Section 110: entitlement to treatment

Part 04-09-01

This document should be read in conjunction with Section 110 Taxes Consolidation Act (TCA) 1997

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Introduction

Section 110 TCA 1997 was initially introduced by FA 1991 to promote securitisation for the financial sector operating within the State. It was designed as a tax neutral regime for securitisation transactions.

This manual is not a comprehensive guide to section 110. It sets out only the areas of uncertainty that Revenue has identified involving section 110 and Revenue's view on the correct application of the law in each instance.

Where officers or taxpayers become aware of other areas of uncertainty where clarity is required they should contact the Financial Services & Anti-Avoidance branch of Business Taxes: Policy & Legislation to have this manual updated.

Guidance on the amendment to section 110 by Finance Act 2011 was published in Tax Briefing 2 of 2012. That guidance continues to be of relevance up to 1 June 2018.

1. Key conditions of section 110

Section 110 sets out a number of conditions which a company must meet in order to be a qualifying company:

a) the company must be resident in Ireland;
b) the company must acquire / hold / create qualifying assets;
c) the company must carry on its business of holding / managing qualifying assets in the State;
d) the company must carry out no activities, other than those ancillary to its business in c);
e) on the first day it acquires qualifying assets, it must have €10m of qualifying assets;
f) the company must provide Revenue with a notification of its intent to be a qualifying company on the relevant form[1]; and
g) all transactions or arrangements, other than those to which ss(4) applies (refer to paragraph 4 below for more details), must be entered into by way of a bargain made at arm's length.

All of these conditions must be met throughout the period of operation or the company will cease to be a qualifying company. The only exception relates to the requirement that the market value of the qualifying assets must not be less than €10,000,000 on the day the assets are first acquired, held or created[2]. There is no requirement that the qualifying assets must be €10,000,000 or more at any other point during the period of operation.

[1] Refer to TDM 04-09-03 on details relating to the notification requirement.

[2] Companies resident outside of Ireland cannot be qualifying companies and their assets cannot be qualifying assets. Where there is a *bona fide* migration of a securitisation to Ireland, for genuine commercial purposes, a company with assets that are, upon migration, qualifying assets, the date of migration is the date on which the €10,000,000 test must be met and the date from which the notification requirement runs. All other tax provisions will apply meaning that a review of historic debt or acquisitions may be required in order to determine how the Irish tax code will treat such transactions.

2. Calculation of the profits of the section 110 company

Section 110(2)(a) provides that the profits of a section 110 company should "be computed in accordance with the provisions applicable to Case I". This is the same wording as applied to the calculation of the profits from a foreign trade taxed under Case III, for example (s.77(5)).

A number of provisions which are applicable to Case I are expressed as applying to Case I (e.g. section 81) while others refer to the taxing of a trade (e.g. section 76D, section 817C, section 452 etc.). While section 110 contains certain provisions which imply that a deduction for yearly interest is permitted this can only be the case where section 77(3) is interpreted as applying. If trade and Case I were not synonymous in the context of section 77(3), section 110 companies would not be entitled to a deduction for any yearly interest as section 77(3) only disapplies section 76(5)(b), which prevents the deduction of yearly interest, in computing income from a trade.

There is some confusion over whether the provisions which are expressed as applying to a trade are applicable to a section 110 company. It is Revenue's position that 'trade' and 'Case I' are generally used synonymously throughout the Tax Acts. Companies should ensure that they take a consistent approach in calculating their taxable profits.

2.1. "Notwithstanding any other provision of the Tax Acts…"

Section 110(2) provides that, notwithstanding any other provision of the Tax Acts, the profits of the qualifying company shall be calculated in accordance with certain rules. The phrase "notwithstanding any other provision of the Tax Acts" is used in a number of places in the Tax Acts, and where two sections apply the question of which takes precedence arises. This must be determined on a case by case basis. For example, taking account of the structure and purpose of the sections it is Revenue's position that the "notwithstanding any other provision of the Acts" in section 811C(1)(b) should be applied after the application of section 110 while the "notwithstanding any other provision of the Tax Acts" in section 110(2) displaces the "notwithstanding any provision of the Tax Acts" in section 138(3).

A slight variant on this is section 129 which provides that "except where otherwise provided…" corporation tax does not apply on distributions by an Irish company. Section 110(2) does otherwise provide, and section 110s are therefore chargeable to tax on such distributions.

2.2. The costs of issuing debt

Whether or not the cost of issuing long term debt is tax deductible depends on a number of factors. The business of qualifying companies will usually involve the issue of debt. As the costs of issuing debt are a cost incurred in carrying on their business, those costs will generally be deducted for tax purposes irrespective of the term of the debt.

3. Arm's length transactions

A company cannot be a qualifying company unless all transactions and arrangements (other than a transaction to which section 110(4) applies – see section 4 below) are entered into by way of a bargain made at arm's length (section 110(1) and the definition of qualifying company refers).

For chargeable periods commencing on or after 1 January 2020, transfer pricing rules will apply to these transactions if they are between associated persons.

For chargeable periods prior to that, and where the transaction is with a non-associated person, it is expected that the directors of the section 110 company should be satisfied with the arm's length nature of the transactions and arrangements. Note that the requirement, while broadly similar to, is slightly different from a transaction being on an arm's length basis. Lightman J looked at the meaning of the phrase and found it **"connotes a transaction between two parties with separate and distinct interests who have each agreed terms (actually or inferentially) with a mind solely to his own respective interests."**[3]

When looking at this condition, a key question to be asked is: Did the qualifying company receive any services / advices that it did not pay for or did not pay full value for? If it did, then consideration has to be given as to whether or not that was part of an arm's length transaction? The absence of a fee is not always evidence that the transaction is not at arm's length.

It is important to note that the language of the relevant part of the definition of qualifying company in section 110(1) requires that this test be applied to "any transaction or arrangement" that the section 110 company enters into. In approaching this test, one must therefore identify the transaction or arrangement to which the test applies. Transactions or arrangements should neither be artificially aggregated nor disaggregated: for example transactions which would naturally fall together in a third party situation should not be artificially segregated and looked at in isolation[4]. Care should be taken where transactions are being 'netted' off outside of the qualifying company, with only the net effect being booked in the qualifying company (net payment arrangements are not problematic for this test).

In certain repack transactions, done from both single and multi-issuance vehicles, the costs of the qualifying company (such as its annual audit fee etc.) will be borne by the arranger. This is done to facilitate matching inflows from the assets held with obligations on the notes issued. Provided the repack transaction is a bona fide commercial transaction carried out between third parties, the fact that certain costs of the company are borne by the arranger will not cause the company to not be a qualifying company.

[3] *Mansworth v Jelley* [2002] STC 1013

[4] Refer to *Bullivant Holdings Limited v Inland Revenue Commissioners* [1998] STC 905, 71 TC 22

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Certain costs of qualifying companies which are wholly owned subsidiaries of investment undertakings may be discharged by that fund vehicle. Such costs would include some or all of the fees of service providers retained to provide services to both the investment fund and the qualifying company (such as investment management fees, custody fees, administration fees, legal fees, etc.). Where this is done for bona fide reasons (for example an investment manager may charge different levels of fees in respect of difference share classes of an investment fund which would be impractical at the qualifying company level; or there is significant overlap between the services being received by the investment fund and qualifying company; there is significant administrative complexity in allocating the fees involving arbitrary apportionments) then the fact that certain costs of the qualifying company are received and discharged directly by the investment fund will not cause the company to not be a qualifying company.

It is important to note that the above statements do not alter the required VAT treatment. Care should be taken that the correct VAT treatment is applied where expenses are not invoiced directly to the section 110 company.

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4. Profit Participating Notes [ss.(4)]

In order to create a tax neutral securitisation vehicle, section 110(4) provides that section 130(2)(d)(iii) will not apply (and section 110(2)(d) provides that the transfer pricing rules do not apply to a security referred to in section 110(4)). Therefore, a key feature of many qualifying companies is a profit participating note ("PPN").

4.1. Drafting of the PPN

In order for a payment under a PPN to be deductible in computing the taxable profits of a qualifying company, ss(4) provides that the interest or other distribution will be deductible if section 130(2)(d)(iii) was the only reason it would not otherwise be deductible. That is, if, for example, section 130(2)(d)(v) also applied to treat any payments on a note as a distribution rather than interest, then those amounts would be treated as a distribution.

In determining whether or not ss(4) applies to a PPN it is essential to determine the true nature of the payment – whether it is interest or a distribution (within section 130). Consideration should be given to all relevant facts (including the legal documents etc.) and relevant law (including company law etc.).

4.2. Restriction on deductibility – "specified persons" [ss.(4A)]

Ss.(4A) restricts the deductibility of profit participating interest under ss(4) to connected parties (known as "specified persons"). The provisions are applicable in the following two instances:

(a) Where the recipient of the interest is a tax exempt entity, such as a pension fund[5] [ss.(4A)(b)(ii)], and, in addition, where that recipient is a "specified person" then the interest is non-deductible; and

(b) Where the interest is payable on listed debt / wholesale debt instrument [ss.(4A)(c)], where the recipient is a "specified person", and where the qualifying company is aware / deemed to be aware that the interest will not (in Ireland, an EU State or a DTA country) be subject to tax (refer to Appendix A for details on what "subject to tax" means), then the interest is non-deductible. Note that this test must be applied each time the qualifying company is claiming a deduction under ss(4), but the awareness test is carried out at the time the security in respect of which the deduction is claimed, is issued.

The definition of "specified person" is two pronged. It includes (post Finance Act 2019):

(a) A company which controls / is controlled by the qualifying company (e.g. parent / sub relationships), or a company which is under the control of the company which controls the qualifying company (e.g. sister companies).

(b) Any person, or persons who are connected (within the meaning of section 10 which links to the section 432 meaning of control[6]) with each other, from whom assets were acquired, to whom loans or advances were made (by the qualifying company or otherwise where they are now held by the qualifying company), or with whom certain agreements were entered into. This aspect of the definition of "specified person" only applies where those assets / loans / advances / agreements make up 75% or greater of the value of qualifying assets of the company.

4.2.1. Meaning of "control" [ss.(7)]

The definition of "control" in ss.(7)(a) is based on that set out in section 11, which refers to ownership or powers conferred by the company's constitution or other documents regulating that company. Where a qualifying company is an orphan entity there is often not control, within the meaning of section 11, thus it might be believed that ss.(4A) does not apply. However, there may be 'other documents regulating the company' which need to be considered rather than simply looking at the ownership of the shares and the rights contained in the constitution of the company.

Ss.(7)(b) extends the meaning of control to where a person has "significant influence" over the company and has a direct or indirect 20% ownership interest in the company.

- Significant influence means the **ability** to participate in the financial and operating policy decisions of a company. Note that it is the **ability to** which is different to having the **power to** which would be found from a review of the company

[5] Revenue are prepared to treat a tax exempt fund that is constituted as a trust and which is not a person, as a company for the purposes of subsection (4A)(b)(ii), provided such an entity is also treated as a company for the purposes of the definition of the term "specified person".

[6] As with the form s.110, what is required here is persons where it would be reasonable for the qualifying company to know that it is under common control or ownership.

documentation. In circumstances where a person does not have the power to participate in the financial and operating policy decisions of a company pursuant to the company's constitution, or under a contract or similar legally binding right, but actually participates in the financial and operating policy decisions of the company, the person may have significant influence. It is also sufficient that a legal or contractual right to participate exists without requiring the person to have actually participated in the financial and operating policy decisions of the company before the test can be met.

- The 20% ownership interest is with reference to issued share capital of a company and securities referred to in ss.(4) (being those referred to in section 130(2)(d)(iii) regardless of whether they are issued by a qualifying company or otherwise). In terms of the securities referred to in ss.(4), the 20% threshold is applied both in terms of the value of the principal of any such notes and the proportion of the interest payable thereon.

This extension[7] was to address the use of orphaning to avoid the application of ss.(4A)[8] in circumstances where an investor does not have 'equity' control over the qualifying company but has a material ownership interest and the ability to direct or influence the investment policy and decisions of the qualifying company.

Taking account of the purpose of the extension, the existence of protective rights similar to those customarily retained by a secured creditor in a bona fide third party financing arrangement offered by a bank, in the ordinary course of that banking business (such as consent rights or the right to remove or replace an investment manager) should not of themselves amount to 'significant influence' over the investee company for the purposes of ss(7)(b).

A wider meaning of control (to that set out under section 11) is also used under the Irish Companies Acts and International Financial Reporting Standards (IFRS) when determining if entities are parent entities or subsidiaries. Given the similarities of the tests that apply to determine the exercise of control by one company over another company for these purposes and the expanded definition of control under section 110(7), in practical terms:

- the qualifying company is not a subsidiary within the meaning of s(7) Companies Act 2014, or
- no other entity has significant influence, within the meaning of IFRS, over the qualifying company

then there should be no entity which has significant influence over the qualifying company for the purposes of s.110(7).

However, in circumstances where contrived steps have been taken such that transactions or arrangements have been entered into and it is not expected, as a result of the steps taken, that the qualifying company is a subsidiary under company law or that the qualifying

[7] By section 28 Finance Act 2019

[8] Refer to section 4.8 below on non-genuine orphaning to avoid the application of ss(4A).

company is under significant influence of a parent entity under IFRS, it is considered likely there is significant influence over the qualifying company within the meaning under ss.(7)(b).

The meaning of 'significant influence' in s.110 is designed to have a broad application. It could apply in a wider range of situations than those that are factored into the analysis of whether a parent entity has exercised significant influence over a subsidiary in the context of identifying parent entities and subsidiaries under Irish company law and IFRS accounting standards. Therefore, other circumstances must be evaluated on their own facts and circumstances, against the criteria set out in s.110(7).

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Where the security referred to in ss.(4) is held by a partnership or other transparent entity, consideration has to be given to how the "subject to tax" and 20% thresholds will apply. This is particularly complex in the case of fund structures where those securities are held by a partnership in which the investment manager (to both the qualifying company and the fund) is a partner who is entitled to 'carried interest'. In this context, 'carried interest' is the compensation that the manager will be entitled to, if certain targets are achieved in relation to the performance of the company/fund. The following illustrative example sets out how the subject to tax and 20% ownership tests are applied in the case of a carried interest entitlement arising to a fund manager for a fund in the form of a limited partnership.

Example on carried interest
Fund LP has a number of limited partners and a general partner, and under Irish tax law would be regarded as equivalent to a partnership formed under the Limited Partnership Act 1907. The investment manager is also a partner in Fund LP. The terms of Fund LP's partnership agreement require that all capital and a return of 8% be returned to the limited partners before the investment manager is entitled to any carried interest. When the 8% return hurdle is passed, the manager is entitled to 20% of profits of the partnership. The partnership has invested in debt securities issued by a qualifying company.

In applying ss.(7) to Fund LP, regard should be had to the partners when determining who has significant influence, who holds the 20% interest in the company and whether or not that person is subject to tax on the amounts received. Because of the facts and circumstances of this structure, the investment manager has significant influence in the qualifying company, but does not hold (directly or indirectly) 20% of the issued share capital (ss.(7)(b)(i)) or principal value of any securities referred to in ss.(4) (ss.(7)(b)(ii)). However, once the investment manager is in receipt of its carried interest the question arises as to whether it is now, directly or indirectly, entitled to receive 20% of the interest payable in respect of those securities (as required by

ss.(7)(b)(iii)). Looking at the transaction in the round the investment manager's carry will never equate to 20% of the interest on those securities as the entitlement to carried interest only applies after the return hurdle has been met. Therefore, while in the later years the investment manager may be entitled to 20% of the interest paid that year, and as in total, from the outset, it will not equate to 20% of the interest paid, the investment manager will not have "control", within the meaning of ss(7), of the qualifying company.

4.3. Restriction on deductibility – "return agreement" [ss.(4B)]

The restriction imposed by ss.(4B) on return agreements applies to an agreement or a combination of agreements that results in a sweep-out of profits or gains of a qualifying company. This does not include loan agreements or debt instruments, whether or not creating or evidencing a charge on assets, as ss(4A) applies to interest paid on certain loans or debt instruments.

Ss.(4B) does not apply to:

(a) performance management agreements entered into by a qualifying company with an investment manager or advisor where the fee payable under the agreement is calculated on the basis of the underlying performance of the assets under management,
(b) agreements solely because of non-recourse, limited recourse or non petition clauses that limit the rights of counterparties to the assets of the company,
(c) interest rate or currency swap agreement entered into by a qualifying company to hedge exposure to interest rates or currency fluctuations, or
(d) credit default swap agreements.

4.4. Restriction on deductibility – Irish property business [ss.(5A)]

Ss.(5A) restricts the ability of qualifying companies to use PPNs in their Irish property business. The Irish property business is any business that involves holding certain qualifying assets (namely loans, units in a fund and shares) that derive their value from Irish land. These restrictions don't apply where the Irish property business carried on is:

a) A CLO transaction
b) A CMBS / RMBS transaction
c) A loan origination business
d) A sub-participation transaction[9].

Activities carried out in preparation of carrying out these activities are also excluded. For CLOs and CMBS / RMBS transactions, the company must be a single purpose vehicle carrying out only that transaction.

4.4.1. Loan origination

Unlike CMBS / RMBS and CLO transactions, a qualifying company can carry on a loan origination business and other qualifying activities.

[9] Each of these four terms is defined in ss.(5A).

4.4.1.1. "On or about the date"

Within the definition of "loan origination" in ss.(5A)(a) is provision that a loan origination business includes both the making of loans by the qualifying company and also the acquisition of loans by the qualifying company on or about the date on which they were advanced.

"On or about the date" deals with situations where, for example, the loans are originated by a bank and then transferred to a qualifying company. It also covers situations where loans are originated by one qualifying company and then transferred to another. This may happen where third-party financing is being put in place in stages, or where lenders require that the bundle of loans associated with their borrowing are ring-fenced from the other assets and liabilities of the qualifying company. It may also happen where a loan book is being built up to a marketable size or risk portfolio.

When determining whether or not the transfers happened "on or about the date" of the advance, regard will be had both to the actual timing of the transfer and also to the intention of the parties at the time the amounts are advanced. All facts around the advance (including both the documentary evidence such as board minutes and other evidence such as the capital structure of the deal which show the intent of the parties involved) will be considered. Commercial delays (where for example alternative financing must be arranged) will not cause a business to fail this test if all other facts indicate that the intention when the loans were advanced was that they would transfer shortly thereafter.

Note that the "on or about the date" wording applies only when determining whether or not the business is a loan origination business and does not impact on the €10m day one requirement.

4.4.1.2. Re-financings

Within the definition of "loan origination" in ss.(5A)(a) is provision that a loan origination business does not include amounts which are advanced as a result of a novation[10] or a refinancing, unless that novation or re-financing is part of **bona fide** commercial transaction which did not have avoiding the application of ss.(5A) as one of its main purposes. Essentially a borrower can refinance their debt with a qualifying company, and have that refinanced debt treated as part of a loan origination business, provided there is no tax avoidance motive in the deal.

The definition of loan origination business refers to the making of an advance. Where a qualifying company holds a loan as part of its loan origination business and that loan is restructured, the result may or may not be part of its loan origination business. If the effect of the reorganisation is that the loan which was held as an asset for the purposes of the loan origination business is written off in exchange for equity shares / debt / receivables (of which the underlying value is derived directly or indirectly from land in the State) then that part of the qualifying company's business will no longer be considered part of a loan origination business and will instead be part of a specified property business. This is on the basis that the definition of loan origination business relates only to the making of advances and not to other activities which are ancillary to the making of those advances.

In some cases where a debtor is negotiating a debt write down with its lender a transfer of the loan to a third-party results, rather than a novation or a refinancing. Where the substance of the transaction is that a new loan has been created the transferred loan can in general be treated as part of a loan origination business. However, any gain realised by the qualifying company on such loans, which would not have arisen had a new advance been made, will not form part of the profits of the loan origination business.

4.4.1.3. Taking equity as part of a loan origination

Some loan origination companies take an equity interest in the business to which they advance the loans, or equity may be taken as part of a refinancing arrangement. Where those borrowers derive their value from Irish land the question arises as to whether or not the holding of shares by the qualifying company is a "specified property business" given that the advancing of loans is not, on the basis that it is part of the loan origination business.

The definition of loan origination business relates only to the making of advances and not to other activities which are ancillary to the making of those advances. As such, loan origination companies which both make advances and take an equity interest in the company may have two separate businesses: the loan origination business and the specified property business (the holding of shares which derive their value from Irish land). However, where the value of the equity is minimal then it need not be treated as a separate specified property business.

[10] A novation is to make new the contract. It is not the assignment and assumption of a contract or rights and obligations under that contract.

4.4.2. CRR / CRD

CMBS / RMBS transactions are defined with references to CRR[11]. Securitisation transactions fall within these definitions if:

a) They are entered into by the original lender who retains the net economic interest in the credit risk, as required by CRR; or
b) They are entered into by a financial or credit institution (both within the meaning of CRR) who acquired the loans, and that financial or credit institution retains the net economic interest in the credit risk, as required by CRR.

CRR can be interpreted as imposing risk retention requirements on a single entity. Under CRR, there may be no requirement on the originator itself to be regulated. However, the Irish tax provisions also refer to the originator's regulatory status. Where a suitably regulated entity uses a subsidiary entity to act as originator for CRR purposes, then provided:

- the regulated entity retains ownership of the subsidiary,
- the subsidiary qualifies under CRR by retaining the net economic interest, and
- the structure is not for tax avoidance purposes,

the transaction may be treated as falling within the definition of a CMBS/RMBS transaction. This approach reflects the approach of CRR, where an originator under limb (a) of the definition of originator may undertake activity directly or through related entities.

Paragraph (b) of the definition of CMBS / RMBS securitisations deals with transactions which involve a purchased loan book. In such cases, they will only qualify as CMBS / RMBS where the securitisation is done by certain institutions. A credit institution "means an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account". As such, the term credit institution will include both the regulated credit institution and any of its subsidiaries who are involved in a similar business as the regulated credit institution.

4.4.2.1. Non-CRR / CRD securitisation structures

The issue also arises as to how securitisation transactions entered into pre CRR, when the obligation to retain the net economic interest in the credit risk was not in place, will be treated. Where the pre CRR / CRD transaction is a **bona fide** securitisation transaction entered into by a bank in respect of either mortgages it originated or a loan book it acquired in the normal course of its business, it should be treated as falling within the definition of CMBS / RMBS for the purposes of ss(5A).

[11] Regulation (Eu) No 575/2013 of the European Parliament and of the Council of 26 June 2013

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4.4.3. Pre FA 16 CLO transactions

A CLO transaction which was entered into prior to publication of the FA16 amendments would not have known that there were certain restrictions, e.g. around the length of a warehousing period. **Bona fide** CLOs which were entered into prior to FA16 will be treated as CLO transactions for the purposes of section 110 provided had they been put in place following the introduction of FA16 they would have complied with the conditions of the definition of CLO transaction.

4.5. Restriction on deductibility – where not "subject to tax"

4.5.1. ss.(4A)

Under ss.(4A)(b) profit participating interest paid to persons other than specified persons (dealt with in 4.2 above) is only deductible under ss(4) where:

(a) the recipient is resident in the State, or if not so resident, is within the charge to corporation tax on that interest or distribution;
(b) the recipient of the interest[12] is a tax exempt entity in an EU (including Ireland) or country with which Ireland has a double tax agreement, such as a pension fund [ss.(4A)(b)(ii)], and, that recipient is **not** a "specified person";
(c) the interest or other distribution is subject to a tax (refer to Appendix A on what "subject to tax" means), in a Member State or a country with which Ireland has a double tax agreement, which generally applies to profits, income or gains received from abroad. This charge to tax must be without any reduction computed by reference to the amount of the interest or distribution (for example a participation exemption in respect of such interest, or a notional or deemed reduction in their taxable income (excluding any reduction calculated by reference to amounts actually paid or to tax actually paid) in respect of such interest); or
(d) withholding tax, under section 246(2), was deducted and is not refundable.

4.5.2. ss.(5A)

Applied after the application of ss(4A), under ss.(5A)(d) profit participating interest relating to an Irish property business is only deductible under ss(4) where:

(a) the recipient is within the charge to corporation tax on that interest or distribution, or in the case of an individual, within the charge to income tax on that interest or distribution;

[12] The legislation requires that the interest is paid to a "person". Where the interest is paid to a tax exempt fund which is constituted as a trust, which would not be a "person" within the meaning of the Tax Acts, such a trust can be treated as a "person" for the purposes of this test provided it is also treated as a "person" for the purposes of the "specified person" test.

(b) the recipient of the interest is a tax exempt entity, such as a pension fund [ss.(5A)(d)(i)(II)];
(c) the recipient of the interest is an EU citizen who is resident in an EU or EEA State and is, in the EU or EEA, subject to a profit, rather than capital gains, tax (refer to Appendix A on what "subject to tax" means) which generally applies to profits, income or gains received from abroad. This charge to tax must be without any:
   A. reduction computed by reference to the amount of the interest or the distribution;
   B. deemed or notional expenses calculated with reference to any financing (whether debt, equity or hybrid instruments); or
(d) withholding tax, under section 246(2) was deducted and is not refundable.

4.6. Interaction of ss(4A) and ss(5A) with ss(4)

Ss(4), which is subject to ss(4A) and ss(5A) provides that interest on certain profit participating loans will not be treated as a distribution, by reference only to s.130(2)(d)(iii). Ss(4A) provides that ss(4) shall only apply to a certain portion of the interest or other distribution, while ss(5A)(d) provides that ss(4) shall only apply to the calculation of the profits of the company in respect of a certain portion of the interest or other distribution.

Therefore, amounts which are restricted by ss(4A) are to be treated as distributions in accordance with section 130(2)(d)(iii) while amounts restricted by ss(5A) remain to be treated as interest (as ss(4) continues to disapply s.130(2)(d)(iii) for all other purposes) while not being deductible in calculating the profits of the company.

4.7. "Main purpose" test [ss.(5)]

S.110(5) provides that ss(4) shall only apply where it would be reasonable to consider that
(a) the payment of interest or other distribution, or
(b) the entering into the security on which the interest or other distribution arises,
was
(A) for bona fide commercial purposes, and
(B) does not form part of any arrangement or scheme of which one of the main purposes was the avoidance of tax[13].

The payment of profit-participating interest to a specified person is not necessarily in itself a breach of this provision.

[13] Refer to Tax & Duty Manual Part 33-01-01 for a discussion of case law on the main purpose test.

Where the qualifying company holds shares in a company and makes loans to that company, consideration should be given to ss(5). The company in which the qualifying company holds shares is likely to be a "specified person" so the question must be asked as to whether the specified person obtains a tax benefit from the structure. Where such a benefit arises, is it one of the main benefits or simply the icing on the cake[14].

4.8. Orphan structures

Orphan structures refer to structures where the shares in the company are held on trust for charitable purposes.

Orphan structures have long been used to create bankruptcy remote structures. The valid commercial reasons for using an orphan structure in many jurisdictions include where bankruptcy remoteness is a valid structural concern (such as where a rating agency requires it, or securitisations by banks will be orphaned for regulatory capital reasons) or where there are a diverse group of investors, with no single investor being permitted to have voting control of the entity. Certain parties, such as the European Central Bank, may also require orphaning. In instances where orphan structures are put in place without any valid commercial reasons (including structures with a non-commercial split of voting and non-voting equity), it is open to consider whether they have been put in place for tax avoidance purposes. It is also likely that the amended definition of control contained in ss.(7) will apply to most of these structures where notwithstanding that a person may not have 'equity' control, within the meaning of section 11, the person has a material ownership interest (ie. greater than 20% ownership interest) and "significant influence" over the company.

When considering whether or not a vehicle has been established for a tax avoidance motive (for example to avoid the restrictions imposed by section 110(4A)), an indicator will be whether or not it has been truly orphaned. Consideration should be given to all agreements surrounding the establishment and operation of the qualifying company, including side agreements and tacit agreements. A vehicle which has an orphan shareholding but is truly part of a group has not been truly orphaned. This may be an indicator that the orphaning has been put in place for tax avoidance purposes.

In addition to ss(5), when looking at a possible tax avoidance transaction, regard should be had to Revenue's tax avoidance area of the website.

5. Residence and place of business

To be a qualifying company, a company must be both resident in Ireland and carry on its business in Ireland.

[14] Refer to Commissioners of Inland Revenue v Sema Group Pension Scheme Trustees [2002] 74 TC 593

5.1. Residence

Revenue has published guidance on corporate tax residency.

Where directors act independently and properly in discharging their duties and undertake the appropriate level of oversight in the company's activities, in each case, in Ireland, it is not anticipated that the company would be resident anywhere but Ireland. In particular, directors should not take instructions from third parties but should discharge their director's duties appropriately and independently.

The following material is either exempt from or not required to be published under the Freedom of Information Act 2014.

[…]

5.2. Carrying on business

The company must, in addition to being resident, carry on the business of holding / managing qualifying assets in the State. There are two elements to this requirement.

Firstly, the company must carry on a business. The word 'business' is an **"an etymological chameleon; it suits its meaning to the context in which it is found"**[15]. However, a review of the case law shows that a purely passive activity is unlikely to constitute a business[16]. Therefore, in structures which involve no active management (active management which is outsourced to an appropriate manager is acceptable) or review over a prolonged period of time, consideration must be given as to whether or not the company is in fact carrying on a business.

Secondly, the business must be carried on in Ireland. If the company does not undertake any significant acts in Ireland, and the directors do not undertake a review of the portfolio in Ireland, or have any input or oversight function in Ireland (for example reviewing the performance of the outsourced investment management, wherever carried on), then arguably the business is not being carried on in Ireland.

The following material is either exempt from or not required to be published under the Freedom of Information Act 2014.

[…]

6. Payment-in-kind ("PIK") notes

Where a qualifying company has a PIK note, section 51 allows for deductibility of the market value, and not the face value, of the notes issued as interest. Consideration should be given to the appropriate discount factors applied to determine the market value of the notes issued in lieu of payment of the interest.

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[15] *Town Investments Ltd v Department of the Environment* [1978] AC 359 at 383

[16] E.g. "The carrying on of 'business', no doubt, usually calls for some activity on the part of whoever carries it on, though, depending on the nature of the business, the activity may be intermittent with long intervals of quiescence in between." Lord Diplock, *Amercian Leaf Blending Co Sdn Hbd v Director –General of Inland Revenue* [1978] STC 561; *Jowett v O'Neill and Brennan Construction Ltd* [1998] STC 482

7. Commodities

7.1. What are "commodities"?

The term "commodities" is defined as tangible assets (other than currency, securities, debts or other assets of a financial nature), which are dealt in on a recognised commodity exchange.

Commodities have been included as qualifying assets for the purpose of section 110 in order to facilitate a section 110 company entering into financial transactions where the underlying asset is a commodity. While it is likely that the section 110 company will purchase or trade the commodities on a commodity exchange, there is no requirement for the company to do this - 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, i.e. oil, gas, gold, copper, corn, rice, coffee etc.

7.2. What is a "recognised commodity exchange"?

The term "recognised commodity exchange" is not defined. TDM Part 04-02-03 sets out the criteria used to assess whether or not a stock exchange is a recognised stock exchange and similar criteria should be applied here. In general terms, Revenue would expect that such an exchange would have national or international recognition - an agreement between two or more parties to exchange goods would not qualify. Revenue would accept that commodities traded on any of the main commodity exchanges (such as the Chicago Board of Trade, New York Mercantile Exchange, London Metal Exchange etc.) would fall within the section.

Appendix I Subject to tax

Ss.(4A) and (5A) both contain "subject to tax" rules[17]. The specific requirements of ss(4A) and (5A) must be applied after the initial "subject to tax" decision e.g. ss(4A) requires that the interest or other distribution is subject to tax without any reduction computed by reference to the amount of such interest or other distribution. This Appendix deals only with the initial subject to tax decision.

Certain payments of interest or other distributions made by a qualifying company must be subject to tax in certain jurisdictions in order that a tax deduction is available to the qualifying company. It is not sufficient for the interest or other distribution to be payable to someone who is liable to tax, they must also be subject to tax. The interest or other distribution itself (other than as set out under D below) must be subject to tax and not an amount which is in some way derived therefrom.

The matters set out in paragraphs C and D below apply only where there is no economic double non-taxation arising from the payment of interest on a PPN.

A. Arising basis

An investor who invests directly in a qualifying company will only be regarded as being "subject to tax" on any interest or other distribution received where they are taxed on that income on an arising basis.

B. Changes in tax rules applicable to an interest payment subsequent to the date of the agreement under which the payment is made

The deductibility of interest or other distributions must be determined for each interest payment as deductibility is being claimed. Therefore, if the tax rules applicable to an investor changes the deductibility of the interest or other distribution may also change, acknowledging the timing of the knowledge test in section 110(4A)(c).

C. Investments via transparent entities

Income from a qualifying company may be received by an investor via a tax transparent vehicle such as a partnership, or an opaque vehicle. In certain circumstances, the income may pass through a series of intermediate investment vehicles before it reaches the ultimate investor. In all such cases, an investor will be considered to be "subject to tax" on his portion of the interest or other distribution made by the qualifying company where the investor is taxed on an arising basis in respect of the amount of income received from the investment vehicle.

[17] The concept of no deduction without inclusion can be found in the EU's Anti Tax Avoidance Directive 2 (implemented as Part 35C TCA 1997) and the OCED's BEPS Action 2 on neutralising the effect of hybrid mismatches. Included, within the meaning of Part 35C is subtly different to "subject to tax" as used in section 110.

Examples of cases where Revenue would consider income as being "subject to tax" where the investment vehicle is tax transparent or otherwise "look through" are—

a **Payments to partnerships (or treated as a partnership)**
Interest or other distribution paid to a partnership, or an entity that is treated as a partnership, will be considered to be "subject to tax" to the extent it is attributable to a partner who is subject to tax on that interest or other distribution on an arising basis in an EU or tax treaty partner country (or would be subject to tax on that basis in the case of a partner, who is not a specified person, if that partner were not a tax- exempt entity such as a pension fund);

b **Payments to a controlled foreign company (CFC)**
Interest or other distribution paid to a company that is considered under the laws of an EU or tax treaty partner country to be a controlled foreign company will be considered to be "subject to tax" to the extent that the interest or other distribution is treated, by virtue of the CFC provisions concerned, as income of another company that is subject to tax on an arising basis in an EU or treaty partner country (or would be subject to tax on that basis in the case of a company, which is not a specified person, if that company were not a tax-exempt entity, such as a pension fund).

c **Payments to US resident investors in US Limited Liability Companies.**
Without prejudice to (a). in keeping with the approach taken in TDM Part 08-03-06, a US Limited Liability Company, which is categorised as a partnership under US tax rules (and where the business is conducted through the LLC for commercial reasons and not for tax avoidance purposes) may be treated as transparent for the purposes of applying the subject to tax rule. Where US-resident investors invest in the qualifying company via an LLC, the interest or other distribution paid by the qualifying company will be considered to be "subject to tax" to the extent that the interest or other distribution is subject to tax in hands of those investors.

d **Payments to a "check the box" entity (for example a non-US company which is disregarded (or treated as a partnership) for US tax purposes**
In the case of a payment of interest or other distribution paid to a "check the box" entity, the amount of that interest or other distribution which will be considered to be "subject to tax" will be the amount of that interest or other distribution which is treated, for US tax purposes, as paid to another person who is subject to US tax on that interest or other distribution on an arising basis (or would be subject to tax on that basis in the case of a person, who is not a specified person, if that person were not a tax exempt entity such as a pension fund);

D. The qualifying company as a transparent entity

a. Where the qualifying company is itself not regarded as an entity (for example where it is "checked open" for US tax purposes or where it is included in a tax consolidation) and makes a payment of interest or other distribution to its parent, the parent company jurisdiction will disregard the payment for tax purposes. However, to the extent the parent is subject to tax on the profits of the qualifying company before the deduction of the interest or other distribution the interest or other distribution will be considered to be "subject to tax".

b. Where the qualifying company is a CFC, another company may be subject to a CFC charge in respect of the profits of the qualifying company before the deduction of the interest or other distribution. In those circumstances, to the extent the profits so chargeable equate to the amount of the interest or other distribution, the interest or other distribution will be considered to be "subject to tax".

Appendix II Schedule of material changes

September 2021	Paragraph 2: Clarification on the interaction with section 129
	Paragraph 3: Clarification arising from the introduction of Transfer Pricing rules
	Paragraph 4: Amendments to deal with FA19 amendments re control and the main purpose test.
	Appendix I: Updated generally following the introduction of the anti-hybrid rules to ensure consistency, as far as possible, between the concept of 'inclusion' in Part 35C and 'subject to tax' in section 110, and specifically the inclusion of Paragraph D on disregarded entities.