

CONTENTS

Securitisation and Structured Finance	1
Carbon Credits	1
Insurance and Reinsurance Securitisations	1
Partnerships	2
Profit Resource Rent Tax	2
Accelerated Capital Allowances for Energy Efficient Equipment	2
Overseas Dividends	3
Investment Funds	4
Relieving Provisions on Deemed Disposals	4
Relief from Capital Gains Tax and Stamp Duty	4
Transfer of Assets	4
E-Stamping	5
Extensions of Relief for R&D Expenditure	5
Pre-Sale Dividends	5
Convertible Shares / Securities	6
Construction Sector - Reverse Charge Procedure for Vat	7
VAT on Property	7
Contact	8

■ THE FINANCE ACT 2008

■ Securitisation and Structured Finance

In recent years, Ireland has become an increasingly popular jurisdiction for the establishment of special purpose securitisation vehicles for structured finance and securitisation transactions, particularly repackagings, synthetic and cash flows CDOs, asset backed commercial paper programmes, credit card receivables, mortgages, loan participation note structures and a host of other receivable financing transactions. The favourable tax laws which apply to securitisation vehicles established under Section 110 of the Taxes Consolidation Act 1997 enable such vehicles to be, in most cases, tax neutral. The securitisation amendments introduced in the Finance Act should enable Ireland to continue to develop as a centre for vehicles that deal in carbon credits as well as insurance securitisations and transactions in partnership interests. These are dealt with separately below.

Carbon Credits

The Finance Act 2008 allows Irish securitisation vehicles established under Section 110 of the Taxes Consolidation Act 1997 to acquire all types of greenhouse gas emissions allowances and interests in such greenhouse gas emissions allowances (e.g. contracts to acquire greenhouse gas emissions allowances etc.).

More generally, the Finance Act 2008 confirms that no stamp duty will arise in Ireland on the acquisition of greenhouse gas emissions allowances or any interest in such allowances.

In addition to the changes in the Finance Act, the Revenue Commissioners of Ireland have also recently confirmed the VAT treatment that will apply transactions in greenhouse gas emissions allowances. This clarification is important as it confirms that VAT suffered by vehicles that are dealing in greenhouse gas emissions allowances in Ireland should be recoverable.

In our view the above changes are substantial developments and should result in Ireland developing as a location of choice for vehicles dealing in the carbon credit markets.

Insurance and Reinsurance Securitisations

The Finance Act 2008 introduces a legislative basis for securitisations of insurance and reinsurance policies. Previously, the Revenue Commissioners had given confirmations on a case by case basis that such contracts of insurance and reinsurance were “qualifying assets” (i.e. they were assets that could be held by an Irish securitisation vehicle).

Partnerships

In the past, opinion had been divided on whether a partnership interest was a “qualifying asset”. This firm had taken the view that certain partnership interests could be “qualifying assets” so long as either (i) the partnership interest was itself a financial asset (e.g. an interest in a mutual fund or collective investment scheme that was structured as a partnership) or (ii) the partnership itself was transparent under its governing law (e.g. an English law general or limited partnership) and the underlying assets were themselves “qualifying assets” .

The Finance Act 2008 removes this uncertainty and confirms that an interest in financial assets held through a partnership is a “qualifying asset”.

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Profit Resource Rent Tax

The Finance Act 2008 introduces a Profit Resource Rent Tax which applies to any petroleum lease in respect of an Irish field entered into pursuant to an exploration licence awarded by the Irish Minister for Communications, Energy and Natural Resources after 1 January 2007. This tax will be charged in addition to the normal corporation tax rate of 25% that currently applies to profits from petroleum extraction activities in Irish territory.

The tax applies when the “Profit Ratio” of a “Taxable Field”, as calculated for an accounting period of a company, is greater than or equal to 1.5.

A “Taxable Field” is an area (e.g. of land, sea bed etc.) in respect of which a petroleum lease has been entered into following on from an exploration licence that was granted by the Irish State.

The “Profit Ratio” is broadly:

(a) the total cumulative profits derived from the field from 1 January 2007, less any losses incurred and after corporation tax has been paid over;

divided by

(b) the total cumulative expenditure on the field from 1 January 2007.

The Profit Ratio is calculated in each accounting period. The new tax is only imposed where the Profit Ratio exceeds 1.5 in that accounting period. The rate of the new tax increases if the Profit Ratio for that accounting period increases and is levied as follows:

Profit Ratio	Profit Resource Rent Tax
4.5 or more	15%
3 - 4.5	10%
1.5 - 3	5%
Less than 1.5	Nil

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Accelerated Capital Allowances for Energy Efficient Equipment

The Finance Act proposes to introduce a scheme whereby certain designated classes of energy efficient equipment purchased for the purposes of a trade will benefit from accelerated capital allowances. The classes of eligible equipment and the relevant criteria will be specified in a list to be prepared by the Minister for Communications, Energy and Natural Resources and the list will subsequently be maintained by Sustainable Energy Ireland. The scheme will initially run for a trial period of three years.

The particular tax benefit is that capital allowances of 100% (i.e. a full deduction) will be available in the first year in which the expenditure is incurred on the equipment covered by the

scheme. Expenditure must be above a certain threshold in order to avail of the increased allowance. The designated technology classes and relevant thresholds are as follows; (i) €1,000 for motors and drives; (ii) €3,000 for lighting; and (iii) €5,000 for building energy management systems. The Act clearly states that the scheme is limited to new energy-efficient equipment purchased by companies, and will not extend to equipment that is leased, let or hired. The allowance is not available to individuals or other non-companies.

The scheme is subject to EU approval and will therefore be introduced by means of a commencement order. It will apply to qualifying expenditure incurred in a three-year period from the date of the commencement order. It is intended to bring Ireland into line with other jurisdictions in providing 100% relief for energy efficient expenditure. It is not yet clear precisely what equipment will qualify for the accelerated allowances and we await regulations to clarify this point.

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Overseas Dividends

Countries adopt different approaches to corporate taxation of dividends. Historically Ireland has adopted a hybrid system. Dividends received by an Irish resident company from another Irish resident company are generally tax free. Dividends from non-Irish companies are generally taxable at 25%. In the past few years an increasingly flexible credit system has developed which permits a credit for foreign underlying tax and foreign withholding tax. An on-shore pooling system eliminates tax on dividends received in most corporate structures. The pooling system permits surrender of excess credits within a corporate group and an indefinite carry forward. If double taxation relief available under a treaty is

less generous than unilateral relief, the Irish recipient company may claim unilateral relief.

The Finance Act can reduce the rate of Irish tax applicable to dividends paid out of trading profits of companies resident in an EU member state or a country with which Ireland has a double tax treaty ("trading dividends"). The paying company/group must meet certain trading-related conditions including that the trade must not relate to an excepted trade (e.g. mining activities) for Irish tax purposes. Trading profits may be traced through tiers of intermediate holding companies for these purposes. An Irish resident company in receipt of trading dividends can elect to treat all (but not some) trading dividends as being subject to tax at the 12.5% rate of tax. The Irish resident company can claim credit for tax on the profits out of which the trading dividend was paid and any excess credit can be used to set off against tax on other trading dividends only.

Dividends other than trading dividends ("non-trading dividends") will generally continue to be subject to tax at the 25% rate and any excess credit from non-trading dividends can be used to offset tax on both trading dividends and non-trading dividends. Interestingly however, where an Irish resident company receives dividends from an investment in a company resident in the EU or a country which has a double taxation agreement with Ireland in respect of a portfolio shareholding (i.e. a shareholding of 5% or less) those dividends will be taxed at 12.5% irrespective of whether they are derived from trading profits or not.

The new regime is intended to eliminate the previous anomaly whereby dividends from non-Irish trading companies were taxed at the 25% rate yet had such profits been earned from an Irish trade, they would have been taxed at the 12.5% rate. The new rules will apply to dividends received on or after 31 January 2008 if an election is made. The new legislation seems to be compliant with recent ECJ caselaw as enunciated in the Cadbury Schweppes case.

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Investment Funds

The Finance Act 2008 contains good news for the Irish investment funds industry as it will ease the tax administration burden arising out of the deemed disposal rules introduced in the Finance Act 2006 and extends relief for reconstructions and amalgamations of funds to include reconstructions and amalgamations of umbrella funds. It also contains an anti-avoidance measure to prevent the tax-free transfer of assets to an Irish corporate investment undertaking which counters a scheme used principally by Irish property companies.

4

Relieving Provisions on Deemed Disposals

Investment funds authorised in Ireland operate under a gross roll up tax regime. Exit tax is deducted by the fund in respect of distributions made for and on redemptions /disposals by investors. However, the Finance Act 2006 introduced deemed disposal rules under which Irish resident or ordinarily resident investors in an Irish authorised fund within the charge to Irish tax, are deemed to dispose of their shares / units on the eighth anniversary of the holding of those shares / units and every eight years thereafter, in respect of shares / units acquired on or after 1 January 2001. The fund must account to the Revenue Commissioners for this tax liability in the same way as if the investor had made an actual disposal of shares / units. This change had no effect on non-Irish investors. This legislation would have necessitated all fund administrators enhancing their systems to track, value and calculate the tax arising on deemed disposals and, where relevant, deal with any tax refund arising on a subsequent disposal, even where a very small amount of the value of the fund was held by Irish resident or ordinarily resident taxable investors. The Finance Act 2008 provides relief for Irish funds from the most difficult aspects of the administration of this eight year deemed disposal rule.

First, it allows a fund to elect irrevocably to value any shares / units which are subject to the deemed disposal provisions as at 30 June or 31 December prior to the date of the deemed disposal event, rather than at the actual date of the deemed disposal event. This will ease the burden for Irish funds by reducing the number of valuation dates for deemed disposals

More importantly, where less than 10% of the value of a fund is held by Irish resident or ordinarily resident taxable persons, a fund can elect not to deduct and account for exit tax in respect of a deemed disposal and, instead, to report annually certain details of the investor to the Revenue Commissioners. Where a fund makes such an election, it must inform the relevant investors who will be obliged to self-assess the tax on the deemed gain arising and to pay the appropriate tax thereon. In the case of umbrella funds, this 10% rule applies at the sub-fund level.

Furthermore, where the value of a fund held by Irish resident or ordinarily resident taxable persons is less than 15%, a fund can elect not to deal with any tax refunds arising out of tax paid on a deemed disposal. Any such refund would be repaid directly by the Revenue Commissioners to the investor.

These relieving provisions will ease the administrative burden placed on those Irish funds that have Irish resident taxable investors and it is expected that the new “de minimis” rules will have the effect of permitting the majority of Irish funds to opt out of accounting for tax on deemed disposals.

Relief from Capital Gains Tax and Stamp Duty

The Act also contains new provisions which extend the relief from capital gains tax currently available on the reconstruction or amalgamation of funds to the reconstruction/ amalgamation of umbrella funds. Under these provisions, an exchange of shares / units in a sub-fund of an umbrella fund for shares / units in a sub-fund of a different umbrella fund will be disregarded for tax purposes, provided it is a bona fide commercial transaction. In addition, the Act introduces an exemption from stamp duty on the reconstruction or amalgamation of Irish authorised funds and also on an exchange of shares / units in a sub-fund of an umbrella fund for shares / units in a sub-fund of a different umbrella fund, provided the particular transaction is undertaken for bona fide commercial reasons.

Transfer of Assets

The Finance Act introduces an anti-avoidance provision targeted at structures used by certain Irish real estate companies. The measure disapplies the tax-free intra-group and

reconstruction rules where assets are transferred to an Irish regulated fund that is a company. Transferring assets to a fund in these circumstances will now no longer be tax free. This anti-avoidance provision was introduced to counter a specific tax planning scheme and so its scope will be limited.

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E-Stamping

The Finance Act introduces a number of amendments designed to facilitate the introduction of e-stamping of documents next year. The system contemplated will in the majority of cases allow taxpayers and advisors to file, pay and receive a stamp for instruments online, without having to present the documents to the Revenue. It is expected that this self-service e-stamping system will be up and running in the second quarter of 2009.

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Extensions of Relief for R&D Expenditure

Groups of Irish resident companies are entitled to a tax credit in respect of expenditure incurred by the group on research and development. The tax

credit is equal to 20% of the difference between the group's expenditure on research and development carried out in Ireland / EU in the year in question and its expenditure on research and development in 2003 (the "base year"). For start up operations or companies with no presence in Ireland in 2003, this means all of the expenditure incurred on research and development will qualify for the relief. For other companies, this means that the only incremental expenditure incurred on research and development in a particular year over and above that incurred in 2003 will qualify for relief. The tax credit given to the group can be allocated to group companies in such manner as they see fit. These companies can use the credit to offset current corporation tax liabilities and, to the extent that credits remain unused, they can be carried forward indefinitely.

Under the Finance Act, the tax credit will continue to be calculated by reference to the 2003 base year (as described above) until 2013. Thereafter, the base year will be the year which is 10 years prior to the relevant accounting period in which the expenditure is incurred (e.g. for 2014 the base year will be 2004, for 2015 the base year will be 2005 etc.).

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Pre-Sale Dividends

The Finance Act introduces a new anti-avoidance provision which affects dividends paid from an Irish resident company to another company in connection with disposals of shares in a company. It deems the dividend to be part of the consideration for the sale for all Irish tax purposes. It is aimed at preventing shareholders from using pre-sale dividends to strip value from shares in Irish resident companies prior to selling those shares. The rule only applies where there exists a scheme, arrangement or understanding whereby an "abnormal dividend" is paid by a

company to its corporate shareholders or to companies connected with them. However, they do not apply where the scheme, arrangement or understanding is effected for bona fide commercial reasons and, not, with the main purpose of avoiding a tax liability.

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6

Convertible Shares / Securities

The Finance Act 2008 provides for a new tax treatment for directors and employees who acquire convertible shares / securities (that is, securities, which includes shares, which are capable of being converted into other securities or money or money's worth) in a company by virtue of being a director or employee of that company or of another company.

Previously, a grant of securities to an employee / director only gave rise to a tax charge if the market value of the securities at the date of grant exceeded the consideration paid by the employee / director for the grant of securities. This meant that shares with very limited rights (save for conversion rights) which had a very low market value, could be issued to employees/directors without a material charge to income tax. Those securities could subsequently be converted into more valuable securities without triggering a charge to tax for the employee. Subsequent disposals were usually subject to preferential capital gains tax rates and no income / payroll taxes.

The new provisions which apply in respect of convertible securities acquired after 31 January 2008. As before, there is a charge to income tax on the grant of such securities on the difference between the market value of the securities at grant and the consideration paid (save where the securities are acquired under an arrangement for

the avoidance of tax, see below). The new rules impose an additional charge to income tax on a conversion of the securities into securities of a different description, a pre-conversion disposal of securities, a release for consideration of the conversion rights or the receipt of a benefit in money or money's worth in connection with the conversion rights.

The amount chargeable to income tax is determined under specific rules but broadly speaking will equate with (i) the increase in the market value of the securities or (ii) the consideration received, in each case, less any consideration paid or related expenditure incurred by the director / employee.

In addition, the new rules provide that where the "employment related" securities are part of a tax avoidance arrangement, the market value of the securities on grant will be determined as if the securities are immediately convertible (assuming this gives a higher value) and the difference between this value and the consideration paid will be subject to income tax.

Exceptions

There are a number of important exceptions to the new provisions. For instance, they do not apply where:

1. the securities are of a class all of which are convertible, are affected by the same event which would otherwise be a chargeable event and the majority of which are not held by employees/directors; or
2. the remuneration from the office or employment are not within the charge to Irish tax when the convertible securities are acquired (i.e. employees moving to Ireland should be granted shares before becoming Irish resident).

Overview

These changes are likely to impact on the use of convertible share schemes which heretofore have been popular and seen as a tax efficient means of remunerating directors and employees. In addition, whilst historically it has been possible for foreign share schemes to be implemented directly for Irish directors / employees without major changes to these schemes, this may no longer be possible as a result of these changes.

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Construction Sector - Reverse Charge Procedure for Vat

The Finance Act introduces a new reverse charge procedure for VAT in respect of supplies by subcontractors to principal contractors in the construction sector. With effect from 1 September 2008, a subcontractor in the construction sector will no longer charge VAT on supplies to the principal contractor. Instead, the principal contractor in receipt of those services will self-account for the VAT due under the reverse charge mechanism and take a deduction for that VAT, if the principal contractor is so entitled.

Where a supply of construction and non-construction services are supplied it will be necessary to split that portion of the unitary charge that is subject to VAT between supplies to which the reverse charge procedure will now apply and “normal” supplies.

The new rules are designed to enhance VAT compliance in the construction sector but will also result in cash flow savings on transactions between subcontractors and their principals. Principals will now account for output VAT and claim a corresponding input credit in the same tax return rather than paying the VAT to the subcontractor and then claiming the VAT back through their tax returns.

The amendments are effective from 1 September 2008. It is essential that principal contractors review their contractual arrangements to reflect these changes and ensure that, in practice they do not inadvertently pay VAT to subcontractors going forward as such VAT would not be recoverable.

VAT on Property

The Finance Act 2008 has made substantial changes to the way in which VAT is charged on property transactions. It applies with effect from 1 July 2008. In brief, the new regime means that sales of freehold interests (and freehold equivalent interests such as 999 year leasehold interests) will be subject to VAT if the property is “new” (i.e. if the property has been completed or substantially developed in the last five years and, if the sale is the second or subsequent sale since such completion or development, the property has been occupied for less than two years). In all other cases, such sales will be exempt from VAT but both parties can opt to charge VAT.

The VAT treatment of leasehold interests (other than leases that are economically equivalent to freeholds) has also changed substantially. Formerly, VAT was charged on the granting of lease for a term of more than 10 years upfront by reference to a capitalised value of the lease. Under the new rules, all leases are prima facie exempt from VAT, irrespective of their term. However, the landlord (without reference to the tenant) can exercise an option to charge VAT in respect of the lease. In that circumstance, the supply of the property under the lease (e.g. rent and premium) will become subject to VAT at a rate of 21%. However, this option to tax is not available in certain circumstances, e.g. where the landlord and tenant are connected to each other (by reference to a broad definition of “connected”) and the tenant has less than 90% VAT recoverability; where the landlord is connected to an occupant of the property; or where the property is used for residential purposes.

Perhaps the most radical change to the VAT on property regime is the introduction of a capital goods scheme (“CGS”). The purpose of the CGS is to monitor the use of the property over a certain period in order to determine entitlement to input

VAT deduction on acquisition or development costs. Each property is given a life (which is generally 20 years or 10 years in the case of refurbishments) (the “CGS Life”). The use of the property and the entitlement to VAT deductibility is established in year one (the “base year”). Every year thereafter during the CGS life, a comparison is done with the base year and, in general terms, if the use of the property for taxable purposes has increased as against the base year, an extra VAT deduction becomes available. If the property is used less for taxable purposes than in the base year, a VAT clawback may arise. If the property is sold within its CGS Life and the sale is VAT exempt or if a lease is granted of the interest which is VAT exempt, a VAT clawback could also arise.

Transitional provisions have been introduced to deal with property interests held on 1 July 2008. Where clients have waivers of exemption in place (which applied to lettings of less than 10 years and allowed the landlord to charge VAT on the rent) in most circumstances, these existing waivers can continue in place. However, waivers of exemption in place with connected tenants may be affected by the new rules and in that event, a VAT clawback could arise. Clients should therefore review all waivers of exemption currently in place.

In general terms, the VAT treatment of residential property has been largely unaffected and it will generally remain the case that the first supply by a property developer of residential property should be subject to VAT but thereafter on subsequent sales, VAT should not arise.

The new rules are complex and far reaching in their effect. It will take practitioners and indeed the Revenue Commissioners some time to come to terms with the nuances of the new legislation. The foregoing is merely a high level summary of the salient points and as always specialist advice will be required for transactions where there are VAT on property issues.

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