

# **Notes for Guidance - Taxes Consolidation Act 1997**

**Finance Act 2021 edition**

## **PART 8A**

### **Specified Financial Transactions**

**December 2021**



The information in this document is provided as a guide only and is not professional advice, including legal advice. It should not be assumed that the guidance is comprehensive or that it provides a definitive answer in every case.

**Notes for Guidance - Taxes Consolidation Act 1997**

**Finance Act 2021 edition**

PART 8A Specified Financial Transactions

CHAPTER 1 *Interpretation*

267N Interpretation

CHAPTER 2 *Credit return*

267O Treatment of credit return

267P Treatment of credit transaction

CHAPTER 3 *Deposit return*

267Q Treatment of deposit return

CHAPTER 4 *Investment certificates and returns*

267R Treatment of investment return

267S Treatment of certificate owner

CHAPTER 5 *Reporting*

267T Reporting

CHAPTER 6 *Application*

267U Application

267V Transactions to avoid tax

## PART 8A SPECIFIED FINANCIAL TRANSACTIONS

### Overview

**Part 8A** provides a regime to tax certain Islamic financial transactions in the same way as conventional financial transactions.

The term Islamic finance refers to financial transactions that are consistent with the principles of Islamic law (Shari'a). One of the main principles of Islamic finance is that the payment and receipt of interest (riba) is forbidden. Islamic financial transactions are typically backed by, or based on, an identifiable and tangible underlying asset, and involve risk sharing between the investor and the investee.

To facilitate commercial transactions, Islamic financial structures have been devised that comply with the basic principles of Shari'a law. These products meet the same economic needs as conventional financial products by using familiar legal structures in an alternative way (insofar as debt is concerned) to achieve the financing objectives.

**Part 8A** provides for the tax treatment of certain credit sale, deposit and investment transactions (referred to in the legislation as “specified financial transactions”) which achieve the same economic result in substance as comparable conventional products. Although designed to cover certain Shari'a compliant structures, the legislation applies to any financing arrangement falling within the meaning of the term “specified financial transaction” regardless of whether the arrangement is, in fact, Shari'a compliant.

Effectively, the provisions treat the return arising on a specified financial transaction as interest for tax purposes and apply all relevant tax legislation pertaining to interest to that return. The legislation does not change the nature of the financial arrangements. It seeks to provide a level playing field for tax between certain types of economically equivalent, but differently structured, finance arrangements.

### CHAPTER 1 *Interpretation*

### Overview

This is the interpretation Chapter for this Part.

### 267N Interpretation

#### Summary

This section is concerned with the interpretation of certain words and expressions used in **Chapter 1**.

#### Details

#### **Definitions**

“assets” are given the same meaning as in **section 532**. (1)

“charges on income” are given the same meaning as in **section 243**.

“credit return” is the return payable to the finance undertaking in respect of a credit transaction and is equivalent to interest on a conventional loan.

The credit return in the case of a credit sale or loan falling within *paragraphs (a) and (b)* (a) respectively of the definition of “credit transaction” is the excess of the amount paid or payable by the borrower over the amount paid by the finance undertaking for the asset.

In case of a mortgage type transaction (*paragraph (c)* of the definition of “credit transactions”), the “credit return” is the excess of the consideration paid or payable to the finance undertaking by the borrower (including any consideration paid or payable for the use of the asset) over the amount paid by the financial institution for the asset. (b)

“credit transaction” defines the credit transactions which are covered by this Part.

**Paragraph (a)** deals with credit sale arrangements whereby a financial undertaking (a) acquires an asset for the purpose of entering into a credit transaction and disposes of the full interest in that asset to a person (hereafter referred to as the borrower) where-

- (i) all or part of the consideration paid by the borrower exceeds the amount paid or payable by the finance undertaking for the asset, (a)(i)
- (ii) all or part of the consideration due from the borrower is not required to be paid until a date later than the date of the disposal, **and** (a)(ii)
- (iii) the excess of the amounts paid or payable by the borrower over the consideration paid or payable by the finance undertaking for the asset is equivalent to the return on a loan of money at interest. (a)(iii)

**Paragraph (b)** covers loans or other transactions whereby a finance undertaking (b) acquires an asset **and** -

- (i) immediately disposes of that asset to the borrower at a marked up price, (b)(i)
- (ii) the borrower immediately disposes of the asset for a price which is at least 95 per cent of the price paid or payable by the finance undertaking for the asset (this generates cash for the borrower), (b)(ii)
- (iii) all or part of the consideration for the acquisition of the asset by the borrower is not required to be paid by the borrower until a date later than the date of the purchase of the asset, **and** (b)(iii)
- (iv) the excess of the amount paid or payable to the finance undertaking by the borrower in respect of the asset is equivalent to the return on a loan of money at interest. (b)(iv)

**Paragraph (c)** covers mortgage type transactions under which— (c)

- (i) a finance undertaking and another person jointly acquire an asset (i.e. this would apply to new purchases), **or** (c)(i)
- (ii) a finance undertaking acquires an asset from the borrower in circumstances where the borrower retains an interest in the asset (i.e. a refinance transaction), (c)(ii)

where-

- (I) the borrower- (c)(I)
  - has exclusive use of the asset immediately (in the case of a new purchase) or retains exclusive use immediately (in a case where he already owned the asset), (c)(I)(A)
  - is exclusively entitled to any income, profit or gain from the asset (including increases in its value), **and** (c)(I)(B)
  - agrees to make payments to the finance undertaking amounting to the sum of the amount paid or payable by that undertaking for the asset and any other consideration paid for the use of the asset, (c)(I)(C)

- (II) the excess of the amount paid or payable (including rent or other amounts payable for the use of the asset) by the borrower to the finance undertaking over the amount paid by the finance undertaking for the asset equates in substance to the return on a loan of money at interest, **and** (c)(II)
- (III) the finance undertaking's interest in the asset passes either immediately or by the end of a specified period to the borrower for a consideration which exceeds the consideration paid by the finance undertaking for the asset. (c)(III)

“deposit transaction” - the definition of “deposit transaction” is designed to cater for transactions equivalent to the standard deposit transactions covered in the legislation dealing with deposit interest retention tax (DIRT - **Chapter 4 of Part 8**). There are two conditions to be fulfilled in order to qualify for the treatment. These are:

1. a sum of money must be deposited with a relevant deposit taker (as defined for DIRT purposes) on terms on which it or any part of it may be repaid either on demand or in circumstances agreed by or on behalf of the person making the deposit and the relevant deposit taker, **and** (a)
2. the relevant deposit taker must make or credit a series of payments to the depositor from profits resulting from the use of the money deposited and in proportion to the money deposited. (b)

“finance company” is defined as a company whose income consists wholly or mainly of either or both of the following:

- income from leasing of plant and machinery
- income from the carrying on of specified financial transactions

“financial institution” is given the same meaning as in **section 891B**.

“finance undertaking” is defined as either a finance company or a financial institution.

“investment certificates” must meet four conditions as follows:

- **paragraph (a)** requires that the certificates be issued to a person in order to establish the claim of that person over the rights and obligations represented by the certificate. Essentially this means that the certificate evidences the investors rights to a share in the ownership of the underlying assets; (a)
- **paragraph (b)** requires that the certificate should entitle the owner to an amount which is equivalent to a share in the profits or losses derived from the underlying asset and which is in proportion to the number of certificates owned; (b)
- **paragraph (c)** requires that the certificates be issued to a person who is not a “specified person”; (c)
- **paragraph (d)** requires that the certificates should be treated as a financial liability of the issuing company in the accounts; (d)

“investment return” this is the amount which would be equivalent to the interest on a conventional bond and means-

- (a) the excess of the consideration paid by the qualifying company on redemption of an investment certificate over the consideration paid in respect of the certificate by the beneficial owner to whom it was first issued, and (a)
- (b) any other periodic payments made by the issuing company from profits or gains derived from the underlying asset. (b)

“investment transaction” is defined as a transaction whereby a person acquires an investment certificate and receives an investment return. It is designed to cover both acquisitions from the original issuer and acquisitions on the secondary market.

“loan” is defined as any loan, advance or other arrangement by virtue of which interest

is payable.

“owner” is defined as the person who would be entitled, if the securities were redeemed at that time, by the issuer, to the proceeds of the redemption.

“public” is defined as individuals generally, companies generally or individuals and companies generally.

“qualifying company” is the company that issues the investment certificates. In order to qualify as such it must-

- (a) be resident in the State, (a)
- (b) issue “investment certificates” and (b)
- (c) redeem the certificates after a specified period of time. (c)

“relevant deposit” is given the same meaning as in *section 256*.

“relevant deposit taker” is given the same meaning as in *section 256*.

“relevant interest” is given the same meaning as in *section 256*.

“specified financial transaction” is defined as a “credit transaction”, a “deposit transaction” or an “investment transaction” and requires that the terms of these transactions must be such as would reasonably have been expected if the parties to the transaction were independent parties acting at arms length.

“specified person” is given the same meaning as in *section 110*, as if a reference to a “specified person” in *section 110*:

- (a) to a qualifying company included a reference to a qualifying company within the meaning of *section 267N* and
- (b) to qualifying assets was a reference to assets within the meaning of *section 267N*.

The definition of “specified person” was inserted by section 24 Finance Act 2013 and ensures that in order for a certificates issued, on or after the 1<sup>st</sup> January 2013, to qualify as an “investment certificate”, the certificate cannot be issued to:

(1) a company—

- (a) that controls directly or indirectly the issuing company, or
- (b) that is controlled directly or indirectly by the issuing company, or
- (c) that is controlled by a third company which also directly or indirectly controls the issuing company

or

(2) a person, who provided assets or received loans from the issuing company where the total value of the loans or assets represents not less than 75% of the total assets of the issuing company.

References to “consideration” are to be construed as follows: (2)

- in *paragraph (a)* references to *consideration* paid or payable by a borrower or a finance undertaking are to be construed as a reference to the aggregate of amounts paid or payable by the borrower or finance undertaking, as the case may be, (2)(a)
- in *paragraph (b)* references to *consideration* paid or payable are not to include any amount in respect of which a borrower or a finance undertaking may claim— (2)(b)
  - a deduction under Chapter 1 of Part 8 of the Value-Added Tax Consolidation Act 2010, or (2)(b)(i)
  - a refund of value-added tax under an order under section 103 of that Act, (2)(b)(ii)
- in *paragraph (c)* references to *consideration* paid or payable are not to include (2)(c)

any amount chargeable by a finance undertaking in respect of fees, charges or similar payments.

## CHAPTER 2

### *Credit return*

#### Overview

This chapter sets out the tax treatment of “credit returns” and “credit transactions”.

#### 267O Treatment of credit return

##### Summary

This section sets out the tax treatment of “credit returns”.

##### Details

A “credit return” is to be treated for all the purposes of the Tax Acts as if it were interest (1) on a loan or other security. The subsection is made subject to **section 130** so as to ensure that any “credit return” which is similar to a distribution will not be treated as interest.

The amount of the “credit return” shall not be regarded as expenditure on an asset for (2) the purpose of calculating a capital allowance, balancing allowance or charge due on that asset.

The amount of the “credit return” shall not be regarded as expenditure on an asset for (3) the purpose of **section 552**. This ensures that the amount of the credit return will not be included in the purchase price of an asset for the purpose of computing a capital gain on the asset.

#### 267P Treatment of credit transaction

##### Summary

This section sets out the tax treatment of “credit transactions”.

##### Details

A “credit transaction” is to be treated as a loan for the purposes of **section 122** (so as to (1) bring it within the Benefit in Kind provisions) and of **Part 8** (so that it can be treated as a loan for the purpose of claiming relief under **section 247** for interest as a charge).

Where a finance undertaking acquires assets for the purposes of the “credit (2) transactions”, the acquisition of the assets will be regarded as made in the course of the trade where the finance undertaking is carrying on a trade that consists of or includes “specified financial transactions”. This ensures that CGT will not arise on the disposal.

The borrower will not be treated as having incurred a loss on the disposal of assets (3) referred to in **paragraph (b)(ii)** of the definition of “credit transaction” in **section 267N** (i.e. where the borrower sells the asset acquired from the bank in order to generate cash).

The finance undertaking will not be entitled to capital allowances on any asset acquired (4) for the purpose of credit sale transactions.

Where an asset is acquired by the borrower under **paragraph (c)(i)** of the definition of (5) “credit transaction” in **section 267N** (a new purchase), the borrower will be deemed to have acquired the full interest in that asset for the purpose of any capital allowances due

on the asset.

The disposal by the borrower of his interest in the asset referred to in **paragraph (c)(ii)** (6) of the definition of “credit transaction” in **section 267N** (where a refinancing occurs) does not give rise to a balancing allowance or charge.

The acquisition by the borrower of the interest in the asset in **paragraph (c)(III)** of the definition of “credit transaction” in **section 267N** will not qualify for capital allowances. (7)

The effect of **subsections (4) to (7)** is that capital allowances should not be given twice on the same asset.

The borrower will not be entitled to a deduction for any capital repayment made to the finance undertaking except in the case of an allowance due under **subsection (5)**. (8)

### CHAPTER 3 *Deposit return*

#### **Overview**

This Chapter sets out the tax treatment of “deposit returns”.

#### **267Q Treatment of deposit return**

##### **Summary**

This Chapter sets out the tax treatment of “deposit returns”.

##### **Details**

The treatment of “deposit return” is made subject to **section 130** so as to ensure that any “deposit return” which is similar to a distribution will not be treated as interest.

A “deposit return” will be treated for all tax purposes as if it were “relevant interest” (a) paid on a deposit of money and the provisions of **Chapter 4** of **Part 8** (deposit interest retention tax) will apply to the return.

The relevant deposit taker will not be regarded as carrying on a trade in partnership with the depositor merely by virtue of the arrangement. This is necessary because Islamic equivalents of deposit transactions have some of the characteristics of a partnership. (b)

### CHAPTER 4 *Investment certificates and returns*

#### **Overview**

This Chapter sets out the tax treatment of “investment certificates” and “investment returns”.

#### **267R Treatment of investment return**

##### **Summary**

This section sets out the tax treatment of “investment returns”.



## Details

An “investment return” is to be treated for the purposes of the Tax Acts as interest on a security and the return will be chargeable to tax accordingly. The section is made subject to **section 130** in order to ensure that any “investment return” which is similar to a distribution will not be treated as interest.

## 267S Treatment of certificate owner

### Summary

This section sets out the tax treatment of an owner of an “investment certificate”.

### Details

The certificate owner shall not be treated as having a legal or beneficial interest in the assets held by the qualifying company. (1)

The income, profit, gains or losses arising from the underlying asset in an “investment transaction” will be regarded as income, profits, gains or losses of the certificate issuing company and that company will be chargeable to Corporation Tax accordingly. (2)

The certificate owner will not be entitled to capital allowances on the underlying assets in the transaction. (3)

## CHAPTER 5 *Reporting*

### Overview

This Chapter sets out the reporting provisions for a “deposit return”, a “credit return” and an “investment return”.

### 267T Reporting

This section applies the interest reporting provisions of **Part 38** to a “deposit return”, a “credit return” or an “investment return” as if that return were an interest payment.

## CHAPTER 6 *Application*

### Overview

This Chapter sets out how the provisions of this Part shall be applied.

### 267U Application

The tax treatment provided in this Part will only apply where a person who is a party to the transaction and is within the charge to tax elects that the legislation should apply. (1)

The election must be made to the inspector of taxes on an approved form and may be made in respect of one transaction or a series of transactions. (2)

Where an election is made, the party making the election must notify any other party to the transaction that this Part applies to that transaction. (3)

## **267V Transactions to avoid tax**

### **Summary**

This an anti avoidance provision.

### **Details**

The new legislation will not apply to a transaction unless it is undertaken for bona fide commercial reasons and does not form part of any arrangement for the avoidance of a tax liability. All taxes are covered by this provision including Stamp Duty, VAT and Capital Acquisitions Tax.