

Ireland

Taxation

HEDGE FUNDS 2009

Hedge fund managers/advisors

Taxation

Tax rates applying to hedge fund managers/advisors

The tax advantageous regime that applied to the Irish International Financial Services Centre (IFSC) ceased with effect from 31 December 2005. Since that date financial services businesses that are tax resident in Ireland pay tax at standard corporation tax rates. The standard rates of Irish corporation tax are 12.5 percent on income where that income arises from an activity that constitutes a trade for Irish tax purposes and 25 percent on non-trading or passive income.

The effective tax rate usually suffered by hedge fund managers/advisors

Most Irish hedge fund managers are structured as Irish incorporated, Irish tax resident companies. The effective tax rate is normally 12.5 percent. However, this will increase to the extent the company generates passive income which is taxable at 25 percent. There are no adjustments that are specific to hedge fund managers that impact on the effective tax rate.

Tax concessions, allowances, or exemptions specifically available to hedge fund managers/advisors

There are no concessions, allowances, or exemptions that are specifically available to Irish hedge fund managers/advisors.

Details of anti-avoidance tax rules that could bring the profits of an offshore hedge fund into tax

Section 1035 TCA 1997 can result in a non-Irish fund with an Irish based investment manager becoming taxable in Ireland. Generally Section 1035 should only apply where the activities carried on by the Irish investment manager are sufficient to constitute a trade of the non-Irish fund for Irish tax

purposes. This could be the case for hedge funds and other alternative types of investment vehicles where very high volumes of trades are executed by the investment manager in Ireland. However, it should be less of a concern for traditional long only funds or a UCITS.

Where Section 1035 would otherwise apply, there is a safe harbor for regulated fund managers that are independent of the non-Irish fund. The conditions for this safe harbor are outlined in Section 1035A TCA 1997. Broadly Section 1035A requires that:

- the investment manager is regulated under Section 10(1) of the Investments Intermediaries Act 1995 or certain EU Directives; and
- the investment manager is not entitled to more than 20 percent of the profits of the non-Irish fund.

Under general Irish tax principles, the offshore fund's profits will be brought within the charge to Irish tax if the offshore fund is managed and controlled in Ireland. In determining where an entity is managed and controlled, one generally looks at the highest level of control of the activity and the place where the company's board of directors (or similar body for non-corporate) meets is indicative of the place of central control. Therefore if the meetings of the directors who exercise control over the offshore funds are held in Ireland or the Irish based manager controls the fund this would point to the offshore fund being managed and controlled in Ireland. Where control is in fact exercised by a single individual, the place of residence of the offshore fund will be the place where that individual exercises such powers.

Requirements to charge VAT (or equivalent sales tax) and the rate

Under Irish VAT legislation, a supply will only be subject to Irish VAT if the place of supply is in Ireland. Investment management services are normally considered to be supplied where received (the reverse charge principle). Therefore where an Irish fund manager is providing an offshore fund with investment management services, the place of supply of investment services is likely to be where the recipient is located (that is, where the offshore fund is established). As a result, the provision of investment management services by an Irish fund manager to the fund is likely to be outside the scope of Irish VAT. In addition the Irish fund manager may be entitled to recover input VAT.

Where the fund is an Irish regulated fund the provision of fund management services should be exempt from Irish VAT. Irish regulated funds may also be able to recover VAT suffered. The broad principle is that VAT suffered is recoverable to the extent the fund has non-EU investments.

An Irish fund manager should be able to recover input VAT associated with the provision of fund management services to non-Irish funds. However, recovery is more limited for services to Irish funds.

Hedge fund structures

Taxation

Tax rates applying to the fund

General

To ensure favorable tax treatment in Ireland, investment funds should be established as regulated funds (see details re different levels of regulation in the Irish regulation section). Irish regulated funds are not chargeable to tax on income or gains except on a gain arising on a chargeable event.

Chargeable events include:

- distributions;
- redemption of units;
- repurchase of units;
- transfer of units;
- cancellation of units; and
- end of each eight year period that the investment in the investment undertaking is held by the investor.

Gains arising will be subject to tax at differing rates depending on the type of chargeable event. Normally regular distributions will be taxed at the standard rate of income tax plus 3 percent (currently 23 percent). All other chargeable events (that is, bullets two through six above) are normally taxed at the standard rate of income tax plus 6 percent (currently, 26 percent). The rate of tax increases to the standard rate plus 26 percent (currently 46 percent) where the fund is considered a Personal Portfolio Investment Undertaking (PPIU). The definition of a PPIU is complex, but broadly a fund is a PPIU in relation to an investor where the investor has or may exercise influence over the selection of assets held by the fund.

Irrespective of the rate of tax applied, the fund generally recovers the tax due on a distribution from the unit holder giving rise to the chargeable event and in the case of tax arising on a transfer of units; the fund must expropriate sufficient units from the unit holder equivalent in value to the required tax. It is important to note that such an expropriation of units to satisfy a tax liability is in itself a chargeable event that is liable to tax. Exemptions to this tax charge exist where the chargeable event is triggered in respect of certain unit holders.

Non-residents

Tax will not arise on the occurrence of a chargeable event where the shareholder giving rise to the chargeable event is non-Irish tax resident and has completed a declaration to that effect in the Revenue Commissioners required format.

Exempt Irish investors

Similar to non-residents, certain classes of Irish tax resident investors including pension schemes, charities, other funds, life companies, etc. can also file a declaration with the fund to ensure tax does not arise in relation to a chargeable event.

Access to double tax treaties

If the fund is Irish tax resident it should have access to a wide range of tax treaties. However, not all of Ireland's treaty partners allow treaty access to such funds. As a result, there can be practical problems obtaining reductions in withholding tax.

Value-added tax registration and charging requirements

For Irish VAT purposes, an Irish regulated fund is engaged in exempt financial services and is therefore not obliged to charge VAT. It may be able to recover VAT charged to it to the extent its investments are outside the EU.

The fund may, however, be obliged to register and self account for VAT if it receives certain specified services from outside Ireland, including consultancy and advertising services. Fund management services and most custodial services supplied to an Irish fund are specifically exempt from Irish VAT.

Irish VAT on services which are not exempt is generally at 21.5 percent.

Withholding tax on dividends or interest payments

There are specific exemptions from Irish interest and dividend withholding tax for payments by Irish regulated funds. However, as discussed above, tax may arise in respect of chargeable events above.

Tax return requirements

The Fund is not required to file a comprehensive annual income or corporation return. It must however file a simple one page return bi-annually covering the tax deducted on chargeable events arising within the period.

Investors

Taxation

There are no hard and fast rules for Irish investors preferred structure. Irish investors can be grouped into three broad groupings; individuals, non-tax payers and institutional investors. While investment into transparent funds is not common for Irish tax resident investors, the general principles for each grouping are as follows:

Individuals

Individuals generally prefer to invest in Irish funds or funds tax resident in either:

- a member state of the EU or EEA; or
- an OECD country with which Ireland has concluded a double taxation agreement (DTA).

Open-ended funds based elsewhere are generally not very attractive to Irish investors from a tax perspective.

An individual's preference for regulated or non-regulated will vary depending on whether the individual is seeking income or capital appreciation. Generally for income an EU/EEA or DTA (and OECD) regulated fund is preferable, whereas for capital appreciation a non-regulated EU/EEA or DTA (and OECD) fund is preferable. The anti avoidance rules referred to above could also impact.

Non-taxpayers

Non-tax payers such as Irish pension schemes, charities, and regulated funds should be largely indifferent in relation to the legal nature of the investment. Two factors that could impact are:

- the extent to which withholding tax is suffered within the structure (if significant transparency may be preferable depending on the circumstances); and
- how actively the fund trades (if the fund was considered to be carrying on a trade for Irish tax purposes, pension schemes, and charities would prefer a non-transparent fund as otherwise they could lose their tax exemption in respect of such income).

Institutional investors

An institutional investor's preference should be determined by whether or not they are carrying on a financial trade for Irish tax purposes.

Where the investor holds the investment on trading account they may prefer a transparent entity where withholding tax is suffered within the fund. Where the withholding tax is not significant they should be indifferent as all the income and gains should be taxed on an accruals basis at 12.5 percent.

Where the investment is not held on trading account there may be a preference for non-transparent as taxation would generally be on the basis of payments made (rather than accruals).

Specific anti-avoidance tax legislation applying to an investor in an onshore fund

The Finance Act 2007 introduced new measures that may impact on the taxation of Irish individual investors in Irish and non-Irish funds. The measures increase the rate of tax where the fund is considered a personal portfolio investment undertaking. Broadly this could be the case where the investor can select or influence the assets held by the fund. This is unlikely to be the case for widely held funds.

Specific anti-avoidance tax legislation applying to an investor in an offshore fund

There is some anti-avoidance legislation that could apply to an Irish investor in an offshore fund as follows:

For investments by Irish investors in non-Irish funds there are essentially three regimes under which the return could be taxed:

- Regulated funds resident in the EU/EEA or OECD member countries with which Ireland has concluded a DTA

For non-Irish EU/EEA or DTA (and OECD) regulated funds income and gains are taxed at the same rates as for Irish funds that is, 23 percent and 26 percent respectively (increases to 46 percent or 64 percent where the fund is a personal portfolio investment undertaking).

- Unregulated funds resident in the EU/EEA or OECD member countries with which Ireland has concluded a DTA

The Finance Act introduced different rates of tax for non-Irish EU/EEA or DTA (and OECD) based non-regulated fund investors. Where the non-Irish fund is not regulated in a similar manner to an Irish fund income is taxed at marginal rates and gains are taxed at 22 percent.

- Other non-Irish funds

The offshore fund rules apply if an investor has a material interest in an offshore fund. An interest in an offshore fund is likely to be a material interest

if it can reasonably be expected that the investor will be able to realize its interest at NAV within seven years of acquisition. The effect of the offshore fund rules is that any gain realized on the disposal of the interest in the offshore fund will be taxed as an income gain rather than a capital gain.

Tax information needs of investors

An Irish tax resident should only require details of distributions, acquisitions and disposals in respect of the offshore fund. Details are not normally required for tax purposes in relation to the income, gains, loss, etc. within the offshore fund.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.