

Ireland as a  
Domicile for  
Special Purpose  
Vehicles

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# Ireland as a Domicile for Special Purpose Vehicles

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## IRELAND AS A DOMICILE FOR SPECIAL PURPOSE VEHICLES

### Background

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

### Why Ireland?

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

The terms of a treaty can ensure that the cash flows from assets can be paid to the SPV without any foreign taxes (or at reduced rates of foreign taxes) on the income and/or capital gains flows on those assets. In addition, the terms of a double tax treaty (in the absence of domestic tax legislation) may help the SPV avoid a taxable presence in the country where the investment manager to the SPV is located. There is no doubt that Ireland’s primary success as an SPV domicile is because of its double tax treaty network in avoiding foreign taxes on the relevant assets. The signing of new treaties in 2010 brings to 59 the number of tax treaties signed by Ireland. Many more treaties are in negotiation and more expected to be signed during the remainder of 2010. Even in countries where it is necessary to use a SPV domiciled in the relevant country of origin of the assets, Ireland may still be used as an SPV domicile for issuing the necessary debt and then holding the units/certificates in the underlying SPV on which flows of income and gains arise backed by the underlying assets held by the SPV. Access to a double tax treaty with the relevant country (or access to EU Directives for EU based assets) is often critical in avoiding foreign taxes on the flows of income/gains from the units/certificates issued by the SPVs.

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

## SPV (“Section 110 Company”) Taxation

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

## Qualifying Section 110 Company

A “*qualifying company*” means a company which:

- (a) is resident in Ireland;
- (b) acquires “qualifying assets” (see definition below) or as a result of an arrangement with another person holds or manages qualifying assets or enters into a legally enforceable arrangement with another person and the arrangement is itself a qualifying asset (such as a derivative);
- (c) carries on in Ireland the business of the holding and/or management of “qualifying assets”;
- (d) apart from activities ancillary to that business, carries on no other activities;
- (e) undertakes the first transaction resulting in the holding and/or management of qualifying assets for a value of not less than €10m;

- (f) notifies the Irish tax authorities that it is a company to which points (a) to (e) apply; and
- (g) carries on no transaction other than by way of a bargain made at arm's length (the legislation specifically excludes profit participating loans from satisfying this requirement).

A “**qualifying asset**” means an asset which consists of, or of an interest (including a partnership interest) in, a “financial asset” which includes shares, bonds and other securities, futures, options, swaps, derivatives and similar instruments, invoices and all types of receivables, obligations evidencing debt (including loans and deposits), leases and loan and lease portfolios, hire purchase contracts, acceptance credits and all other documents of title relating to the movement of goods, and bills of exchange, greenhouse gas emissions allowances, contracts for insurance and contracts for re-insurance, commercial paper, promissory notes and all other kinds of negotiable or transferable instruments.

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

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

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

## Financing & Withholding Tax

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

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

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

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

- (A) If the person by or through whom the payment is made is resident in Ireland:
  - (a) the debt security has a maturity of less than 2 years; and
  - (b) either (i) the debt security is held in a recognised clearing system and issued in minimum denominations of US\$500,000 or €500,000 **or** its foreign currency equivalent or (ii) the person beneficially entitled to the interest is resident in Ireland and has provided their tax reference number to the person making the payment, **or** (iii) the person who is the beneficial owner of the debt security and who is entitled to the interest is not resident in Ireland and has made a declaration to that effect.

OR

- (B) If the person by or through whom the payment is made is not resident in Ireland:
- (a) the debt security has a maturity of less than 2 years; and
  - (b) the notes are held in a recognised clearing system; and
  - (c) the notes are issued in minimum denominations of US\$500,000 or €500,000 or its foreign currency equivalent.

## Profit Extraction

### **Profit Participating Loans/Notes**

Interest payments (even those which vary with the Section 110 company's profits) made by the Section 110 company (on moneys raised to enable it to hold or manage qualifying assets) will generally be tax deductible. It is typically possible to structure the Section 110 company so that investors hold debt (for Irish tax purposes) but which has many of the characteristics of equity (i.e. profit participating, deeply subordinated, very long term, participation in an additional return on liquidation of the Section 110 company etc). It is common for such debt to be recognised as debt for Irish tax purposes while for example recognised as equity for US tax purposes.

### **Other tax deductions**

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

## Stamp Duty

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

## Value Added Tax (VAT)

A Section 110 company will not be subject to Irish VAT on its activities. However, to the

extent to which it suffers any Irish VAT (which if structured properly should be minimal) it may be able to recover all or a percentage of its VAT costs depending on where the assets of the Section 110 company are located. If the Section 110 company is investing in non-EU assets, it will be able to recover 100% of any Irish VAT input costs.

## Transfer Pricing

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

## Revenue Notification

In order to avail of Section 110 status it is necessary that the qualifying company completes and submits to the Irish Revenue a Section 110 notification form before the end of its first accounting period. This is only a one-page notification containing minimal detail with no Revenue ruling required.

## Double Tax Treaties

Ireland has a large tax treaty network which is continually expanding. It has signed double taxation agreements with 59 countries, of which 49 have the force of law. A list of countries with which Ireland has ratified tax treaties and with whom Ireland has signed but not yet ratified tax treaties is included in Appendix I.

## International Accounting Standards (IAS)

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

## Irish Corporate Structure and Related Matters

Irish SPVs can be established as either limited or unlimited private or public companies under the Companies Acts 1963-2009. Up until 2006, many structured finance and securitisation transactions required the use of a public limited company where there was a “public” offer of securities but this changed following the enactment of the Investment Funds, Companies and Miscellaneous Provisions Act 2006 (the “**2006 Act**”) in December 2006. As a result, private limited companies are now the most common form of business entity used in Ireland.

### Debt Offers

Private companies can make the following types of offers of debt securities:-

- ▣ an offer addressed solely to qualified investors;
- ▣ an offer addressed to less than 100 persons (other than qualified investors);
- ▣ an offer where the minimum consideration is at least €50,000 per investor for each separate offer;
- ▣ an offer of debt securities whose denomination per unit amounts to at least €50,000;
- ▣ an offer of debt securities where the offer limits the amount of the total consideration for the offer to less than €100,000;
- ▣ an offer of classes of instruments which are normally dealt in on the money market (such as treasury bills, certificates of deposit and commercial papers) having a maturity of less than 12 months.

The most common exemption for most Section 110 transactions is where the notes or bonds issued by the SPV have a minimum denomination of €50,000. This is usually the case for non-retail offerings to get around the provisions of the Transparency Directive.

### Private Companies

The essential features of a private limited company are that the liability of shareholders is limited to the amount of share capital subscribed and certain obligations imposed on public limited companies do not apply to private limited companies.

The main advantages of using a private limited company are that:

- (i) it usually takes no more than five working days for a private company to be registered with the Companies Registration Office;
- (ii) the minimum number of shareholders is 1;
- (iii) the minimum issued share capital is €1 (the requirement for a PLC is approximately €40,000);
- (iv) there is no requirement to obtain a certificate of entitlement to do business/trading certificate and so the SPV can be ready to start trading with five working days;
- (v) for US federal income tax purposes, a private company may elect to be treated as a flow-through or corporate entity (whereas public limited companies automatically default to corporate tax treatment).

### **Public Companies**

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

It can take up to three weeks from the date of filing registration documentation with the Companies Registration Office for a certificate of entitlement to trade to issue for a plc.

### **Audit Committee Exemptions**

The European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations, 2010 (S.I. 220 of 2010)(the “**Regulations**”) give effect in Ireland to Directive 2006/43 EC on statutory audits. While the Regulations contain provisions on many aspects of auditing, they also require the board of directors of “public-interest entities” to establish an audit committee.

For the purposes of the foregoing, a “**public-interest entity**” is defined as including, *inter alia*, (a) companies or other bodies corporate governed by the laws of an EU Member State whose transferable securities are admitted to trading on a regulated market of any Member State (in Ireland this means the Main Securities Market of the Irish Stock Exchange), (b) credit institutions and (c) insurance undertakings. This requirement commences six months after the date of the Regulations coming into force, thus giving an operative date of 20 November 2010.

This is unlikely to be relevant for many of the Section 110 entities that have been formed in Ireland except where the Irish SPV has listed its debt on a regulated market of an EU member state. However, in such circumstances, there may be some exemptions available. For example, if the sole business of the Irish SPV relates to the issuing of “asset backed securities” (as defined in Commission Regulation (EC) No 809/2004), the SPV may be able to avail of an exemption from the requirement to establish an audit committee (under Regulation 91(9)(d) of the Regulations). In order to do so, the Irish SPV must include a statement in its annual report, or in an annual return or other periodic statement delivered by it to a competent authority, explaining why it considers that the establishment of an audit committee is not appropriate for it.

For further information in relation to the Regulations, please see our other publications available on our website or contact any member of our Banking & Capital Markets team.

### **Ongoing Obligations**

An Irish SPV as well as having to file annual tax returns will also have to prepare and file annual audited accounts with the Companies Registration Office.

An SPV will also need to file details of all “charges” over its assets with the Companies Registration Office within 21 days of the creation of such charges to preserve their priority.

In addition, a Section 110 company (which is Irish incorporated – it is possible to have a non-Irish incorporated Section 110 company which is Irish tax resident) must have a registered office located in Ireland and maintain its books and records at a designated location. An Irish incorporated company must have a minimum of one director resident in the EEA (which is a state that is a contracting party to the Agreement on the European Economic Area signed in Oporto on 2 May 1992) although in practice there are normally two Irish resident directors in order to ensure that the Section 110 company is tax resident in Ireland under the central management and control test.

It should be noted that the maximum number of directorships which a person may hold in a private company is 25 so this should be borne in mind when selecting an appropriate director of the SPV.

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

Regulation EC No. 24/2009 of the European Central Bank concerning statistics on the assets and liabilities of financial vehicle corporations (“FVCs”) engaged in securitisation transactions (ECB/2008/30) (the “FVC Regulation”) imposes reporting obligations on many categories of FVCs resident in a Member State that are involved in securitisation transactions. This may not be relevant to all section 110 vehicles.

#### **Listing debt securities of SPVs on the Irish Stock Exchange**

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

The Irish Stock Exchange has a turnaround time of maximum of 3 working days on the initial draft followed by a 2 day turnaround on subsequent drafts.

**APPENDIX I**

List of the 59 Countries with whom Ireland currently has a Double Taxation Agreement that has been signed, of which 49 currently have force of law.

- ▣ \*Albania (signed 16 October 2009)
- ▣ Australia
- ▣ Austria
- ▣ \*Bahrain (signed 29 October 2009)
- ▣ Belarus
- ▣ Belgium
- ▣ \*Bosnia & Herzegovina (signed 3 November 2009)
- ▣ Bulgaria
- ▣ Canada
- ▣ Chile
- ▣ China
- ▣ Croatia
- ▣ Cyprus
- ▣ Czech Republic
- ▣ Denmark
- ▣ Estonia
- ▣ Finland
- ▣ France
- ▣ \*Georgia (effective from 1 January 2011)
- ▣ Germany
- ▣ Greece
- ▣ \*Hong Kong (signed 22 June 2010)
- ▣ Hungary
- ▣ Iceland
- ▣ India
- ▣ Israel
- ▣ Italy
- ▣ Japan
- ▣ Korea
- ▣ Latvia
- ▣ Lithuania
- ▣ Luxembourg
- ▣ Macedonia
- ▣ Malaysia
- ▣ Malta

- ▣ Mexico
- ▣ \*Moldova (effective from 1 January 2011)
- ▣ \*Morocco (signed 22<sup>nd</sup> June 2010)
- ▣ Netherlands
- ▣ New Zealand
- ▣ Norway
- ▣ Pakistan
- ▣ Poland
- ▣ Portugal
- ▣ Romania
- ▣ Russia
- ▣ \*Serbia (effective from 1 January 2011)
- ▣ Slovak Republic
- ▣ Slovenia
- ▣ South Africa
- ▣ Spain
- ▣ Sweden
- ▣ Switzerland
- ▣ \*The Republic of Turkey (effective 1 January 2011)
- ▣ \*United Arab Emirates (signed 1 July 2010)
- ▣ United Kingdom
- ▣ United States
- ▣ Vietnam
- ▣ Zambia

\*The Republic of Ireland has signed a double taxation agreement and although not yet in force has the force of law by virtue of section 826 (1) TCA 97. Consequently Ireland will allow dividends, interest and patent royalties etc to be paid gross to the above countries free of withholding tax even though the new agreements are not yet in force.

Negotiations for new agreements with Armenia, Kuwait, Montenegro, Saudi Arabia, Singapore and Thailand have been concluded and are expected to be signed shortly.

Negotiations for new agreements with the following countries are at various stages: Argentina, Azerbaijan, Egypt, Tunisia, and Ukraine.

It is also planned to initiate negotiations for new agreements with other countries during the course of 2010.

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

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