Tax Treatment of Stock Lending and Sale and Repurchase (Repo) Transactions

Part 04-06-13

This document should be read in conjunction with Chapter 3 of Part 28 of the Taxes Consolidation Act 1997

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Introduction

This manual sets out the corporation tax treatment[1], for certain stock lending and repo transactions. Stock lending and repo transactions involve the temporary transfer of stocks or securities from one party to another with a simultaneous commitment to reverse the transaction at some point in the future.

The difference between a stock loan and a repo transaction is that in a repo contract there is an agreed return date whereas in a stock loan contract there is no pre-agreed return date.

There are two important aspects to stock lending and repo transactions for tax purposes:

I. Transfer of Title

A key feature of the transactions is that a transfer of legal title occurs which is subsequently reversed on completion. Taxation of these transactions based on the strict legal form would result in a charge to Capital Gains Tax or Income/Corporation tax. Notwithstanding this legal form, the substance is essentially one of lending.

II. Income Receipts/Payments

Where stock is the subject of the loan/repo, the borrower is normally entitled to any dividend/interest payments made because a transfer of legal title occurs so that the stock is held in the borrower's name. However, the borrower will normally be required to reimburse the lender for any such dividend/interest payments. This compensating payment is termed a "manufactured payment".

The effect of this reimbursement transaction is that:

- the lender is effectively placed in the same position as if it had not loaned the stock and had received the real dividend, and
- the borrower, as if it had not borrowed the stock and so received no dividend.

In stock lending and repo transactions the profit earned by the lender will either be reflected in a small margin between the "selling" and "repurchase" price or in the form of a fee paid by the borrower, depending on the particular circumstances.

[1] Stamp Duty does not apply to stock lending or repo transactions where the transactions comply with the conditions set out in sections 87 and 87A of the Stamp Duties Consolidation Act 1999. See the Notes for Guidance for stock lending and repo transactions for further information.

1. Key Definitions [Section 753A]

The following definitions are key definitions required to understand and apply Chapter 3 ('Stock Borrowing and Repurchase Arrangements') of Part 28 of TCA 1997.

1.1 Stock Lending Transaction

A stock lending transaction is a transaction (referred to as a 'stock borrowing' in section 753A) where a stock buyer obtains qualifying securities from a stock seller and promises to provide to the stock buyer with the qualifying securities or equivalent stock within 12 months of the date of the original transfer.

1.2 Repo Transaction

A repo transaction is an agreement (referred to as a 'repurchase agreement' in section 753A) between a stock seller and a stock buyer where the stock seller agrees to sell qualifying securities to the stock buyer on terms that:

- the stock seller will repurchase, and
- the stock buyer will resell

the qualifying securities or equivalent stock within 12 months of the date of the conveyance of qualifying securities by the stock seller to the stock buyer under the repo transaction (this conveyance is also known as a **'stock transfer'**).

1.3 Equivalent Stock

Equivalent stock is stock of an identical:

- type,
- nominal value,
- description, **and**
- amount

as that which was originally transferred to the stock buyer[2].

The Appendix sets out how the meaning of "equivalent stock" is amended in the case of certain events. Those events are where the following occur after the date of the stock transfer or borrowing:

- converted,
- subdivided,
- consolidated,
- redeemed,
- made the subject of a takeover,
- call on partly paid stock,
- capitalisation issue,

[2] For this purpose, the term "equivalent stock" has the same meaning as in section 87 of the Stamp Duties Consolidation Act 1999 (SDCA), in the case of a stock lending transaction, and as in section 87A of the SDCA in the case of a repo transaction. Equivalent stock applies only to stock, within the meaning of SDCA, and not all securities.

- rights issue,
- distribution or
- subject to another similar event.

1.4 Stock Return

The stock return refers to the return of qualifying securities within 12 months of a stock lending transaction or a stock transfer pursuant to a repo transaction.

1.5 Stock Buyer

A stock buyer is a stock borrower in a stock lending transaction or a repo buyer in a repo.

1.6 Stock Seller

A stock seller is a lender in a stock lending transaction or a repo seller in a repo.

1.7 Manufactured Payment

A manufactured payment represents compensation paid by the stock buyer to the stock seller for any dividends or interest accruing to the stock buyer for the duration of the stock lending or repo transaction.

The effect of this reimbursement transaction is that:
- the lender is effectively placed in the same position as if it had not loaned the stock and had received the real interest or dividend, and
- the borrower, as if it had not borrowed the stock and so received no dividend.

1.8 Qualifying Institution

A qualifying institution is a lending and borrowing institution (whether trading or non-trading) which is within the scope of Irish tax and is a:
- company within the charge to corporation tax,
- building society,
- pension fund (including foreign pension funds exempt from tax under section 790B),
- charity, or
- investment undertaking.

1.9 Qualifying Securities

Subject to exceptions outlined in paragraph 2.2 below, these provisions apply to 'qualifying securities' only, being:
- all interest-bearing, discounted or premium-bearing securities, or
- equities quoted on recognised stock exchanges.

The stocks/securities may be denominated in any currency.

2. Qualifying Conditions and Restrictions [Sections 753A and 753B(1)]

The tax treatment set out in Chapter 3 applies where the conditions and restrictions set out in this Chapter are satisfied.

2.1 Financial Transactions

There are two components of a financial transaction:

1. the transfer of the qualifying securities under a stock lending or repo transaction, and
2. the stock return (which under the agreements is within 12 months of the transfer referred to in 1.).

For a transaction to be considered a financial transaction:

a) either the stock seller or stock buyer must be a qualifying institution, and
b) the other party to the transaction must not be an individual or a partnership,

It must be **reasonable to consider** that the transaction, and all associated agreements, arrangements or transactions, are equivalent to the lending of money, or money's worth, at interest. Such transactions are typically treated as secured loans for accounting purposes.

For the purposes of this section, where a transaction:

- meets all the criteria set out above, and
- is treated as a secured loan for accounting purposes under IFRS or FRS 102,

the **"reasonable to consider"** test shall be met.

2.2 Non-Qualifying Transactions

A financial transaction will not be a **qualifying transaction** (one that qualifies for the tax treatment set out in Chapter 3) if the underlying securities have certain features, namely:

2.2.1 Equities Loaned Across Dividend Payment Dates (S753B(1)(a))

Stock lending or repo transactions involving equities that are lent across dividend payment dates will not qualify except where:

- the lender (i.e. the stock seller) would have been entitled to a refund of all tax withheld under domestic law or the terms of a Tax Treaty, and
- the dividend is paid in cash (i.e. not a scrip dividend).

Where DWT is deducted from the dividend paid to the stock buyer, a stock seller who is eligible to have the DWT refunded under domestic law or the terms of a Tax Treaty may apply for a refund of the DWT deducted from the payment to the borrower (refer to paragraph 3.6).

2.2.2 Securities Lent Across Coupon Dates (S753B(1)(b))

Stock lending or repo transactions involving securities which are lent across coupon dates will not qualify except where:

- the lender of the bonds (i.e. the stock seller) would have been entitled to a refund of all tax withheld under domestic law or the terms of a Tax Treaty, or
- both parties to the transaction are subject to 20% withholding tax under the provisions of section 246, no part of which is repayable.

2.3 Accounting Treatment

Statutory audited accounts of the relevant institutions, insofar as these transactions are concerned, must recognise the substance rather than the form of the activities. In this regard the accounts must be unqualified.

3. Tax Treatment

3.1 Introduction

The corporation tax treatment of stock lending and repo transactions was previously dealt with by way of a Statement of Practice which was set out in the previous version of this Manual.

From 1 January 2020 the tax treatment of those transactions is set out in Chapter 3 of Part 28 of the Taxes Consolidation Act 1997, on which guidance is provided in this updated Manual. Where applicable, an entity must follow the treatment in relation to all transactions which meet the qualifying criteria, which are set out in Chapter 2 of this Manual. That tax treatment is that the economic substance of a stock lending/repo transaction will be recognised for corporation tax purposes rather than the legal position. This means that the accounting profit earned (being the fee or margin) shall be taxed in accordance with the provisions set out in Chapter 3 of Part 28 of TCA 1997.

Where a stock lending or repo transaction is carried on in the course of a corporate trade, the practice of calculating profits chargeable to corporation tax in accordance with accounting profits[3] rather than in accordance with Chapter 3 of Part 28 shall continue[4].

The timing of profits recorded for qualifying transactions should be based on the timing of the profits per the accounts prepared (under IFRS or UK/Irish GAAP) rather than actual amounts received in the financial year.

It should be noted that the anti-hybrid rules (refer to TDM Part 35C-00-01), are applied after the tax treatment provided for by Chapter 3 of Part 28. In the context of all stock lending and repo transactions (and not just those to which Chapter 3 of Part 28 applies), particular regard should be had to:

- Chapter 4 of Part 35C which deals with deduction / non-inclusion outcomes arising on Financial Instruments,
- Chapter 6 of Part 35C which deals with withholding tax mismatch outcomes, and
- Chapter 9 of Part 35C which deals with mismatch outcomes arising from structured arrangements.

3.2 Substance [Section 753B(2)]

Section 753B(2) provides that a qualifying transaction (refer to paragraph 2) will not be regarded as a disposal/acquisition for tax purposes. In addition, the subsequent return of the stock by the stock buyer will not be regarded as an acquisition/disposal. This means that:

- profits or gains on subsequent disposals of the stock by the stock seller will be calculated with reference to the original acquisition date and cost, and

[3] Calculated accordance with IFRS or GAAP (as set out in TDM 04-05-03a)
[4] Regard should be had to section 81(o) TCA 1997 where relevant

- if the loan and return take place at different prices, then any profit earned will be treated as a fee received by the stock seller and taxable in full.

3.3 Fees [Section 753B(2)]

Stock lending and repo fees and margins are taxable in full as interest income, subject to any statutory exemption from tax of income of the recipient.

3.4 Manufactured Payments [section 753C]

3.4.1 Payment of Manufactured Payments by Stock Buyer

Subsection (2) provides that a stock buyer may deduct the amount of the manufactured payment directly from the related real dividends or interest. The deductible amount is limited to the actual amount received by the stock buyer:

- after the application of any foreign tax relief under Schedule 24, but
- before the application of encashment tax under Schedule 2.

Subsection (3) provides that a manufactured payment should not be deducted from the real dividend/interest where that real dividend/interest:

- is exempt from tax either because the income is franked investment income or because the stock buyer is exempt from tax - i.e. the borrower is a charity, pension fund or the pension fund business of a life assurance company, or
- does not give rise to Irish tax in the hands of the stock buyer, for example by virtue of an entitlement to credit relief for foreign tax under Schedule 24.

Subsection (3) also provides that a manufactured payment should not be deducted from any other amount in the tax computation.

Subsection (4) provides that if the manufactured payment made by the stock buyer is lower than the related real dividends or interest, the difference shall be taxable in the hands of the stock buyer as interest income.

3.4.2 Receipt of Manufactured Payments by Stock Seller

Manufactured payments are generally taxable in the hands of the recipient (the stock seller). Subsection (5) provides that they are typically treated as if they were actual payments of dividends/interest from the securities underlying the stock lending or repo transaction.

Manufactured payments will be treated as exempt from tax when received by a stock seller in the following scenarios:

1. **The corresponding real dividend/interest would have been an exempt receipt.** This can occur where the stock seller receiving the manufactured payment is:
    - a tax-exempt fund such as charity or pension fund, or

- an Irish resident company for whom the real dividends would have been franked investment income.

2. **The corresponding real dividend/interest would not have given rise to Irish tax by virtue of foreign tax credits in respect of the dividend/interest if it had been received by the lender**.
   This can occur where an Irish taxable stock seller is in receipt of manufactured payments in respect of overseas securities where the real dividends/interest on such securities would have attracted a nil Irish tax liability by virtue of an entitlement to a credit against Irish tax for foreign tax.

   This situation occurs where the combined rate of foreign underlying tax and withholding tax would have exceeded the Irish tax rate if the stock seller had received the real dividend/interest.

Where the compensatory payment:

- exceeds the amount which the stock seller would have received (net of foreign withholding tax, but before Irish encashment tax) had they held legal title to the stock (i.e. the payment represents more than compensation for the interest/dividends foregone), and
- that excess amount is not in the nature of transaction fees[5],

the stock seller shall be chargeable to tax under Case IV of Schedule D in respect of that excess amount.

3.5 Rebates

Rebates of interest on cash collateral, being a full or partial compensation to the counterparty, cannot be deducted for tax purposes otherwise than directly from the interest arising on such cash collateral.

3.6 Refund of Dividend Withholding Tax [Section 753D]

A refund of Dividend Withholding Tax ("DWT") may be claimed from Revenue in certain circumstances where in the course of a qualifying transaction:

- Irish DWT has been deducted from a dividend received by a stock buyer as a result of the transaction, and
- the stock buyer pays the net dividend to the stock seller by way of a manufactured payment[6].

Section 753D provides that a refund of that DWT may be claimed by the stock seller where **all six** of the following criteria apply:

[5] It must be clear from the underlying documentation that the amount is in the nature of a fee
[6] In the case of DWT refund claims made by stock sellers in the course of a Case I trade, the manufactured payment made must meet the definition set out in paragraph 3.3.

1. A dividend was paid to a stock buyer as a result of a qualifying stock lending or repo transaction (refer to paragraph 3.1);

2. The corresponding stock return for that transaction has taken place;

3. The dividend received by the stock buyer was subject to Irish DWT;

4. The stock seller would either have either been entitled to:
    - a repayment of that DWT, or
    - receive the dividend without deduction of that DWT

    if they had not entered into the transaction and had instead received that distribution directly;

5. The stock seller has not been compensated by the stock buyer (or any connected party) for that DWT, or any part thereof;

    and

6. The stock buyer is not entitled to a repayment, credit, deduction or other relief for that DWT, or any part thereof under:
    - section 831 (Parent Subsidiary Directive)
    - a double tax arrangement having the force of law by virtue of section 826(1)
    - Schedule 24, or
    - any other provision (including under the law of a territory other than the State).

Before a claim is made for a refund of DWT, taxpayers should ensure that the amount of the refund is not restricted by the operation of section 835AO (the anti-hybrid rule which neutralises hybridity that would otherwise give rise to relief for tax withheld at source to more than one of the parties involved).

Where a stock seller is entitled to claim a refund of DWT, the stock seller must provide **all** of the following information with their claim:

1. Confirmation that the stock buyer received a dividend under a stock borrowing or repurchase agreement, and that DWT was withheld from that amount.

2. A signed declaration from the stock buyer that the stock buyer has no entitlement to any repayment, credit, deduction or similar in respect of that DWT.

3. Confirmation that the stock seller—

    (a) was the legal owner of the qualifying securities or equivalent stock—
    - immediately prior to the financial transaction, and
    - immediately following the financial transaction,

(b) would have received the dividend directly had the stock borrowing or repurchase agreement not been entered into, and

(c) would have either been entitled to—
- a repayment of that DWT or
- to receive the dividend without the deduction of that DWT

had the dividend been received directly by that stock seller.

4. A dividend voucher (or eVoucher).

5. The relevant DWT exemption declaration.

6. Any other information or documentation the Revenue Commissioners may deem appropriate.

4. Records [Section 753F]

Section 753F requires a party to a qualifying transaction to keep records of any such transactions. Such records must be maintained for a minimum of six years.

These records include, but are not limited to:

- the name and address of both parties to the transaction;
- the agreement underlying the transaction;
- any documentation in respect of any associated agreements, arrangements or transactions;
- the type, nominal value, description, and amount of qualifying securities (including any equivalent stock) involved in the transaction;
- the date of the stock lending or (stock transfer pursuant to the) repo transaction;
- the date of the corresponding stock return;
- details of any
  - manufactured payments, or
  - other payments made by the stock buyer to reimburse the stock seller for any dividend/interest foregone as a result of the financial transaction;
- details of the interest rate or rate of return applicable to the transaction; and
- details of the fees, profits, margins or other financial gain accruing, charged or expected to arise as a result of the transaction.

Where a party to the transaction is:

- an investment undertaking, or
- a pension fund (or a foreign pension funds exempt from tax under section 790B)

the records must be maintained by a person who is authorised to act on behalf of (or for the purposes of) the qualifying institution, and regularly does so.

5. Tax Avoidance [Section 753E]

5.1 Main Purpose Test

Section 753E(2) provides that a transaction shall only be a qualifying transaction where it would be reasonable to consider that it:

- has been undertaken for bona fide commercial reasons, and
- does not form part of any arrangement or scheme of which the main purpose[7], or one of the main purposes, is the avoidance of tax.

5.2 Capital/Rights/Entitlement to Assets

Special rules apply when determining, for tax purposes, the:
(a) capital (both share capital and loan capital)
(b) voting rights, or
(c) entitlement to assets on a winding up,
of each party (and its associates) to a qualifying transaction during a transaction period.

Section 753(3) requires the amount held by each party:
- before the stock lending or (stock transfer pursuant to the) repo transaction took place, and
- during the transaction period,

to be reviewed. The percentage holding of each amount during a transaction period shall be the amount that does not give rise to a tax advantage for that party (or its associates).

[7] See Tax and Duty Manual Part 33-01-01 – Main Purpose Tests for further information.

Appendix: Meaning of "Equivalent Stock" Following Certain Events

Borrowed/Transferred Stock Event	**Meaning of Equivalent Stock Following Event**
Stock Conversion, Subdivision or Consolidation	The stock into which that borrowed/transferred stock has been converted, subdivided or consolidated.
Stock Redemption	A sum of money equivalent to the proceeds of the redemption of the stock.
Company Takeover	A sum of money or stock, being the consideration or alternative consideration which the stock seller has directed the stock buyer to accept.
Call on Partly Paid Stock,	The paid-up stock but only where the stock seller has paid the sum due to the stock buyer.
Capitalisation Issue	The borrowed/transferred stock together with the stock allotted by means of a bonus on that stock.
Rights Issue	The borrowed/transferred stock together with the stock allotted on that stock. The stock seller must have directed the stock buyer to take up the rights issue. The stock seller must have paid to the stock buyer all sums due in respect of the stock allotted.
Distribution in the form of: • stock or • a certificate which may at a future date be exchanged for stock or where an option is exercised to take a distribution in the above form	The borrowed/transferred stock and • stock or • a certificate equivalent to those allotted by the distribution.
Any event similar to the above	• The borrowed/transferred stock and/or • a sum of money or stock equivalent to that received in respect of the borrowed/transferred stock as appropriate based on the facts and circumstances of the event.