Ireland as a Domicile for Special Purpose Vehicles

DILLON EUSTACE

DUBLIN CAYMAN ISLANDS NEW YORK TOKYO

/v

Contents

Ireland as a Domicile for Special Purpose Vehicles

/v

IRELAND AS A DOMICILE FOR SPECIAL PURPOSE VEHICLES

Background

Ireland has emerged as a favoured location for special purpose vehicles ("**SPVs"**) that are used in many financial transactions including securitisation, asset repackaging and financing transactions. In particular, Irish SPVs are being increasingly used as investment vehicles, whether that is for private equity, credit opportunities, distressed debt, life settlements, LPN structures, etc. Irish SPVs are also being used in conjunction with alternative investment funds establishing in Ireland (or re-domiciling to Ireland) so that such funds can minimise foreign taxes on their underlying investments. The wide diversity of deals has emphasised Ireland's growing importance as an onshore SPV domicile.

Why Ireland?

There are three main reasons for choosing Ireland as a location for establishing SPVs. Firstly, Ireland has an extensive double tax treaty network which is constantly expanding. Secondly, as a member of the EU and OECD it is not considered to be an "offshore" jurisdiction. Thirdly, Irish tax legislation provides for special tax treatment in relation to qualifying SPVs.

The terms of a treaty can ensure that the cash flows from assets can be paid to the SPV without any foreign taxes (or at reduced rates of foreign taxes) on the income and/or capital gains flows on those assets. In addition, the terms of a double tax treaty (in the absence of domestic tax legislation) may help the SPV avoid a taxable presence in the country where the investment manager to the SPV is located. There is no doubt that Ireland's primary success as an SPV domicile is because of its double tax treaty network in avoiding foreign taxes on the relevant assets. The signing of new treaties in 2015 brings to 72 the number of tax treaties signed by Ireland with a number of additional treaties in negotiation. Even in countries where it is necessary to use an SPV domiciled in the relevant country of origin of the assets, Ireland may still be used as an SPV domicile for issuing the necessary debt and then holding the units/certificates in the underlying SPV on which flows of income and gains arise backed by the underlying assets held by the SPV. Access to a double tax treaty with the relevant country (or access to EU Directives for EU based assets) is often critical in avoiding foreign taxes on the flows of income/gains from the units/certificates issued by the SPVs.

In addition to the above primary advantages, Ireland also offers an excellent legal and accounting/tax infrastructure, efficient listings of securities on the Irish Stock Exchange (the "**ISE**"), English speaking workforce, stable political and economic environment and good flight access and general infrastructure. All these factors (together with its favourable SPV tax environment) make Ireland a genuine player in the choice of SPV domicile.

SPV ("Section 110 Company") Taxation

Section 110 of the Irish Taxes Consolidation Act, 1997 ("**TCA**") provides for a special tax regime where Irish SPVs meet the requirements for "qualifying companies" (see definition below). Such qualifying companies are commonly referred to as "Section 110" companies. Transactions involving a Section 110 company may be structured to be tax neutral. While the Section 110 company tax rules provide that a "qualifying company" will be subject to Irish corporation tax at a rate of 25% on its taxable profits, such taxable profits can be eliminated with appropriate structuring. It is important to note that although the qualifying company must notify the Revenue Commissioners if it wishes to be treated as a Section 110 company, no special tax rulings or tax authorisations are required in Ireland in order for the Section 110 company to achieve this tax neutral status. Furthermore, no minimum taxable profits are required to be left in Ireland.

Qualifying Section 110 Company

A "*qualifying company*" means a company which:

(a) is resident in Ireland;

(b) acquires "qualifying assets" (see definition below) or as a result of an arrangement with another person holds or manages qualifying assets or enters into a legally enforceable arrangement with another person and the arrangement is itself a qualifying asset (such as a derivative);

(c) carries on in Ireland the business of the holding and/or management of "qualifying assets", including, in the case of plant & machinery acquired by the qualifying company, a business of leasing that plant and machinery;

(d) apart from activities ancillary to that business, carries on no other activities;

(e) undertakes the first transaction resulting in the holding and/or management of qualifying assets for a value of not less than €10m;

(f) notifies the Irish tax authorities that it is a company to which points (a) to (e) apply;

and

(g) carries on no transaction other than by way of a bargain made at arm's length (the legislation specifically excludes profit participating loans from satisfying this requirement).

A "**qualifying asset**" means an asset which consists of, or of an interest (including a partnership interest) in a financial asset, commodities or plant and machinery. A "financial asset" is defined as including shares, bonds and other securities, futures, options, swaps, derivatives and similar instruments, invoices and all types of receivables, obligations evidencing debt (including loans and deposits), leases and loan and lease portfolios, hire purchase contracts, acceptance credits and all other documents of title relating to the movement of goods, and bills of exchange, carbon offsets, contracts for insurance and contracts for re-insurance, commercial paper, promissory notes and all other kinds of negotiable or transferable instruments. "Commodities" means tangible assets (other than currency, securities debts or other assets of a financial nature) which are dealt with on a recognised commodity exchange ("recognised commodity exchange is not defined" – the Irish tax authorities would expect such an exchange to have national or international recognition). While the Section 110 company may purchase or sell the commodities on a recognised commodity exchange, there is no actual requirement for the company to do so and instead all that is necessary is that the company should be able to demonstrate that the assets it holds, acquires or manages are of a kind normally traded on a commodity exchange. Plant and machinery is not specifically defined but includes, aircraft, ships, rolling stock, motor vehicles and other equipment and in the case of plant and machinery acquired by the qualifying company, a business of leasing that plant and machinery. Alternatively it is also acceptable for the Section 110 company to enter into legally enforceable arrangements with another person which arrangements themselves constitute qualifying assets.

There are two tests of **tax residence** in Ireland **-** a central management and control test and an incorporation test. The tests can be quite complicated however, suffice to say that if the Section 110 company is owned by a charitable trust (thus not having to consider any group ownership for the purposes of the test) then it is most likely that the Section 110 company would be regarded as tax resident in Ireland under the incorporation rule. In respect of the central management and control test, this concept is not defined in Irish legislation and its meaning is taken from the UK case law which is not legally binding in Ireland but is regarded as persuasive. The case law meaning of central management and control is, in broad terms, directed at the highest level of control of the business of the company and is to be distinguished from the place where the main operations of the business are to be found.

Case law has established that the location of certain functions is relevant in determining where the central management and control of a company is exercised. The most important of these is the location of directors' meetings. This assumes that such meetings are the medium through which major and strategic decisions are taken by the company. Therefore, a Section 110 company will be regarded as tax resident in Ireland if meetings of the board of directors are held in Ireland and major policy and strategic decisions of the company are taken at those meetings.

It will be noted from test (d) above that the Section 110 company must not carry on any other activities (apart from those that are ancillary to the business of the holding and/or management of qualifying assets).

Financing & Withholding Tax

Typically hybrid debt is used to finance Section 110 companies. There are no tax restrictions on what form of debt is used (i.e. whether the Section 110 company raises monies by means of a loan, the issue of notes or bonds etc). Interest payments made by the Section 110 company may be made free of Irish withholding taxes provided the recipient of the interest is tax resident in a country with whom Ireland has a double taxation agreement or, in a country with which Ireland has signed but not yet ratified a double taxation agreement or is tax resident in a Member State (other than Ireland) of the EU. Ireland's current double taxation treaties are set out in Appendix I.

Section 110 companies can also take advantage of the "*Eurobond*" exemption to pay interest gross. A "Eurobond" is defined in the tax legislation as a security which is quoted on a recognised stock exchange and carries a right to interest (i.e. zero coupon bonds do not qualify).

Interest on Eurobonds may be paid free of Irish withholding tax if the paying agent is not based in Ireland or, if they are, the Eurobonds are held in a recognised clearing system. The Eurobond route is an attractive route for those Section 110 companies wishing to raise finance from a wide range of persons resident in different countries.

Lastly, Section 110 companies can take advantage of Ireland's "*wholesale debt*" exemption for avoiding Irish withholding taxes. This exemption will apply to commercial paper issued by a company where:

(A) If the person by or through whom the payment is made is resident in Ireland:

(a) the debt security has a maturity of less than 2 years; and

(b) either

(i) the debt security is held in a recognised clearing system and issued in minimum denominations of US$500,000 or €500,000 **or** its foreign currency equivalent, or
(ii) the person beneficially entitled to the interest is resident in Ireland and has provided their tax reference number to the person making the payment, or
(iii) the person who is the beneficial owner of the debt security and who is entitled to the interest is not resident in Ireland and has made a declaration to that effect.

OR

(B) If the person by or through whom the payment is made is not resident in Ireland:

(a) the debt security has a maturity of less than 2 years; and
(b) the notes are held in a recognised clearing system; and
(c) the notes are issued in minimum denominations of US$500,000 or €500,000 or its foreign currency equivalent.

Profit Extraction

Profit Participating Loans/Notes

Interest payments (even those which vary with the Section 110 company's profits) made by the Section 110 company (on moneys raised to enable it to hold or manage qualifying assets) will generally be tax deductible. In light of the on-going double non-taxation consultations that are going on at an EU level, Ireland, in an effort to position itself with first mover advantage, introduced selective anti-avoidance provisions in 2011 which can in certain circumstances curtail the deductibility of certain profit dependent interest or swap payments made to a recipient resident in an EU or Irish tax treaty partner country, where such payments are not subject to tax under the law of that jurisdiction. Subject to satisfying certain conditions the aforementioned provisions do not apply to payments of interest on "quoted Eurobonds" or commercial paper (see wholesale debt exemption above).

Other tax deductions

There are of course other mechanisms for reducing taxable profits in a Section 110 company to nil. A tax deduction is available for management fees, arrangement fees, swap payments (subject to above), administration fees, etc.

Stamp Duty

For so long as the Section 110 company remains a qualifying company (within the meaning of Section 110 TCA) no charge to Irish stamp duty arises when bonds or notes are issued by a Section 110 company. In addition, there is no Irish stamp duty arising on the transfer of such notes or bonds.

Value Added Tax (VAT)

A Section 110 company will not be subject to Irish VAT on its activities. However, to the extent to which it suffers any Irish VAT (which if structured properly should be minimal) it may be able to recover all or a percentage of its VAT costs depending on where the assets of the Section 110 company are located. If the Section 110 company is solely investing in non-EU assets, it should be able to recover 100% of any Irish VAT input costs.

Transfer Pricing

Ireland introduced transfer pricing rules in 2010. These rules only apply to certain domestic or international trading transactions entered into between associated entities and have no application in the context of a Section 110 company.

Revenue Notification

In order to avail of Section 110 status it is necessary that the qualifying company completes and submits to the Irish Revenue a Section 110 notification form on or before the due date for submission of its first corporation tax return. This is only a one-page notification containing minimal detail with no Revenue ruling required.

Double Tax Treaties

Ireland has a large tax treaty network which is continually expanding. It has signed double taxation agreements with 72 countries, of which 70 have the force of law. A list of countries with which Ireland has ratified tax treaties and with whom Ireland has signed but not yet ratified tax treaties can be found on the Irish Revenue Commissioners website - http://www.revenue.ie/en/practitioner/law/tax-treaties.html and is also included in Appendix I.

International Accounting Standards (IAS)

Due to initial concerns raised (when IAS was introduced in Ireland in 2005) over the treatment of various items in the financial statements under IAS accounting (which could compromise the profit neutrality of a Section 110 company), Section 110 companies by default calculate their taxable profits on the basis of Irish GAAP accounting rules as they existed as at 31st December 2004. Section 110 companies may nevertheless also base their taxable profits on accounts drawn up in accordance with IFRS (or Irish current GAAP rules) as the starting point for calculating taxable trading income by making a specific election to do so. Once a Section 110 company elects to use IAS accounting or current Irish GAAP rules (for tax purposes) it will not be entitled to revert (for taxation purposes) to Irish GAAP accounting rules as they existed at 31 December 2004.

Irish Corporate Structure and Related Matters

Section 110 companies can currently be established as limited or unlimited, private or public companies.

The Companies Act 2014 (the "**Companies Act**") came into effect on 1st June 2015 and has introduced significant reforms in the area of company law in Ireland. It is intended to make it easier for companies to do business here.

DACs and LTDs

The vast majority of companies registered in Ireland prior to the enactment of the Companies Act were private companies limited by shares. One of the key structural reforms in the Companies Act is that it provides for two new forms of private limited company to replace all existing private companies limited by shares. The new company types are a private company limited by shares (an "**LTD**") and a designated activity company (a "**DAC**").

An LTD is, subject to certain exemptions allowing it to make limited offers to a small number of investors, prohibited from offering securities (equity or debt) to the public. An LTD is also prohibited from having its securities admitted to trading or listed on any market, whether regulated or not, in the State or elsewhere or applying for any such admission.

A DAC, being an entity designed to carry out a particular activity / have a particular purpose will often be the most fitting company model for a Section 110 SPV. Since the coming into force of the Companies Act, the majority of Section 110 companies would appear to be incorporating as DACs. A DAC may offer debt securities to the public (but not equity securities), and in addition, a DAC is able to issue listed debt.

There are a number of differences between DACs and LTDs. An LTD does not have an objects clause and there is no limit on its corporate capacity. In addition, an LTD need only have one director, whereas a DAC must have a minimum of two.

A common essential feature of DACs and LTDs is that the liability of shareholders is limited to the amount of share capital subscribed. In addition, certain obligations imposed on public limited companies do not apply to DACs and LTDs.

The main advantages of using DACs and LTDs are that:

(i) it usually takes no more than five working days for a DAC or LTD to be registered with the Companies Registration Office (the "**CRO**");

(ii) the minimum number of shareholders is one;

(iii) the minimum issued share capital is €1 (the requirement under the Companies Act for a public limited company is €25,000, at least 25% of which must be fully paid up before the company commences business or exercises borrowing powers); and

(iv) for US federal income tax purposes, DACs and LTDs may elect to be treated as a flow-through or corporate entities (whereas public limited companies automatically default to corporate tax treatment).

Public Companies

Public limited companies ("**PLCs**") have the same essential characteristics as DACs and LTDs (i.e. the liability of members is limited to the amount of nominal capital subscribed) but there are certain key differences, many of which, as touched on above, are significant in the context of securitisation and structured finance transactions. In addition, there is no restriction on the number of members in a PLC but the minimum number is one; shares may be issued to the public and may be listed on a stock exchange and certain additional reporting and capital requirements apply to such companies.

Listing debt securities of Section 110 companies on the ISE

A number of years ago, the ISE introduced rules regarding the listing of specialist debt securities. These rules, which were updated following the implementation of the Prospectus Directive, have provided a relatively inexpensive and timely listing process and have proved very popular for many arrangers since their introduction (not just for Section 110 companies but also non-Irish resident SPVs).

The ISE has a turnaround time of maximum of three working days on the initial draft followed by a two day turnaround on subsequent drafts.

On-going Obligations and Regulatory Requirements

Section 110 companies must comply with certain general legal and Irish company law requirements. For instance, a Section 110 company must:

- prepare and file annual audited accounts with the CRO, in addition to having to file annual tax returns;

- file details of all registrable "charges" over its assets with the CRO in order to preserve the priority of those charges. In this regard, the Companies Act, in addition to retaining the pre-existing one-stage procedure of making the filing within 21 days of creation of the charge, introduces a new optional two-stage filing procedure, whereby a notice of intention to create a charge, followed within 21 days by a confirmation of creation of that charge can be filed;

- if incorporated in Ireland, have a registered office located in Ireland, maintain its books and records at a designated location and have a minimum of one director resident in the European Economic Area. In practice there are normally two Irish resident directors in order to ensure that the Section 110 company is tax resident in Ireland under the central management and control test. When selecting an appropriate director of a Section 110 company, it should be borne in mind that the maximum number of directorships which a person may hold in a private company is twenty five.

Certain European financial services regulations also affect and/or have the potential to affect Section 110 companies. For instance:

- *Regulation (EU) No. 1075/2013 of the European Central Bank of 18 October 2013 concerning statistics on the assets and liabilities of financial vehicle corporations ("**FVCs**") engaged in securitisation transactions (recast) (the "**FVC Regulation**")*

  The FVC Regulation, which replaced ECB Regulation (EC) No. 24/2009 with effect from 1 January 2015, imposes statistical reporting requirements on many categories of FVCs resident in an EU Member State which are involved in "securitisation" transactions or schemes. In addition, since November 2015, all non-FVC Section 110 vehicles are required to file quarterly and annual statistical returns with the Central Bank of Ireland (the "**Central Bank**"). However, information must be provided on a ‘best efforts’ basis and there doesn’t seem to be an expectation that non-FVC Section 110 companies would have to generate new data solely in order to comply with this requirement.

- *Regulation 648/2012 on OTC derivatives, central counterparties and trade repositories (as amended and supplemented) (“**EMIR**”)*

  As a result of EMIR, Section 110 companies which are party to derivative contracts are subject to certain obligations, particularly reporting and risk mitigation requirements. Most SPVs are likely to be classified under EMIR as non-financial counterparties (“**NFCs**”), with the extent of their reporting obligations determined by the volume of derivative transactions in which they engage. Although delegation of reporting obligations to counterparties is permissible, the relevant SPVs remain primarily responsible for compliance. Risk mitigation requirements also apply in relation to derivative contracts which are not centrally cleared (regardless of the classification of the SPV). An amendment to EMIR which came into effect in January 2016 has introduced requirements, *inter alia*, for financial and non-financial counterparties of securities financing transactions (“**SFTs**”) to report details of such transactions to trade repositories (a counterparty which is subject to the reporting obligation may delegate the reporting of the details of SFTs).

- There are also additional regulatory requirements that Section 110 companies may be subject to, depending on their size, turnover and the type of company that they are, such as, for example, an obligation to establish an audit committee and to include a compliance statement within the directors' report that accompanies financial statements submitted to CRO.

A Section 110 company will generally not be regulated by the Irish authorities. However, “public offer” and other regulatory requirements may be relevant depending on the scope of the offer and whether the securities issued by the Section 110 company are to be listed. The nature of the activities and the assets held by a Section 110 company will also determine whether other regulatory requirements apply. For example, reinsurance Section 110 companies must be authorised by the appropriate authority.

It is worth noting that in relation to the Alternative Investment Funds Managers Directive (Directive 2011/61/EU) (“**AIFMD**”), the current generally accepted industry viewpoint in Ireland is that, where investors participate in a Section 110 company by way of debt rather than through shares or units, that Section 110 company is outside the scope of the AIFMD regime. This view appears to have been endorsed by the Central Bank which has advised that that (i) registered FVCs or (ii) financial vehicles engaged solely in activities where economic participation is by way of debt or other corresponding instruments which do not provide ownership rights in the financial vehicle as are provided by the sale of units or shares, do not need to seek authorisation as, or appoint, an alternative investment fund manager, unless advised otherwise by the Central Bank. The Central Bank has stated that it does not intend to do so, at least for so long as the European Securities and Markets Authority continues its current work on this matter.

Alternative Uses

In addition to the traditional structures, Section 110 companies are now being used in various other structures, such as aircraft leasing, life settlement issues and regulated fund structures where either a qualifying investor or alternative investment fund is used with one (or more) Section 110 subsidiaries as a structure (fund/Section 110 structure) to minimise withholding taxes on underlying investments. Alternatively the Section 110 company can be positioned above the fund to facilitate qualification for benefits of the Ireland/US double tax treaty).

For more details on any of these structures please do not hesitate to contact us our visit website at www.dilloneustace.ie.

APPENDIX I

List of the 72 Countries with which Ireland currently has signed Double Taxation Agreements, 70 of which currently have the force of law:

Albania	Estonia	Luxembourg	*Saudi Arabia
Armenia	*Ethopia	Macedonia	Serbia
Australia	Finland	*Malaysia	Singapore
Austria	France	Malta	Slovak Republic
Bahrain	Georgia	Mexico	Slovenia
Belarus	Germany	Moldova	South Africa
Belgium	Greece	Montenegro	Spain
Bosnia & Herzegovina	Hong Kong	Morocco	Sweden
*Botswana	Hungary	Netherlands	Switzerland
Bulgaria	Iceland	New Zealand	Thailand
Canada	India	Norway	The Republic of Turkey
Chile	Israel	Pakistan	United Arab Emirates
China	Italy	*Panama	United Kingdom
Croatia	Japan	Poland	United States
Cyprus	Korea	Portugal	*Uzbekistan
Czech Republic	Kuwait	*Qatar	Ukraine
Denmark	Latvia	Romania	Vietnam
Egypt	Lithuania	Russia	Zambia

* The Republic of Ireland has signed a double taxation agreement and although not yet in force has the force of law by virtue of section 826 (1) TCA. Consequently Ireland will allow dividends, interest and patent royalties etc to be paid gross to the above countries free of withholding tax even though the new agreements are not yet in force.

Negotiations for new agreements with Azerbaijan, Kazakhstan and Turkmenistan have been concluded and are expected to be signed shortly.

Negotiations for a new agreement with Ghana are ongoing.

It is also planned to initiate negotiations for new agreements on an ongoing basis.

CONTACT US

Our Offices

Dublin
33 Sir John Rogerson's Quay
Dublin 2
Ireland
Tel: +353 1 667 0022
Fax: +353 1 667 0042

Cayman Islands
Landmark Square
West Bay Road, PO Box 775
Grand Cayman KY1-9006
Cayman Islands
Tel: +1 345 949 0022
Fax: +1 345 945 0042

New York
245 Park Avenue
39th Floor
New York, NY 10167
United States
Tel: +1 212 792 4166
Fax: +1 212 792 4167

Tokyo
12th Floor,
Yurakucho Itocia Building
2-7-1 Yurakucho, Chiyoda-ku
Tokyo 100-0006, Japan
Tel: +813 6860 4885
Fax: +813 6860 4501

e-mail: enquiries@dilloneustace.ie
website: www.dilloneustace.ie

Contact Points

For more details on how we can help you, to request copies of most recent newsletters, briefings or articles, or simply to be included on our mailing list going forward, please contact any of the team members below.

Conor Houlihan
e-mail: conor.houlihan@dilloneustace.ie
Tel: +353 1 667 0022
Fax: + 353 1 667 0042

David Lawless
e-mail: david.lawless@dilloneustace.ie
Tel: +353 1 667 0022
Fax: + 353 1 667 0042

Mark Thorne
e-mail: mark.thorne@dilloneustace.ie
Tel: +353 1 667 0022
Fax: + 353 1 667 0042

Conor Keaveny
e-mail: conor.keaveny@dilloneustace.ie
Tel: +353 1 667 0022
Fax: + 353 1 667 0042

Kate Curneen
e-mail: kate.curneen@dilloneustace.ie
Tel : +353 1 667 0022
Fax: + 353 1 667 0042

Sean Murray
e-mail: sean.murray@dilloneustace.ie
Tel: +353 1 667 0022
Fax: + 353 1 667 0042