in a number of ways would benefit from simplification and modernisation in light of the fact that there is significant administrative burden for funds and administrators by requiring them to have systems and processes to collect IUT, particularly for a relatively small number of domestic investors.

It could be argued that the administrative burdens imposed by the regime are disproportionate. Moreover, the landscape in which the IUT collection regime exists has changed radically since its introduction. There is now far more extensive reporting by funds of who their investors are and what amounts have been paid to them. Indeed, the Common Reporting Standard ("CRS") requires Irish funds to report extensively on foreign investors and it could easily be adopted to apply to Irish investors as well, such that the Revenue Commissioners would have detailed records of all Irish investors who have received distributions from funds and, therefore, could easily collect tax on a self-assessment basis.

We propose that consideration is given to seeking submissions, as part of the review, on changing the exemption regime to link it to the CRS reporting regime with the CRS regime extended (for investors in funds) to include Irish residents. Thus, where investors have provided their correct CRS information to the fund, exemption from IUT would apply. Irish investors in such funds could safely be exempted on the basis that details of all their income and gains earned from the fund would be reported to the Revenue Commissioners by the fund and such taxes could then be collected through self-assessment. Individuals are already required to include all of this information on their tax returns so there should be no increased burden from the taxpayer's perspective. However, it would allow the funds industry to refine the currently inefficient infrastructure required to service what is, in effect, a small element of the funds industry i.e. the relatively small proportion of Irish investors.

The review could also seek submissions on retaining a simplified version of the IUT regime as a protective measure which would apply where the fund did not receive the investor's CRS information.

The review could also consider how the taxation of fund products (both foreign and domestic) could be improved and simplified.

2 Investment Limited Partnerships

2.1 Dividend Withholding Tax

At present, dividends paid to a "collective investment undertaking" are not subject to dividend withholding tax. However, while collective undertakings such as Irish Collective Asset-management Vehicles ("ICAVs"), Unit Trusts, Public Limited Company ("PLC") funds, and Common Contractual Funds ("CCFs") qualify for this exclusion, Investment Limited Partnership, ("ILPs") do not fall within the exception.

While an ILP is considered to be a "transparent" entity for Irish income tax, corporation tax, and capital gains tax purposes, the situation is less clear in respect of dividend withholding tax. The Revenue Commissioner's ("Revenue's") official position is that DWT must be applied on dividend payments to any partnership (which would include an ILP). This is the case even where the partners might themselves qualify for an exemption from DWT. Instead, Revenue's position is that DWT should be applied on dividends paid to any partnership and, if an exemption applies, the relevant partners should each make a refund claim.

We do not believe there is any policy reason for excluding ILPs from the existing exemption for collective investment undertakings. While an ILP is a tax transparent entity, we note that so are common contractual funds ("CCFs") to which the exemption applies. Consequently, there is no distinction (from a tax perspective) between ILPs and CCFs. We feel ILPs should be afforded the same treatment as other regulated investment funds.

A DWT exemption is of particular importance to ensure the jurisdiction has a full and efficient suite of products available to compete for global private equity investment. Private equity funds normally make their investments through wholly-owned subsidiaries, which are typically incorporated in the same jurisdiction as the fund. Any withholding tax on distributions to an ILP from its Irish subsidiaries potentially negates the appeal of the other very welcome improvements to the ILP legal and regulatory regime.

Consequently, we recommend that the review should seek views on introducing such an exemption. While we believe it appropriate that the proposed exemption from DWT is legislated for, if this is not considered acceptable, we believe that maintaining the status quo would nevertheless be undesirable for the industry and Revenue. This is because we would expect that DWT will generally be refundable for the vast majority of international investors who use ILPs. However, the need to process and apply for a refund creates a significant administrative burden for all of the investors and is an inefficient use of Revenue's time and resources. We understand that it is for this reason that Revenue have previously given concessions (on a case-by-case basis) from the operation of DWT on dividends paid to partnerships where all of the partners qualify for an exemption. However, the need to seek such a concession in every case will be inefficient and ultimately no assurance could be given to a fund promoter or investors that the concession would be obtained. Indeed, where the concession is given based on a list of named partners, a new concession would be needed if a new partner were admitted.

Therefore, the review could consider a self-accounting regime along the following lines:

- A DWT exemption is introduced for ILPs as proposed.
- Where an ILP receives a dividend from an Irish resident company (without the application of DWT) and the ILP is in possession of valid declaration from all of its investors that they qualify for an exemption from DWT, then the ILP has no obligation to account for any DWT. To aid alignment and simplification, consideration could be given to using CRS declarations instead of having separate DWT declarations as is presently the case.
- Where an ILP receives a dividend from an Irish resident company (without the application of DWT) and the ILP is not in possession of valid declaration from all of its investors that they qualify for an exemption from DWT, then the ILP makes an annual return to Revenue in respect of DWT on that dividend of an amount equal to the share of partnership profits attributable to those partners for which no exemption declaration is available. The ILP would reduce the distributions made to the non-exempt investors accordingly and would provide them with a notification of the DWT withheld.

This approach has some similarities with the existing Qualifying Intermediary ("QI") regime in that it essentially allows payments of dividends gross to the ILP (like a QI) and places the obligation on the ILP to account for DWT in respect of its non-exempt investors.

2.2 Reverse hybrid rules

The reverse hybrid rules are intended to address a situation where the profits of a "hybrid entity" are not within the charge to tax in any jurisdiction because of a mismatch in how the tax authorities in the entity's home jurisdiction and the tax authorities in the investors' jurisdiction view the entity.

Specifically, the rules pertain to a situation where the tax authorities in the entity's home jurisdiction see it as a tax-transparent entity (such that they do not tax the entity's profits because they consider those profits to arise directly to the shareholders / investors in the entity), whereas the tax authorities in the shareholders' / investors' jurisdiction view it as a separate, foreign entity and so do not tax the investors on the profits retained in the entity.

The Anti-Tax Avoidance Directive ("ATAD") has a limited exemption from the reverse hybrid rules for qualifying collective investment schemes ("CISs"). Ireland has legislated for these rules as applying to ILPs and Common Contractual Funds and other Irish partnerships where their affairs are managed by an alternative investment fund manager. To qualify for the exemption, the CIS must be widely held and hold a diversified portfolio of assets. While the directive permits this exemption, the terms "widely held" and "diversified portfolio" are not defined. As a result, Ireland is obliged to form its own interpretation of these terms. At present the legislation provides that for the purposes of determining whether a relevant investment undertaking holds a diversified portfolio of assets, regard shall be had to;

(i) the nature of the assets held by the relevant investment undertaking,

(ii) the extent to which the relevant investment undertaking is exposed to the risks and rewards of different classes of assets (whether directly or indirectly),
(iii) the number of investments made by the relevant investment undertaking,
(iv) the means through which the investment objective of the relevant investment undertaking is to be achieved, as set out in its prospectus, and
(v) where the assets held are derivatives, the assets to which the derivatives give exposure.

However, the legislation also provides that a relevant investment undertaking shall not be determined to hold a diversified portfolio of assets in the following circumstances;

(a) in a case in which the undertaking holds securities, where more than 10 per cent of those securities are issued by a single issuer, or
(b) in a case in which the undertaking holds land, unless the undertaking holds 3 or more properties and the market value of each of those properties is less than 40 per cent of the total market value of the properties held.

While the above definitions were consulted on with industry, it has emerged that, in practice, the condition in (a) above is very limited in practice. We suggest that the review reviews the definition of "diversified portfolio".

3 Section 110 regime

The Section 110 (securitisation) regime has been a significant enabler in the success of the Irish funds and investment management industry. While it has, in the main, been a tax neutral structure it is an important tool in supporting the development and growth of the regulated funds and asset management industry in Ireland, which employs over 17,000 people directly and a great many more indirectly. A report from Atlantic Star Consulting using quarterly data from the Central Bank of Ireland and the European Central Bank[1] reports that Irish SPVs (which are Section 110 companies) directly and indirectly employ over 4,000 full time equivalent employees, hold over €1 trillion of assets, and pay management, maintenance and other service fees to Irish providers of more than €0.5 billion. The report does not estimate tax revenues and while the regime is intended, as a policy matter, to be neutral from a corporation tax perspective, nevertheless, it is reasonable to infer that this activity generates material amounts of (i) payroll taxes from the people directly and indirectly employed, (ii) income tax and corporation tax from the Irish service providers engaged by these SPVs, and (iii) VAT on service fees (which many SPVs are not entitled to recover due to their VAT exempt status).

If Ireland did not have the Section 110 regime, fund promoters and asset managers would be forced to find alternatives abroad. The success of Luxembourg's securitisation and Reserved Alternative Investment Fund ("RAIF") regimes or the UK's newly launched Qualifying Asset Holding Companies ("QAHC") regime are examples where this is occurring.
If the Section 110 regime was restricted in any significant way, it would inevitably lead to

[1] Atlantic Star Consulting Irish SPV Report, Q4-2022

migration of these structures offshore. What would potentially follow is a migration of other elements of the funds and asset management industry, such as regulated funds, along with their supporting infrastructure (managers, administrators, custodians, etc). Thus, it is important that the Section 110 regime continues to be available.

In addition, it is clear that the regime needs modernisation and simplification in a number of important ways. For example, the Section 110 regime was amended to introduce anti-hybrid rules several years before the general adoption of anti-hybrid rules in the Irish tax legislation as part of the EU anti-tax avoidance directive. Unfortunately, this means that the Section 110 regime now is subject to two different sets of anti-hybrid measures which have broadly similar objectives but operate independently of each other. Consequently, there is unnecessary complexity due to these overlapping sets of rules.

There are a number of other areas where modernisation and simplification could enhance the regime and support our vision for the jurisdiction to build a reputation for trust, capability and innovation. Consequently, we recommend that the review should seek submissions on how to best enhance and reform the Section 110 regime. Where concerns are identified, addressing same should be approached from the perspective of retaining the regime and maintaining broad access to it, with any such concerns addressed by targeted changes.

4 Promoting ESG investment

We believe that there are strong social and economic reasons to promote the allocation of capital towards companies that demonstrate strong ESG fundamentals. There is an ability to support and position Ireland as the leading international domicile for regulated ESG products to flourish and potentially think about how to incentivise investment in this area, and support our vision for the jurisdiction to build a reputation for trust, capability and innovation.

Consequently, we propose that consideration is given to seeking submissions, as part of the review, on how to encourage investors, including Irish investors, to invest in projects and initiatives which will support the rebuilding of the economy, including the Irish economy. From the funds industry perspective, there are changes to the tax regime which directly connect with the funds taxation regime and others which are indirectly connected in that they could improve the taxation treatment of companies into which funds invest or otherwise improve the general taxation environment.

For example, the rate of IUT for funds which invest in those initiatives could potentially be reduced. The tax rate of Irish deposits is 33% and if it was decided to incentivise investment through regulated investment products, a significantly more attractive rate could be offered to encourage large scale investment and to overcome the inertia that would inevitably exist if only an equal or marginally better rate were offered. For example, a 20% rate of IUT could be applied in respect of qualifying funds (with qualification being linked to an appropriate scheme of ESG taxonomies or an ESG labelling or rating system).

If it is intended to make Ireland a more attractive location for inward investment and as a platform for international ESG investment (both of which are often effected through

investment via funds), the review could explore opportunities to simplify its tax legislation where it can reasonably do so and consideration should be given to seeking submissions, as part of the review, on how this might be achieved.

In this regard, the review could consider the outcome of the previous Departmental consultation on Ireland's territorial regime of taxation and seek views on any remaining areas where the Department would like industry input on how such a regime might be implemented.

The greatest benefit received from such a move is one of greater simplicity in the application of the corporation tax regime. Reduced complexity for business in the operation of the regime should reduce the barriers to conducting business internationally from an Irish base which arise where a regime is complex to administer.

Businesses and Revenue alike can benefit from reduced administrative complexity and greater certainty arising on the amount of Irish tax payable on these profits.

Even though the foregoing proposals suggest an exemption from tax, we believe the benefits of simplicity can be achieved in a context which would see Ireland benefit from additional protections to avoid the erosion of its tax base. For example, the existing foreign tax credit regime, while complex, will in many cases result in no net Irish tax arising. While this results in a form of effective exemption, the complexity of the regime makes it appear unattractive and creates uncertainty.

5 IREF regime

As you will be aware, the IREF tax regime was introduced in Finance Act 2016 as a way of imposing taxation on Irish funds that were heavily invested in Irish real estate. In broad terms, the regime, in its current form, seeks to apply a 20% taxation on distributions and gains earned by investors who would otherwise be exempt from Irish taxation. The regime has been changed a number of times since its introduction and various anti-avoidance rules have been introduced including rules which can impose a deemed taxation charge where the fund has borrowed from related parties.

The Commission on Taxation has drawn particular attention to the role of IREFs (along with REITs) in the Irish property market and noted the taxation of institutional investors is an area that has attracted increased attention and was raised by stakeholders responding to the Commission's public consultation, particularly in the context of housing policy and affordability. In making its recommendation, the Commission stated that the review "should include an assessment of whether the structures are achieving their intended policy objectives (recognising that trade-offs exist in this space), their impact on the supply and affordability of housing, as well as whether they are meeting the needs and expectations of the users of such structures."

While acknowledging that it had insufficient time to consider the issues in an in-depth way, the Commission did say that its view is that the ability to attract inward capital investment to fund the supply of housing needs to be carefully balanced with enabling an appropriate

share of tax being paid on returns from Irish assets.

It is worth noting that the Commission did note that "there are trade-offs involved in pursuing these objectives through tax policy". As such, the review could explore whether tax policy is the best approach to addressing policy concerns in this sector (such as the balance between attracting institutional investment and supporting individual homebuyers). It might well be the case that tax policy is not the optimal way to deal with some of these issues.

The review might seek views as to the role that institutional capital in Ireland can play, particularly as there are few individual investors with sufficient capital available able to take the risk to invest in large scale development in the current environment. For example, it might be through investments of scale, facilitated by institutional investors, that Ireland can tackle the current constraints of supply and affordability facing the Irish real estate market and Irish society as a whole. Tax policy in this area needs to facilitate the deployment of stable, long-term investment and development capital into the Irish market. Investors are understandably hesitant to invest in a market in flux and a focus on ensuring stability and certainty for taxpayers operating in an area that has seen significant regime change in recent years would be welcome. As such, the review could seek views on the regime and its effectiveness with a view to determining whether any modifications are warranted. In addition, it could explore how different government agencies could align their approaches (e.g., the above-mentioned tax rule deeming a taxable income amount to arise in respect of certain debt and the Central Bank of Ireland's leverage limits on IREFs).

6 Product mix

As discussed above other jurisdictions have continued to innovate in their funds product mix e.g., Luxembourg's securitisation and RAIF regimes and the UK's QAHC regime. We believe that a successful international funds and asset management centre needs to continuously modernise and innovate to maintain and keep its place.

We think that the review could be used to seek submissions in this area (noting that this would involve looking at both tax non-tax related matters), this could include a review of the use of limited partnerships (other than ILPs) as a means to facilitate private equity investment.