Executive summary

Ireland is a leading domicile for regulated funds. Irish regulated funds are exempt from Irish tax on income and gains derived from their investments. However, regulated funds have been used by investors as an investment vehicle for Irish real estate assets. It is internationally accepted for jurisdictions to retain taxing rights over income and gains on real estate assets. The use of Irish regulated funds for investing in Irish real estate assets by some investors has been seen as eroding the country’s tax base. Consequently, the Irish Government announced in September 2016 that they were consulting on how best to protect the Irish tax base.

The Irish Government is aware of the importance of international investment for the economy and sought to find the least impactful way to protect the tax base in respect of Irish real estate assets.

With the publication of the Finance Bill 2016 comes the proposed introduction of a new fund category called an Irish Real Estate Fund (IREF) and a new 20% withholding tax imposed on distributions, either as a dividend from or a gain on redemption of the investment, which relate to IREF profits.
Detailed discussion

Under the proposed legislation, a fund is an IREF where 25% or more of the market value of the assets is derived, directly or indirectly, from Irish property or one of the main purposes of the fund is to acquire Irish property.

There are a number of points to emphasize:

- UCITS\(^1\) are specifically excluded from the new rules.
- The vast majority of Irish Qualifying Investor Alternative Investment Funds (QIAIFs) are not significantly invested in Irish property and will be unaffected by the new rules.

QIAIFs in relation to Irish real estate more commonly take the form of an Irish Collective Asset Vehicle (ICAVs), an Irish plc or Unit Trust.

The impact of the draft legislation is to tax investors in an IREF who currently benefit from a tax free investment into Irish property. The current tax benefits are provided through an exemption at the fund level on the income and gains earned by the fund, and also with an exemption on all distributions out of the fund if the investor has completed a relevant declaration as a nonresident or as an exempt Irish investor.

The headline change introduced is a withholding tax of 20% on all dividends and gains on redemption from the IREF in respect of accounting periods commencing from 1 January 2017 or 20 October 2016 if there is a change in accounting period following the release of Finance Bill 2016.

There are however categories of investors who will not be subject to withholding tax and these are currently listed as:

- Irish and equivalent European Union (EU) or European Economic Area (EEA) pension schemes, Personal Retirement Savings Accounts and EU cross-border schemes holding the IREF directly or indirectly.
- Other Irish regulated funds or equivalent funds authorized by a Member State of the EU or the EEA.
- Irish life assurance funds and equivalent overseas life assurance funds.

Equivalent means such non-Irish funds above must be subject to at least the same supervisory and regulatory arrangements that apply in Ireland.

The Finance Bill 2016 does provide an exemption from withholding for capital gains realized on land held for a period of at least five years where it was purchased for consideration equal to market value and subsequently sold to a person unconnected with the IREF or any of its investors. This means these gains should be excluded from the calculation of IREF profits for the purposes of withholding tax on dividends or gains on redemption. This is unlikely to apply to gains on development land as such gains would be subject to tax as trading income and not capital gains.

There are a number of anti-avoidance provisions aimed at preventing restructurings to avoid the new rules on or after 1 January 2017. A number of other provisions are expected to prevent transfers of interests from affected investors to exempt investors and other types of avoidance mechanisms.

Taxable Irish investors in real estate will continue as before to be taxed under normal rules on dividends and gains on redemption.

Further changes are likely to be included through the various stages of the Bill to clarify certain issues. While a number of technical amendments will be required to ensure the legislation works as intended, there are also a significant number of areas where clarification is required.

It currently appears that certain exempt investors like charities are caught by the new rules which was likely unintentional.

There are no provisions dealing with unintended double tax where a fund may use subsidiary companies but this is expected to be resolved.

It is unclear at what point in time the 25% test applies in determining if a fund is an IREF.

Clarity is required on whether Ireland’s tax treaties will be applicable in reclaiming any amounts deducted similar to real estate investment trusts (REITS).

Clarity also is required on the calculation of the profits of the IREF in assessing what is regarded as a distribution subject to withholding tax and the interaction with accounting and tax rules. The current understanding is that accounting recognition of profits will be acceptable subject to some adjustments for what would be regarded as non-deductible expenses.
Impact

While it applies for accounting periods beginning on or after 1 January 2017, the draft legislation suggests that any distributions, including gains on redemption, in respect of accumulated profits to that date, including realized or unrealized gains on property assets, paid after 1 January will be subject to withholding tax. Therefore, it appears that no grandfathering will apply and consequently there may be a need to look at what is the impact of any accumulated profits and any potential reorganization options before the new legislation comes into effect.

Endnote

1. UCITS is the acronym for Undertakings for Collective Investment in Transferable Securities Directives related to the EU Directive The Undertakings for Collective Investment in Transferable Securities Directive 2009/65/EC, which allows collective investment schemes to operate freely throughout the EU on the basis of a single authorization from one member state.
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