Response to the Department of Finance public consultation on Funds Sector 2030: A Framework for Open, Resilient & Developing Markets

KPMG response

15 September 2023

KPMG

1 Stokes Place
St. Stephen's Green
Dublin 2
D02 DE03

1 Harbourmaster Place
IFSC
Dublin 1
D01 F6F5

Telephone +353 1 410 1000
Fax +353 1 412 1122
Internet www.kpmg.ie

Jorge Revilla
Head of Asset Management
t: +353 1 410 2776
M: +087 744 2776
e: jorge.revilla@kpmg.ie

Gareth Bryan
Head of Asset Management Tax
t: +353 1 410 2434
M: +087 744 2434
e: gareth.bryan@kpmg.ie

Jim Clery
Head of Real Estate Tax Partner
t: +353 1 410 1172
M: +087 744 1172
e: jim.clery@kpmg.ie

Mr. Brian Corr
Funds Review
Department of Finance
Miesian Plaza
50-58 Baggot Street Lower
Dublin 2 D02XW14
Ireland

15 September 2023

Dear Brian,

KPMG's Response to the Department of Finance's Consultation Paper on the Funds Sector 2030 Review: A Framework for Open, Resilient & Developing Markets

We welcome the government's engagement with stakeholders on the future of the investment funds and asset management sector, with the aim of ensuring it remains resilient, futured-proofed and at the forefront of international best practice.

Our Asset Management practice, comprising 500+ professionals, collaborates with over 250 global asset managers, across all asset classes. We audit 25% of Ireland's serviced funds, encompassing c. 1,750 sub-funds, and additionally provide tax, consulting and advisory services to a significant number of both Irish and International asset managers with business in Ireland. As such we believe we have the sector knowledge and experience to provide feedback on this consultation paper.

In our submission we have answered the questions in the same layout as was presented in the consultation paper. Should you wish to discuss any part of this submission, please do not hesitate to contact Jorge Revilla, Gareth Bryan or Jim Clery.

Yours faithfully,

Jorge Revilla, Gareth Bryan and Jim Clery

Contents

Section 1: Investment funds and asset management landscape

Q1. What policy supports have been most impactful in attracting the funds sector to Ireland and/or the EU in recent decades?

The investment funds and asset management sector in Ireland has been particularly successful since its establishment over 30 years ago due to the following key policy supports:

- The effective implementation of the Undertaking for Collective Investments in Transferable Securities (UCITS) Directive and the EU's Alternative Investment Fund Managers Directive (AIFMD).
- A strong and globally respected regulator in the Central Bank of Ireland (CBI).
- A competitive tax regime for regulated investment funds, which exempts funds from corporate tax and capital gains tax on their investment returns, in addition to a broad treaty network of over 70 countries.
- The development of a skilled and experienced workforce for the investment funds and asset management sector, which benefits from high-quality education, training and professional development programs.
- Ireland is an investment management centre of excellence with a global reach, which is serviced by the largest global asset managers, administrators, custodians, depositaries, transfer agents and legal, audit, tax and other professionals.

Q2. What characteristics set Ireland apart from other jurisdictions when selecting a fund's domicile?

The selection of the fund's domicile can be crucial to the success of the fund and there are a number of advantages to the fund promoter and investors of choosing an Irish domiciled fund:

- A regulatory framework that is well established, transparent, flexible and provides certainty for fund promoters and investor.
- Aided by the EU passporting rights Irish regulated funds can easily be distributed throughout the EU. In addition, Ireland is a major hub for crossborder distribution where Irish funds are sold into 90 countries globally.
- A strong ecosystem of service providers to support the establishment and ongoing operations of the funds locally with globally renowned administrators, custodians, depositaries, transfer agents and legal, audit, tax and other professionals.
- A deep pool of talent and expertise in the investment funds and asset management industry, with a skilled and experienced workforce that can cater to the needs of all types of funds and investment strategies.
- A favourable tax regime that provides certainty and transparency to fund managers and investors, with no tax on the income or gains arising to Irish-domiciled funds, no withholding tax on distributions to non-Irish investors, and a broad treaty network of over 70 countries.
- Ireland is the Eurozone's only English-speaking jurisdiction with a common law legal structure similar to the UK and US. The geographical location/time-zone enables Ireland to serve the European Union but also other global markets in the U.S. and Asia.

Q3. What are the most important trends evident in the sector?

Key trends we are seeing in the sector include:

- The growth of the ETF product and the move to passive investing.
- The increase in demand for private asset investment funds (infrastructure, real estate, hedge funds and private equity), and the requirement for an indirectly regulated alternative investment fund (AIF) structure to facilitate these asset classes.
- Increased investor sentiment (particularly institutional) for onshore product options in established and well respected fund and asset management jurisdictions.
- An increased interest in/demand for ethical and sustainable investments aligned with evolving ESG regulations.
- Significant growth in the size and number of credit funds, which is aligned to trends we are seeing in the growth of the non-bank financing sector.
- The growth of digital technology such as artificial intelligence, blockchain, cloud computing, and digitalisation.

Q4, What are the key risks and challenges for the sector in the medium to long-term and how can they be managed?

Competitiveness:

The Irish funds and asset management sector operates in a highly competitive global environment, it is important for the success of the sector that we remain agile and at the forefront of policy, legal and tax developments so we move in line with market and industry demands and are able to meet the ever-evolving needs of investors and fund promoters.

Product:

Fund promoters want a single EU domicile to base their business and want to have the ability to launch a full suite of investment products from that jurisdiction. Ireland has no competitive product for private assets and ELTIFs. We are seeing mangers that chose Ireland for their European base, having to launch product in Luxembourg and other jurisdictions because there is no fit for purpose options locally.

In the short term we need to improve the Investment Limited Partnership (ILP) and loan origination fund regime. In addition, we need an ELTIF framework that works and competes internationally, and we need to establish an indirectly regulated fund regime for private assets.

Innovative product and speed to market:

Innovation in the industry is vital and developments need to keep pace with investor's needs. In addition, transparency and certainty in relation to authorisation times and speed to market are hugely important. Ireland should be a global leader in ESG investing; and be more advanced in relation to digital, tokenisation and crypto developments.

Full employment / housing crisis:

Ireland is nearing full employment and the ability to hire local talent is becoming more difficult, one option to fill vacant positions is to hire from overseas. However, foreign employees relocating to Ireland face several challenges which take away the appeal of Ireland as a location to work. These challenges include high personal taxation, the lack of housing / accommodation and access to international schools which make hiring from overseas difficult. This is limiting the growth of the Irish Funds industry.

UK Fund Review:

The industry here has enjoyed significant business from the UK with (i) strong capital flows into Irish domiciled funds, (ii) UK investment advisors/managers establishing Irish funds and (iii) the servicing of these funds locally. The UK have recently conducted their own UK Funds Review and there is a risk following this review that the UK will make it more attractive for UK investors to invest in UK funds instead of EU/Irish funds) and/or incentivise the servicing of UK promoted funds in the UK.

Q5. What are the key opportunities for the sector in the medium to long-term and how can they be delivered?

Product: There would be significantly more growth in the sector in terms of number of funds, assets under management and associated local employment, if we had a full suite of products that compared favourably with other fund jurisdictions. For example, the industry has seen significant interest and growth in private assets over the past few years, however Ireland does not have a competitive product for this asset class. The introduction of new product offerings, such as an indirectly regulated AIF and an appropriate ELTIF 2.0 regime would significantly improve Ireland's ability to attract private asset investment strategies.

Regulation: A regulator that continues to be highly respected globally but is also efficient and transparent with authorisations and is innovative to keep pace with investor's needs.

Talent: Develop the skills and talent needed for industry growth. We need to grow greater depth in talent pool in private asset strategies, PE and valuations, specifically, we need to upscale our workforce towards mathematics, CFAs and FRM as we move up the asset management value chain. Also encouraging Irish talent 'home' from offshore locations and associated incentivises.

Taxation: Simplification of the investment fund tax regime (discussed in further detail in sections 4, 5 and 6).

Competitiveness: As covered in question 4, the funds and asset management sector need to remain agile and at the forefront of policy, legal and tax developments. To help achieve this the establishment of a dedicated fund unit with subject matter experts within a Government Department, with a mandate to promote the industry in Ireland, to drive policy initiatives, and to ensure a holistic approach is taken to product, tax treatment, legislative and regulatory frameworks and promotion would be welcomed.

Q6. How will technological change and innovation influence the sector's future development?

Without a doubt the growth of digital technology such as artificial intelligence, blockchain, cloud computing, and digitalisation has the potential to transform and enhance many aspects of the industry. Asset managers and service providers who embrace innovation and technology change will be well positioned to succeed in this evolving industry.

It will be important that the regulatory and legislative frameworks keep pace with technological developments; and robust risk management and compliance procedures will be essential to ensure long-term sustainability and strong investor protection.

Q7. How best can Ireland position itself in the future as a location of choice for EU and international firms?

The implementation of the opportunities set out in our response to question 5 above will position Ireland well as the location of choice for EU and International firms.

Q8. How can Ireland best support the growth and development of the market for ESG products and the transition to carbon neutrality?

In many jurisdictions it is often tempting for the regulator to be highly prescriptive in the administration of ESG regulation. Whilst seemingly paradoxical, the best way for the Irish regulator and ecosystem to promote the growth and development of ESG products is through a "open tent" policy that allows investment funds to operate within a wide set of ESG parameters that meets them where they are today in the process of transition to carbon neutrality whilst protecting investors from the more lascivious actors in the space that might try to green wash their products. To promote a transition, it is important to recognise where the industry is right now and work collaboratively with the industry to evolve at a reasonable pace towards carbon neutrality.

Q9. For the NBFI sector, those investment funds providing credit intermediation, what are the key opportunities for the sector in the medium- to long-term and how can they be delivered?

The NBFI sector has seen significant growth in Ireland and globally in recent years, private credit has been replacing bank credit to support SMEs and allow them to invest in their future to compete better, which in turn benefits domestic economies.

Ireland has been servicing the NBFI sector for some time and has a deep knowledge base and related experience exists in the ecosystem. To further develop NBFI opportunities consideration should be given to (i) enhancing the range of products available and (ii) exploring from a regulatory perspective the viability of new business models and solutions that would work for all stakeholders.

The development of an ELTIF and an indirectly regulated fund regime as discussed in questions 4 and 5 would also support the NBFI sector. In addition, enhancements to the loan-originating fund regime would benefit the NBFI sector.

Section 2: The regulatory and supervisory framework

Q10. How important is an effective regulatory framework for Ireland to maintain its status as a leading funds domicile?

In short, it is very important. Whilst Ireland is the 2nd largest fund domicile in Europe, it is a considerable distance away from being the leading domicile. Challenges remain with the authorisation process and we believe there needs to be greater agility to deal with industry developments and meeting opportunities to deal with escalated issues.

We believe that the Irish Government can play a greater role going forward in the development of Ireland as a respected and efficient funds domicile. With this in mind, we concur with the proposal put forward by Irish Funds for the creation of a new dedicated Funds and Asset Management Unit at Government Department level which would have the capacity, resources and expertise to ensure the funds and asset management sector contains all the tools necessary to enable it to compete on a 'level playing field' on the international stage.

We believe this would make the sector agile to support innovative development and act as a driver to close the gaps in Ireland's product offering compared to other jurisdictions (e.g. unregulated limited partnership vehicle, the ELTIF product, improvements to the ILP and loan origination regimes).

Q11. Taking account of the European and international aspect of the Irish framework and key EU files such as Capital Markets Union (CMU) and the Retail Investment Strategy, what improvements could be made to the legislative, regulatory and supervisory framework?

The current fund management company guidance (CP86) framework is unique to Ireland, and we believe that the CP86 framework needs to be updated to take greater account of, and provide clearer guidance to, governance arrangements required of fund management companies which perform the 'top-up' MiFID service of individual portfolio management (IPM).

Not only this, but the UCITS and AIFMD regimes in general should be amended to better take account of this IMP activity. We have seen recently how, in the absence of any EU legislation on the matter, Ireland recently consulted on the imposition of new K-factor capital requirements on such fund management companies in order to take account of this IMP activity. Whilst Ireland is to be commended for filling a European wide legislative gap in this area, these new rules, if/when implemented will result in more complicated capital requirements for Irish management companies compared to their European peers.

Despite the introduction of the ELTIF regime at an EU level in 2015, the Central Bank of Ireland AIF rulebook has not yet been updated to take account of this product. Following the publication of the new ELTIF regulation 2023/606 we concur with the Irish Funds submission already made to the Central Bank that it allows for the authorisation of ELTIFs as a standalone vehicle outside the existing Central Bank RIAIF and QIAIF regimes. It is also important that Ireland's local arrangements for the implementation of the ELTIF regime do not impose requirements above the minimum required across the EU as to do so would put Ireland in a disadvantageous position in relation to other countries who choose not to adopt extra requirements.

Q12. What elements of EU policy, including CMU policy, are most relevant to the growth and development of the funds and asset management sector in Ireland and why?

The following actions contained in the EU CMU Plan of 2020 are relevant to the growth and development of the funds and asset management sector in Ireland.

CMU Action 3 - Supporting vehicles for long-term investment and CMU Action 4 - Encouraging more long term and equity financing from institutional investors. Both these actions could be facilitated by the full implementation of the ELTIF regime and the reform/improvement of the unregulated limited partnerships act. This in turn would assist in achieving the objective in funnelling more investment in long-term projects such as infrastructure.

CMU Action 5 - Directing SMEs to alternative providers of funding. This can be facilitated by the improvement of the current rules on loan originating QIAIFs (L-QIAIFs). It is important that the domestic Irish QIAIF regime be amended to take account of upcoming developments relating to Loan originating funds contained in the upcoming changes to AIFMD. This objective is relevant in that it would facilitate the growth of businesses by supplying them with much needed credit they need in order to fund their expansion. The provision of credit to businesses by the traditional banks has decreased since the financial crisis and it is important that non-bank lending be facilitated in order to fill this gap.

CMU Action 9 - Supporting people in their retirement. Certain aspects of the existing tax regime applicable to returns earned by investors from regulated funds runs contrary to this regime. For example, the current "8-year deemed disposal" rule and inability to offset losses, both of which can impact on investors saving for retirement and investors saving for the long term. Please refer to the responses in Section 4 of the Consultation, Taxation of Investment Products in this regard. The changing demographics across Europe, and also in Ireland, make it particularly important that the aging working population be encouraged to save for retirement.

Q13. What peer jurisdictions, most notably from other EU jurisdictions are most relevant? Outline the reasons why.

Luxembourg and UK are the most relevant jurisdictions.

Luxembourg as the largest and most successful fund domicile in Europe to date has established itself as being aware of and responsive to the new product types required by investors in the funds industry. One significant trend is the development of the indirectly regulated AIF product (Luxembourg RAIF) which has seen significant growth and is attractive to private assets.

The Monterey Insight Luxembourg (Dec 2022) reported "For unregulated funds, the RAIFs have the greatest increase totalling US$458.4bn of assets representing a 38.6% increase compared to US$330.8bn in 2021. During the same time, LuxLPs & SOPARFIs reached US$681.4bn (US$470.0bn in 2021), a 45.0% increase of assets."

Strong UK business and relationships: the industry here has enjoyed significant business from the UK with (i) strong capital flows into Irish domiciled funds, (ii) UK investment advisors/managers establishing Irish funds and (iii) the servicing of these funds locally. The UK have recently conducted their own UK Funds Review and there is a risk following this review that the UK make it more attractive for UK investors to invest in UK funds (v EU/Irish funds) and/or incentivise the servicing of UK promoted funds in the UK.

In addition to looking at Ireland as a fund domicile and back-office service provider, greater attention should be paid to making Ireland attractive as a location for high value trading and discretionary portfolio management activities such as we see in London, Paris and Frankfurt. All factors affecting fund management companies and their staff should be factored into this equation, not just regulation and corporate taxation, but also personal needs to creation and maintenance of a successful, high value Irish funds industry. Such needs could include personal taxation, appropriate training/talent, housing, and the availability of international schools.

It is worth pointing out that whilst Ireland was a popular destination in terms of the number of financial services companies relocating from the UK post Brexit; some studies have reported that, in terms of the number of employees relocating, Ireland actually ranked in third place behind Paris and Frankfurt.

Q14. How does the funds framework in Ireland compare to those other jurisdictions?

The framework developed over the past 30 years as the industry grew has stood well for the sector. Ireland compares favourable against other fund jurisdictions. We have (i) a strong and globally respected Regulator, (ii) Government support through the Department of Finance that has delivered an effective tax regime for funds and investment vehicles and has played an important role in the introduction of legislative enhancements for the industry, (iii) a well-established industry represented organisation in Irish Funds and (iv) a centre of excellence for the management and servicing of investment funds with world class asset managers, administrators, custodians, depositories, transfer agents, lawyers, auditors and other professional advisors.

To continue to thrive we must remain agile, competitive and innovative to keep pace with investor needs. To achieve this, we need (i) a better system for the development and enhancement of investment products and the associated legislative updates and (ii) simplification to the taxation of investment products (see responses to questions 24-45).

Q15. Are there any updates or changes needed to the current legislation governing the legal structures used to establish investment funds?

Investment Limited Partnership (ILP):

The recently enhanced ILP legislation was warmly welcomed by the industry. However, a number of issues arise outside of primary legislation and need to be addressed. In summary amendments are required in respect of (i) the generally acceptable accounting standards that may be used by ILPs, (ii) the Irish tax regime to ensure it is possible to establish an Irish holding company that is fit for purpose, (iii) an amendment to tax legislation is required to afford ILPs the same exemption from Dividend Withholding Tax (DWT) available to all other Irish regulated funds; and (iv) the reverse-anti-hybrid rules need to be updated to better reflect industry practices.

Indirectly Regulated funds:

We believe (and concur with Irish Fund's submission which sets out the updated and changes needed) that the Irish indirectly regulated fund offering needs to be significantly enhanced through the establishment of a new indirectly regulated product regime and by making improvements to existing unregulated fund structures.

Q16. How do the Irish legal structures compare to the vehicles available in other jurisdictions?

Regulated funds:

Ireland has five regulated fund structures, and these are competitive with regulated structures in other jurisdictions. The Irish structures are (i) Variable Capital Investment Companies, (ii) ICAVs, (iii) Unit Trusts, (iv) CCFs and (v) ILPs. As set out in question 15 there are several enhancements needed to the ILP to ensure it can compete globally.

Indirectly Regulated funds:

Although there are three indirectly regulated fund option in Ireland (i.e. when an AIFM is included in the structure) with (i) unregulated unit trust, (ii) unauthorised fixed capital company and (iii) 1907 Limited Partnership, each have their narrow purpose and do not provide the level of functionality as indirectly regulated products in other jurisdictions. As a result, we see minimal investment flow into Irish indirectly regulated fund structures.

What Ireland needs is an indirectly regulated fund structure that is flexible and appropriately meets the demands of the private asset strategies, and which will position Ireland in a more competitive position vis-a-via other jurisdictions. These structures will also benefit the growth of the NBFI sectors as set out in question 9.

Q17. Are there investment or financing vehicles that are currently unregulated but that should be regulated in the future? If your answer is yes, please explain how these entities should be regulated and the rationale for doing so.

As discussed in question 16, there are three indirectly regulated fund option in Ireland with the (i) unregulated unit trust, (ii) unauthorised fixed capital company and (iii) 1907 Limited Partnership, each have their narrow purpose and do not provide the level of functionality as unregulated products in other jurisdictions.

Our request is to expand and enhance the fund structures that are available for “unregulated” AIFs so they are fit for purpose and compete with similar unregulated AIF structures in other jurisdictions such as the Luxembourg RAIF regime and the UK QAHC regime.

It is important to recognise that although these are “unregulated” AIFs they are indirectly regulated by the CBI under AIFMD and thus subject to, inter alia, regulatory monitoring and macro-prudential requirements.

Q18. Unregulated vehicles are not subject to the same restrictions, requirements and reporting obligations as regulated ones. Does this pose a risk to investors or to the wider financial system?

We believe that the risks of allowing unregulated products can be appropriately balanced by the participation of a AIFM regulated management company in the chain. We have seen how the combination of a regulated management company and unregulated products has been successful in other jurisdictions in order to create what is described as an indirectly regulated fund.

Section 3: Assessing the impact of the funds sector

Q19. Where relevant, detail how your organisation, or the wider sector, contributes to the economy with particular reference to employment, revenues and regional development.

KPMG's contribution:

KPMG is Ireland's leading professional services firm, offering a range of Audit, Tax, Deal Advisory and Consulting services to a broad range of domestic and international clients across all sectors of business and the economy. We have over 4,200 staff and uniquely among the large audit firms, we are managed on an "all-Ireland" basis with six offices located across Ireland in Dublin, Belfast, Cork and Galway.

Our Asset Management practice, comprising 500+ professionals, collaborates with over 250 global asset managers, across all asset classes. We audit 25% of Ireland's serviced funds, encompassing ~1,750 sub-funds, and additionally provide tax, consulting and advisory services to a significant number of both Irish and International asset managers with business in Ireland.

Wider sector's contribution:

Across Ireland, the asset management industry directly employs over 17,000 people, across ~180 companies.[1] Indirect employment, particularly in legal and accounting services is also significant, contributing an additional ~17,000 to total employment impact in the sector. [2]

The largest employment sub-sector of the industry is the fund administrator/depository companies which account for close to 55% of all FTEs directly employed within the industry. This reflects Ireland's focus on the middle/back-office element of the asset management value chain. Investment/asset management and/or fund management companies contribute an additional ~21% of total directly employed FTEs. [2]

Of those directly employed in the industry, the majority are based in Dublin (62%), there are also significant cohorts based across the country in areas such as the South-West (8.4%), South-East (8.6%), Mid-East (9.7%) and Mid-West (6.8%)

The sector also generates close to ~€9.9bn in direct revenues and a further ~€5bn in indirect and induced revenue impact. This in turn creates a total ~€12bn in gross value added for the Irish economy (€7.5bn directly and ~€4.5bn indirectly).[2]

Q20. What role can the sector play in deepening Ireland's capital markets and, in particular, supporting retail investors access to investment opportunities and domestic SME's access to finance? What measures can be taken or supported (if underway) to meet this objective?

SME access to finance

- Since the financial crisis, Irish SMEs have found it challenging to access funding with outstanding business loans to SMEs falling from €27.1bn in 2010[3] to €12.3bn by the end of March 2023.[4]

- As domestic banks have somewhat re-treated from the sector, non-bank lenders and other private capital providers have gained in popularity owing to their flexible terms and agile approach. Data from the central bank suggests that Irish SMEs borrowed almost €4bn from non-bank lenders between 2019 -2020, across a wide variety of products.[5] These lenders tend to be niche players with a particular sector focus (e.g. real estate) with asset managers the most common ultimate owners of these organisations.

Retail investor access to investment opportunities

- Improving financial literacy, assess to transparent financial and product advice and financial well-being is increasingly important for all of us. There's a culture gap with a lot of Irish people putting money in inefficient deposits rather than investing in investment funds which have shown to give investors consistently better returns particularly in the longer term. Although Ireland is a global hub for domiciling and servicing of investment funds, Irish household participation rates in investment funds is extremely low at less than 1% (11% is the EU27 aggregate). Educating and incentivising the Irish market to develop a bigger pool of retail investment capital is needed.

- Authorised investment funds in Ireland are established as either Undertakings for Collective Investment in Transferable Securities (UCITS) or Alternative Investment Funds (AIFs) both of which have features that make them attractive to retail investors:

- UCITS were designed so that retail investors could have transparent, regulated, and cross-border investment opportunities. There are now 5,280 UCITS funds domiciled in Ireland with net assets of €2.92bn.[5]

- In particular, Ireland is particularly prominent in relation to the domicile of Exchange Traded Funds (Irish domiciled ETFs represent over 60% of the total European ETF market) which have proved popular with retail investors.[6] This can in part be attributed to a favourable to a double taxation treaty with the US, where ETFs domiciled in Ireland typically suffer 15% withholding tax on US dividends versus 30% in domiciles such as Luxembourg where a less advantageous tax treaty exists.

- Ireland also has specific regulatory structures dedicated to alternative investment funds that are targeted directly to retail investors: Retail Investor Alternative Investment Funds (RIAIFs). However, this structure remains relatively less prominent versus its institutional equivalent (QIAIFs).

Q21. What role can the sector play in meeting wider Government policy objectives in areas such as investment in domestic enterprises and infrastructure? What measures can be taken or supported (if underway) to meet these objectives?

With a rapidly growing population, Ireland will need to invest heavily in major infrastructure projects in order to meet demand. Whilst some of this funding will come from the public sector, private capital markets will have a significant role to play. For example, Real Estate Investment Trusts (REITs) have become large players in Irish residential market.

Private credit funds also have a role to play, who can provide project financing with more bespoke forms of lending versus traditional term loans allowing them to accurately meet the needs of borrowers.

In addition, there is a growing trend for private equity investment i.e. the investment into businesses that are not listed on a stock market, to support economic development and invest in SMEs and innovation. However, attracting private equity investment needs a suitable partnership investment structure and while the ILP regime is suitable for regulated investment, our existing unregulated partnership legislation (the Limited Partnership Act 1907) is not suitable for this kind of investment structure in its current form.

Q22. What role can the sector play in meeting wider Government policy objectives in areas such as pensions and long-term savings? What measures can be taken or supported (if underway) to meet these objectives?

European Long Term Investment Funds (ELTIFs) is a pan-European regime for alternative investment funds (AIFs) which channel the capital they raise towards European long-term investments in the real economy, in line with the European Union (EU) objective of smart, sustainable and inclusive growth.

ELTIF 2.0 will come into force in January 2024 and will be authorized by the Central Bank of Ireland once the ELTIF regime is put in place. This needs to be a priority as previously discussed.

They present significant advantages for pension funds and long-term savings by opening less-liquid investments through a trusted and well-regulated structure that attracts both retail and professional investors.

The intention behind the Regulation is to enable EU-authorised AIFMs to market EU AIFs which they manage as 'ELTIFs' to both professional and retail investors (as defined under MiFID) across the EU. Authorised managers will be able to make use of an EU-wide passport, subject to a notification procedure established under the EU's Alternative Investment Fund Managers Directive (AIFMD).

ELTIF 2.0 expands the scope of eligible assets and investments, relaxes diversification requirements and removes the €10,000 minimum investment threshold for retail investors.

Q23. What role does the sector play in supporting investment in the economy and the savings needs of investors in the EU, and outside the EU, where relevant?

Investment funds play a crucial role in facilitating the accumulation of personal savings, whether for major investments or for retirement. They are also important because they make institutional and personal savings available as loans to companies and projects which contribute to growth and jobs.

Owing the open nature of global capital markets, improvements in Ireland's funds industry can have implications beyond the EU. For example, asset managers who either have their funds services or domiciled in Ireland will often be located outside of Ireland (US is a leading location). As such capital from savings and pensions located globally may travel through the Irish financial system. Efficient structures and delivery of services provides benefits for both original investors and asset managers.

However, Irish pension funds allocate less than 0.01% of their portfolios to local PE and VC funds, considerably less than their European counterparts.[8] There could be an opportunity for policy makers to suggest ways to facilitate Irish pension scheme investment into local enterprises.

Sources

[1] https://www.gov.ie/pdf/?file=https://assets.gov.ie/252183/23466078-2078-4d2f-a0e6-10f42b48db6a.pdf#page=null

[2] 1621327591-2021-05-irish-funds-indecon-report-2021-executive-summary.pdf

[3] 20. Ireland | Financing SMEs and Entrepreneurs 2022 : An OECD Scoreboard | OECD iLibrary (oecd-ilibrary.org)

[4] https://www.centralbank.ie/docs/default-source/statistics/data-and-analysis/credit-and-banking-statistics/business-credit-and-deposits/2023q1_trends_in_sme_and_large_enterprise_credit_and_deposits.pdf?sfvrsn=e9f69e1d_3#:~:text=The%20total%20outstanding%20stock%20of,compared%20to%20the%20previous%20quarter.&text=Gross%20new%20lending%20to%20core,quarters%20to%20end%2DMarch%202023.

[5] https://www.centralbank.ie/statistics/statistical-publications/behind-the-data/the-role-of-non-bank-lenders-in-financing-irish-smes

[6] https://www.irishfunds.ie/facts-figures/industry-statistics/irish-domiciled-ucits/

[7] https://www.irishfunds.ie/set-up-distribution/why-ireland/

[8] https://impact-investor.com/irish-venture-capital-association-calls-for-pension-funds-to-back-irish-enterprises/

Section 4: Taxation of investment products

Q24. For an Irish investor, as set out above, tax legislation separately classes investments as:
a) Irish bank accounts
b) EU/EEA bank accounts
c) Other bank accounts
d) Dividends from companies
e) Capital gains on the sale of shares in companies
f) Irish life products (new basis)
g) Irish life products (old basis)
h) Foreign life products
i) Irish funds
j) EU/EEA/OECD equivalent funds
k) EU/EEA/OECD non-equivalent funds
l) Other distributing funds
m) Other non-distributing funds
n) Personal Portfolio Investment products

Taking account of the different nature of the investment products, is this an appropriate way to class investments for the purposes of taxing the returns on those investments? Does the differing tax treatment of different investments drive investor behaviour, and if so how? Do you propose an alternative method / methods of classifying investment products?

We propose addressing each of the above questions separately.

Is the current classification of investments for tax purposes appropriate?

Overall, the approach to taxing investments is far too complex, with too many different regimes applying which make it almost impossible for an individual without a tax qualification to understand the tax regime that applies in each case.

At present each investment product has to be analysed individually to consider and determine its tax status. This adds considerably to the compliance burden for individual taxpayers, and in general has a tendency to push people towards structured products.

Many of the differences between the tax treatment of Irish and non-Irish products were conceived when we had a very different tax environment, and in particular prior to the introduction of AEOI, FATCA, etc. We have now reached a point where there is no economic or policy reason why differential treatment should continue to apply. It is also an anachronism that there should be any difference between Irish/EU investment products and other investment products. Indeed, this differentiation is hard to justify as Ireland encourages non-Irish individuals and entities to invest through Irish fund products.

There is no reason why there should be any differentiation in the tax treatment of investments in fund and insurance products, which essentially are just different mechanisms for achieving the same investment result/strategy. It is difficult to discern any policy reason for favouring one over the other.

Investments in company shares:

In relation to the list of investments outlined in the question above, we do not see any reason to align the tax treatment of capital gains on disposals of company shares and dividend income from companies with the general investment taxation regime. There are other forums where the modernisation of the taxation of these items should be discussed given their importance in encouraging a growth economy and entrepreneurship (for example reducing the tax rate on dividends to match the capital gains tax rate, and reducing the overall capital gains tax burden), but we propose that this should not be part of this consultation.

Please note, in considering our comments in respect of questions 24-32 of this consultation, our views relate to the types of investments set out in (a)-(c) and (f)-(n) above, as appropriate. For the avoidance of doubt, our comments do not relate to the taxation of capital gains on disposals of company shares or dividend income from companies.

Does the differing tax treatment of different investments drive investor behaviour?

Investor behaviours are influenced by the tax treatment of investments.

For example, at present there is no loss relief for losses arising on the disposal of certain investment products. Take as an example, investments in Irish and EU regulated investment funds, which are availed of by many ordinary investors wishing to benefit from professional investment management capability and diversification. The absence of loss relief can give rise to irrational investment decisions with investors holding on to underperforming investments in the hope that they will recover, because the tax cost of shifting is too high.

Take the following example:

Original investment:	
Investment in original fund	100
Current value of original fund	70
Hypothetical new investment:	
If original investment is sold, amount available to invest in a new fund	70
Future value that the new fund must reach to break even (after 41% tax)	121
% increase in value of the new fund needed to reach this break-even point	73%

This results in the following:

- The investor stays invested in the underperforming fund in the hopes of getting back to par.
- There is an impact on competition between financial products, with the incentive being to remain invested in the underperforming product.
- Potentially, a very significant delay in the tax paid to the State, as loss-making or underperforming investments are held longer than they should otherwise be.

There are also further behavioural impacts, including that investors gravitate towards products that offer CGT treatment to leave open the availability of loss relief, should a loss arise. Many of these products are US products, which imposes US inheritance/estate tax on the value of these products where an individual dies with only minimal exemptions. This US estate tax is then creditable against Irish CAT on the same event. As a result, inheritance tax on the inheritance of a vast array of investment products are paid in the US rather than in Ireland.

Do you propose an alternative method / methods of classifying investment products?

In relation to the investment products listed at (a) to (c) and (f) to (m), there are in our view two primary options available that should meet the policy objectives of Government, maintain Irish tax revenues (and possibly grow them), while at the same time being a fair system of taxation for Irish retail investors, whilst not interfering with the attractiveness of Irish funds to international investors. These options also have the benefit of simplifying the overall regime, and remove the need to separately analyse each product under various definitions, as the tax treatment should be consistent across all product types:

> **Option A:** Tax all of the realised income and gains annually from these investment products as a single source of income under Case III. This would allow for the taxation of net income and gains after allowance for losses, for example. We will deal with the rate of tax to apply at the appropriate question below, or
>
> **Option B:** Maintain the existing distinction between capital and income, a fundamental and longstanding principle in Irish taxation. In this scenario, all income should be taxed as a single source of income under Case III (noting that where there are investments in income-based products, losses are relatively unlikely); and all capital items whether gains or losses subject to the general capital gains tax regime.

Under both of these scenarios, the 8-year deemed disposal rules would become obsolete. Quite aside from achieving a greater level of fairness for retail investors, this would also enable investors to adopt long-term investment strategies, rather than being incentivised into short-term strategies. Incentivising long-term investment strategies supports the allocation of capital to projects that promote long-term value creation in the economy.

Another possibility would be that an investor elects into either Option A or B on purchasing a product. If an investor elects into Option A, there is a 8-year deemed disposal. PPIPs and PPIUs are automatically elected into Option A as a separate single source on their own.

Anecdotally, we are aware of individuals considering moving to Ireland who have been discouraged due to the complexity of our taxation system for investment assets, and the need to entirely dispose of entire portfolios prior to coming to Ireland rather than run a risk of Irish taxation on Case IV income actually exceeding their total net gains (e.g., due to the lack of loss relief on offshore funds). This is a very live issue which is operating to disincentivise more senior talent, management and entrepreneurs, and indeed retirees, from moving to Ireland.

It would be desirable for the taxation system relating to products under category (f) above (Irish Life Products – New Basis) to be consistent with that applying to all investment products. Whilst similar modernisation should be considered in the context of Irish Life Products – Old Basis, given the highly specialised nature of these products and the potential knock on implications and unintended consequences, feedback from specialist industry groups regarding any changes should be conducted before any proposal are brought forward.

Q25. The return on certain investments is taxed through the operation of a withholding tax at source, while others must be self-assessed by the investor. In either case, the tax may be a final liability tax, or it may be an amount against which reliefs and credits are allowed.

a) Is it desirable that, where possible, taxes are:
i. deducted at source; and
ii. final liability taxes? Or
b) Is it desirable that:

i. taxes are self-assessed; and
ii. taxed at a marginal rate with reliefs and credits available against investment returns, meaning taxpayers would have to file a tax return each year.

Do the answers to a) and b) differ for different types of investment product or different types of taxpayer?

Self-assessment versus deduction at source:

In general, Ireland operates a self-assessment tax regime. The operation of the self-assessment regime is made complicated and confusing for taxpayers by having certain items taxed on a final tax basis outside of the self-assessment tax return. In all cases, we would recommend strict adherence to the self-assessment basis of taxation, where all income is taxed at a person's marginal rate. In saying this, we do not advocate necessarily the cessation of all withholding tax at source, which will play its part in simplifying collection, however it should not be applied as a final tax.

This approach will make very little difference to taxpayers on higher incomes but could have a substantial benefit for individuals on low incomes. It would also remove the arbitrary disparity in the tax treatment of taxpayers who are under 65 years old relative to those who are older.

For lower income taxpayers, a greatly simplified tax return should be developed which would not require the volume detail required on the normal Form 11. This could be reduced to just a few pages and could be applied to anyone with annual income and gains (other than employment or pension income) of less than €30k.

The deduction at source mechanism that currently applies to life products and collective investment vehicles had a clear purpose at the time it was put in place. Specifically, it was implemented to ensure the required level of tax was collected at a time when: (i) the self-assessment regime in Ireland was significantly less effective at ensuring compliance and (ii) Revenue had inadequate visibility concerning investments held by Irish investors due to a lack of broader tax information reporting at that time. We do not believe that these same conditions exist today to support the continued use of the deduction at source mechanism where that tax is a final tax on the investor.

In addition, in our view, a deduction at source mechanism can disincentivise promotors of investment products from targeting Irish investors. The mechanics of the IUT and LAET regimes are complex and we have seen cases in practice whereby promotors simply won't offer products to Irish investors, due to the additional cost and complexity associated with operation of the tax at source.

Tax rate:

The disparity in tax rates applicable to certain collective investment products and direct holdings (e.g., equities, bonds, etc.) disincentivises Irish retail investors from accessing the benefits of diversification (e.g., reduced risk) that a collective investment product provides. Putting the non-availability of loss relief aside (which is dealt with in later questions), the various increases in the tax rate applying to returns from collective investment products from 20% to a rate which is now above both the marginal rate of income tax and capital gains tax has led to under investment in such products.

In our view, there should at least be an alignment of rates with the respective marginal rates of income tax and capital gains tax. In addition, consideration should be given to reducing the rates further to stimulate investment in diversified investment products in an effort to move investors away from overconcentration / non-diversification of investment risk. This could be done in tandem with broader policy objectives (e.g., a reduced rate for investment in ESG focused products). While a static modelling of the effect of such a reduction in rate may suggest a reduced Exchequer yield, we recommend that this is validated using a dynamic modelling approach.

Q26. If any investment returns continue to be taxed on a final liability basis what link, if any, should there be between the rate of DIRT and the rate of tax applied to other investment products? Should consideration be given to reintroducing a "non-standard" rate to any products?

Please see our response to Q25 above – we have recommended a move away from the final liability basis of taxation, alongside a reduction / alignment of tax rates.

Q27. Are there places where the taxation of investment income and gains need to be simplified or modernised? For example, in relation to the taxation of ETFs, the old basis of taxation for life products, or harmonising the exemptions from IUT and LAET.

Yes. Please see our other responses. There should be no difference between IUT and LAET.

Q28. Given the differences in the data reported to the Revenue Commissioners under international reporting standards when compared to domestic reporting obligations, should additional reporting be introduced to, for example, facilitate the pre-population of tax returns where tax liabilities are to be self-assessed?

As mentioned, there is considerable complexity already associated with these products. The burden of additional reporting would need to be weighed up against the benefits of having tax returns pre-populated. There are advantages to pre-populating returns given the complexity, but it could require significant additional work to verify the correct treatment.

To the extent that the taxation of such products could be greatly simplified (in line with our proposals elsewhere in our responses), pre-population of returns could be a positive development.

Q29. Where investments in investment undertakings, life policies or offshore funds give rise to a loss, no relief is available against other income. Where an individual has a gain on one such product and a loss on others, that loss may not be offset against the gain on a similar product. Is it desirable that loss relief, or a limited form of loss relief, be introduced for investments in these products? Note that reliefs cannot be given where the tax is a final liability tax deducted at source.

As set out in our response to an earlier question, we believe that tax relief for losses should be granted for all investment products. A denial of such relief is manifestly unfair and gives rise to sub-optimal investment decisions. It inevitably leads to investors retaining loss making investments for longer than they should in the hope that they will turn around. They perceive this to be preferable to switching to a product with better prospects, as switching would give rise to asymmetrical taxation of any recovery of the loss incurred on the first investment.

Allowing tax relief for losses would ensure that tax is only paid on actual "net gains" which should address the fairness issue. Importantly, it should also lead to investors managing their investments more effectively, which should ultimately lead to higher returns and a higher tax yield.

The introduction of loss relief for investments taxed under the IUT / LAET regimes, should also encourage investors to take advantage of the risk diversification benefits associated with professionally managed life policies and collective investment funds. From a societal perspective, this should be more desirable than retail investors assuming unnecessary risks by holding concentrated pool of investments.

We recommend that loss relief be introduced in tandem with the broader alignment of the taxation treatment of different investment products.

Q30. Are there differences within the regimes (e.g. in relation to who can make a declaration under LAET compared to those who may make a declaration under IUT) which should be addressed?

In our view, there should be broad alignment between the categories of investors who are exempted under both regimes. That said, in our responses to earlier questions, we advocated a move to a self-assessment regime which should negate the need for the existing declaration process. To the extent that there is a move to a self-assessment regime, we recommend that there should be broad alignment between the taxation of returns from different products.

Q31. How should derivative products which mirror the performance of regulated investment products be taxed? Should they be taxed at the same rate as the investment product they mirror or should they be taxed under first principles?

We believe that they should continue to be taxed under first principles. To do otherwise would give rise to unnecessary complexity for taxpayers.

Q32. Are any additional anti-avoidance rules required for any of the measures suggested in answer to previous questions?

Appropriate anti-avoidance rules are an important feature of an effective tax regime. Given the extensive range of anti-avoidance rules already incorporated into Irish tax law, we do not believe that additional anti-avoidance rules are required.

Section 5: The role of the REIF and IREF regimes in the Irish property market.

I R E F s

Q33. Are there aspects of the way in which property funds are taxed, or defined, that could be aligned with other existing standards, for example, the recent changes in the Central Bank of Ireland's macro prudential measures for property funds?

The current penal IREF income tax consequences of excessive leverage operate at a relatively modest LTV level of 50% or 1:1.25 interest cover. Furthermore, the IREF regime in general applies to Irish funds where a relatively low level (25%) of their overall investments comprise Irish real estate assets.

The policy rationale for establishing these leverage limits at levels which exceed the Central Bank's macroprudential rules for Irish property funds is unclear. Specifically, the Central Bank rules envisage somewhat higher leverage which we understand to be 60%. Even then, the macro prudential rules only apply to Irish funds that invest 50% or more of their overall portfolio, directly or indirectly, into Irish property assets.

We believe that there is a strong case to be made that the IREF rules should be aligned with the macro prudential rules. Better alignment of the two regimes would lead to greater clarity and efficiency.

Q34. IREFs invest in property of all descriptions, as developers, financiers and landlords. Do IREFs, and the regime as it is currently designed, support investment in housing policy objectives?

In our experience, IREFs are a useful and widely used structure for large investment into long term residential rental accommodation. Accordingly, and subject to our comments herein, we consider that IREFs in their present form play an important role in supporting housing policy objectives and have contributed to attracting foreign investment into Irish real estate.

Furthermore, we would caution that the introduction of further adverse changes to Ireland's tax and investment environment would be very damaging to our attractiveness as a location for the investment of capital by international real estate investors.

Q35. How does the IREF regime compare to property fund regimes in other comparable EU jurisdictions?

It is more complex than most jurisdictions, with the result that it is very challenging for investors (particularly new investors) to navigate. There is a much greater level of uncertainty and vagueness around the Irish tax implications of Irish property investment structures and profit distributions. The Irish tax rules are cumbersome to apply in practice. The complexity and ambiguity reflected in the tax legislation necessitates an undesirable overreliance on Revenue guidance to navigate and operate the rules in practice.

Q36. Are there aspects of the IREF regime that are not operating as intended or that are acting as an impediment to investment?

The frequent layering of additional restrictions into the regime has created investor uncertainty and undermined confidence in the stability of our real estate tax regime. This is a significant challenge, particularly when dealing with new foreign investors. Further adverse changes to the regime would, in our view, be detrimental to attracting foreign mobile capital.

The inability to easily access exemptions for indirect "good" investors and the overreliance on Revenue guidance as a means of clarifying the application of the rules is a concern. A less complex, clearer legislative solution would be welcomed.

Q37. We invite comment in relation to the tax treatment of IREFs, in particular in relation to the following:

- **The tax rate applicable to both resident and non-resident investors**
  We recommend that a legislative clarification be provided that Irish corporate investors are not subject to close company surcharge on returns from an IREF.

- **The tax exemptions that apply to certain categories of investors**
  We recommend that no changes be made to the current position.

- **The tax rate applicable at the level of the fund**
  We recommend that no changes be made to the current position.
  .
- **The overall tax treatment of IREFS – should an alternative mechanism be considered?**
  We would recommend that the IREF regime should not be changed or modified in any material way. We believe that foreign investors require regime stability/certainty. Ireland's attractiveness to foreign capital would be materially damaged if any significant additional adverse changes are introduced.

R E I T S

Q38. REITs invest in property as landlords and as developers of property to hold for rent. Do REITs, and the regime as it is currently designed, support investment in housing policy objectives?

Throughout the world, REITS can and indeed do play a significant role in the ownership, supply and proper running of efficient rental markets. The US and Germany being strong examples of countries that have well run residential REIT entities of significant scale.

The Irish REIT regime on its introduction was a 'fit for purpose' regime to attract retail and foreign investment. It led to the creation of four large Irish REITs one of which, IRES, was totally dedicated to

Irish residential property. It is the landlord of close to 4,000 residential units. We understand that IRES has been regarded as a standard setter in the domestic rental market as a professional, compliant and well managed operator. This benefits its tenants and the market generally.

The changes to the REIT regime introduced in 2019 with regard to: (i) the capital reinvestment conditions and (ii) the exit rules, fundamentally damaged the attractiveness of the Irish REIT regime and has led to the de-REITing of all but this one REIT. If Ireland wishes (as it should) to have a vibrant, functioning REIT system, these Finance Act 2019 changes should be reversed. It is highly unlikely that another residential REIT could be launched under the current rules.

Q39. While REITs are a structure used in many jurisdictions for collective investment in property, Ireland now has only one remaining REIT. Are there aspects of the REIT regime that are not operating as intended or that are acting as an impediment to investment?

As noted in our response to Q38, the changes introduced by Finance Act 2019 made the regime commercially unworkable. The key issues are: (i) the reinvestment conditions and (ii) the exit disposal rules introduced in Finance Act 2019. These have made the regime unattractive. It is unlikely another REIT will float due to those requirements.

Q40. How does Ireland's REIT regime compare to REIT regimes in other jurisdictions?

The Finance Act 2013 version of Ireland's REIT regime was attractive or on a par with REIT regimes in place in other main EU jurisdictions. However, the Finance Act 2019 changes rendered the Irish REIT regime ineffective and inferior to most other REIT regimes which are functioning well.

We can provide previously published regime comparators if requested.

Q41. We invite comment on the tax position in relation to REITs, in particular in relation to the following:

- **The standard REIT structure, common internationally, of exemption for qualifying property profits within the REIT subject to a range of conditions including a requirement that a high proportion of the profits (85 per cent in Ireland) be distributed annually for taxation at the level of the shareholder**

  These are broadly fit for purpose in our view. That said, a number of improvements could be made:

  - The REIT legislation should be amended to allow for temporary breaches of the LTV requirement in circumstances where asset values have fallen.

  - An amendment should be made to provide that the profit distribution requirement would be met in circumstances where the funds were used to invest in certain specific development projects, in particular in the residential sector. For example, it may be beneficial for all parties (developers, REITs, tenants) if REITs were able to directly develop or forward fund new residential developments to unlock new supply at a price point that was aligned with their long-term hold return requirements.

Absent such a measure, it is difficult for REITs to acquire or access new residential stock at scale in the current market. This is exacerbated by the wider viability challenges associated with new apartment developments. The residential stock of an Irish REIT will not be renewed by replacement if REITs are unable to access new developments. Ultimately, their attractiveness to retail investors will diminish over time.

- **The tax exemptions that apply to certain categories of investors**
  In our view, these are fit for purpose.

- **The tax rate applicable at the level of the REIT**
  In our view, these are broadly fit for purpose except for the issues highlighted in our responses to Q38 and Q39 with regard to: (i) the reinvestment conditions and (ii) the exit regime introduced in Finance Act 2019, which are uncommercial and have contributed to the effective demise of the regime.

  Separately, it is critical that Irish REITs are included in the BEPS Pillar 2 exemption for REITs.

REITS AND IREFS

Q42. Should the IREF and REIT regime continue to exist in tandem?

Yes, they serve different investor requirements and timescales.

Q43. Is there an appetite for retail investors to invest in property, if so, what is the best type of vehicle to accommodate such investment

Yes, there is and a REIT is the most appropriate vehicle for such investment. However, the reduction in the attractiveness of Ireland's REIT regime since the Finance Act 2019 changes has led to the effective demise of REITs and reduced the opportunity for retail investors to invest capital in real estate (including in particular residential real estate). The opportunity for REITs to raise capital and participate in the Irish market has largely been terminated.

Section 6: The role of the Section 110 regime

Q44. What policy objectives should section 110 be supporting?

The Section 110 regime is a very important feature of the Irish tax regime. Section 110 SPVs play a vital role across a wide range of sectors, including for the securitisation of mortgages by banks, the leasing of aircraft, and the provision of receivables financing, to name but a few. Section 110 SPVs are also widely used within the Irish funds and asset management industry, where they are often used in conjunction with regulated funds as a means of ringfencing assets for loan security purposes, as feeders into Irish funds, or as an alternative investment vehicle to the main fund. In addition, Section 110 SPVs are often used as a special purpose debt issuer for trading groups that wish to raise debt financing from international markets.

Therefore, from a policy perspective, Section 110 companies are needed to support a wide range of sectors and businesses operating in Ireland today. It is important that the Section 110 regime continues to support the development and growth of these groups in Ireland into the future. In this regard, it will be important that the flexibility and ease of use of Section 110 SPVs is retained.

We note the concerns raised regarding certain aspects of the use of Section 110 SPVs within the Irish property market. We believe these concerns have been adequately addressed by the tax changes introduced in Finance Act 2016 for "specified mortgages". Retention of these rules in their current form would ensure that the policy objective of protecting the Irish tax base with respect to Irish property transactions is met, while still permitting the use of Section 110 SPVs in the Irish property market, in which they continue to play an important commercial role.

We also note that concerns have been raised with respect to the use of Section 110 SPVs as debt issuers for corporate groups that wish to raise public debt financing in the capital markets. This type of activity is currently permitted and, in our view, should continue to be permitted. Restricting the use of Section 110 SPVs for these purposes would have a seriously disadvantageous effect on Irish industry as, in many cases, a non-Section 110 company undertaking such activities would be taxed on its gross income rather than its net profits (thereby effectively levying a 25% surcharge on Irish borrowers). Irish domestic businesses and groups would be particularly disadvantaged if this use of Section 110 SPVs were to be curtailed as they may not have other entities within their corporate groups that could effectively and efficiently issue debt to international capital markets, placing them at a disadvantage when compared with foreign-headquartered multinational enterprises.

Finally, we would highlight that while Section 110 SPVs are used for a wide variety of purposes, as outlined above, their predominant use is in the Irish funds and asset management industries, where they play a crucial role in promoting and developing Ireland as an international fund domicile, a preferred jurisdiction for international investors, and private assets centre of excellence. Ensuring the Section 110 regime is supportive of the Irish funds and asset management industries must be a key policy objective. Providing access to a tax neutral SPV structure is crucial for any jurisdiction that wishes to be competitive as a preferred domicile for funds and asset managers. We would highlight that recent legal and operational developments, along with the OECD BEPS initiative which seeks to align the jurisdiction in which profits are earned and where value is created, have resulted in a trend among international fund managers to choose one jurisdiction where substance (such as fund managers, etc.), primary funds and SPVs are located (or at least one European jurisdiction as their platform in Europe).

In this regard, if Ireland does not have an effective Section 110 regime available to international fund managers, the unavoidable result is that international investors will eschew Irish unregulated vehicles, causing international fund managers to look to establish their EU platforms elsewhere for both their regulated funds and their SPVs, as both go increasingly hand-in-hand.

Q45. What changes are needed, if any, to ensure the section 110 regime meets those policy objectives?

We believe that the rules as presently drafted, while complex, are generally well understood by businesses and practitioners. We also believe that the current rules strike a reasonable balance between facilitating the necessary flexibility in the Section 110 regime to support the commercial requirements of its users, while also preventing the misuse of the regime. We believe that the specific anti-avoidance rules currently in place in Section 110 are effective in this regard (though as noted below, certain of these provisions have been made redundant through the introduction of broader anti-avoidance provisions into Irish law).

The "specified mortgage" anti-avoidance rules contained in Section 110 are also effective in ensuring that profit participating debt cannot be used to sweep super profits from Irish property or distressed property debt super profits out of the company and the country in a way that ensures little or no Irish tax liability would arise.

In this regard, we propose that at a minimum the existing flexibility and utility of the regime should be maintained, and further complexity in the form of new specific anti-avoidance minimised, to the greatest extent possible.

We also believe that there are opportunities for improvements to be made to the Section 110 regime that would improve its effectiveness for its users. We believe that the following refinements of the Section 110 regime should be considered in this regard:

- **Consolidation of redundant anti-avoidance provisions**

  Finance Act 2011 introduced a form of anti-hybrid rules into the Section 110 legislation. These rules have been effectively supplanted and rendered redundant by the introduction of the anti-hybrid and interest limitation rules which Ireland has since enacted. We recommend that this unnecessary duplication of the rules be removed.

- **Tax deduction for foreign taxes**

  The continuing inability of Section 110 SPVs to claim a deduction for foreign taxes adversely impacts the regime's reputation. On the basis that it is intended that Section 110 SPVs should be tax-neutral, we recommend that this issue (in so far as it pertains to the Section 110 regime) be resolved.

- **The 8 Week Election Deadline**

  We believe that this deadline should be extended, as the imposition of this short timeframe is arbitrary and needlessly punitive in scenarios where human error results in notifications being submitted beyond this date.

- **Section 452 Election**

  Section 452 is an elective provision that permits companies that are paying interest in the ordinary course of a trading activity to disapply an anti-avoidance provision which would otherwise deny a tax deduction for interest paid to non-EU 75%+ associated entities. Section 110 companies compute their taxable profits using trading principles and it has been the longstanding practice that this permits such companies to make a Section 452 election. However, Irish Revenue have recently questioned this interpretation in certain circumstances. We do not think this more limited interpretation was intended and we believe the uncertainty should be resolved through legislative amendment.

- **Irish Dividend Income**

  The exemption that generally applies to Irish companies on the receipt of dividend income from other Irish companies should also apply with respect to the receipt of dividend income by a Section 110 SPV (the "franked investment income" exemption). We note that Revenue have recently stated that, in their view, this is not the case. Given that there is no apparent policy rationale for such a differentiation, we recommend that a technical amendment be made in order to ensure that the franked investment income exemption applies to Section 110 SPVs also.

- **Accounting Standards**

  Due to the introduction of new GAAP in 2005, an amendment was made to the Section 110 legislation whereby a company could, unless it elected otherwise, continue to compute its taxable profits using Irish GAAP as it stood at the end of 2004. This amendment was necessary to prevent large fluctuations in the profits and losses of Section 110 SPVs as a result of the requirement under new GAAP to fair value all of their financial assets and liabilities.

  With the passage of time, the number of accountants with the relevant expertise in 2004 GAAP is fast reducing. Therefore, we recommend that the possibility of finding a more permanent solution to this issue be explored.

- **Bankruptcy Remoteness**

  For various commercial and regulatory reasons, the use of an orphan funding structure may be required. For example, it is common for orphan funding structures to be used to achieve bankruptcy remoteness for the borrower.

  However, the use of such orphan structures can present an issue for Irish groups under existing Irish tax rules. For example, Irish groups who want to retain economic ownership of the orphan through an e-note or profit participating note may suffer withholding tax on the payment of interest from the Section 110 orphan on the basis that the note holder is resident in Ireland and not in a tax group with the Section 110 company. We recommend that a resolution to issues such as that outlined above are found.

Section 7: General questions

Q46. In addition to the matters covered in this public consultation, are there other issues relevant to the Terms of Reference, which you wish to bring to the attention of the Department? Yes / No

Yes.

Q47. If you have answered "yes", please provide a brief summary of those issues, providing any information or references to material that you consider relevant to the Terms of Reference and the Department's work

The following additional comments are complementary to our responses to the questions asked in section 5 relating to IREFs and REITs in the property market.

IREFs and REITs are not the only vehicles available to investors for Irish real estate activities but there is a significant disparity between the tax treatment of these vehicles, and the treatment of alternative vehicles such as Irish limited companies and non-resident companies.

Furthermore, active domestic real estate developers are a crucial part of the delivery of top class commercial and residential real estate – both of which are core to ensuring Ireland continues to compete for investment from the multinational sector. The domestic developers who do not deploy IREFs or REITs are at a competitive disadvantage arising from differences in the regimes.

In order to provide a more attractive unregulated regime for international investors, and to support active domestic developers of Irish real estate, we recommend that legislation be introduced to:

- Apply the 12.5% trading corporation tax rate to the rental income of active real estate businesses.
- Apply Case I principles to the calculation of rental income for such active real estate businesses.
- Eliminate the close company surcharge for active real estate businesses.
- Re-introduce a targeted form of rollover relief for Capital Gains Tax purposes, whereby active real estate businesses can defer capital gains tax on the disposal of real estate assets where the proceeds are re-invested in newly developed real estate assets within a reasonable timeframe.

An active real estate business would include one which has developed the relevant asset or manages the asset itself. Provision could also be made for "large scale" landlords, e.g. more than a certain number of units.

Q48. This consultation is necessarily wide-ranging. As we would not be able to take forward all proposals immediately, what do you think the top 3 priority proposals should be for government implementation and why?

The following are the key areas we feel should be prioritised. The first looks at "Product" and the development and enhancement of our product offering in the alternative and private asset space. Investment in private assets is seeing significant global growth but Ireland's involvement is lagging as we do not have a produce that competes internationally. The second ask is for a "Dedicated Funds Unit" which will help future proofing the sector by ensuring the sector contains all the tools necessary to enable it to compete on a 'level playing field' on the international stage.

Product:

- Product solutions for private assets (an effective indirectly regulated product regime)
- Improvements to the ILP so it can compete with other limited partnership products in other jurisdictions.
- Improvement to the AIFMD loan origination funds rules/restrictions
- Establishment of an ELTIF framework that meets investors needs and competes internationally.

Dedicated Fund Unit:

The establishment of a dedicated fund unit with subject matter experts within the Department of Finance, with a mandate to promote the industry, to ensure greater agility to respond to market demands and competitor jurisdiction developments, to drive policy initiatives, and ensure a holistic approach is taken to product development, tax treatment, legislative and regulatory frameworks.

kpmg.ie