TASC Seminar
12th January, 2017

‘Section 110’ Companies: A Success story for Ireland ?

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Introduction : The Development of ‘s. 110’ firms in Ireland

- Financial Vehicle Corporation’s (FVC’s) are large, have large gross income, no employees, no fixed assets, and pay very little corporate tax.
- Incorporated using tax provisions in ‘section 110’ of the 1997 Finance Act, hence they are also known as ‘section 110’ firms.
- A subset of firms referred to as Special Purpose Vehicles (SPV’s).
- ‘section 110’ firms includes firms dealing with financial products such as assets backed securities (ABS), commercial paper, distressed debt, securitisation, etc.
- leasing aircraft;
- purchase of distressed property loans mostly outside Ireland, but also controversially within Ireland.
- This latter group of firms may thus make large profits from taking control or properties, yet pay little or no corporate tax on profits.

Introduction : The Development of ‘s. 110’ firms in Ireland

- The plan of the seminar is as follows:-
- (1) a brief description of 'Section 110' firms and their tax benefits;
- (2) Revenue and Central Bank estimates of the number of 'section 110' firms and why these are under-estimates of the population, with subsequent implications for CB estimates of the size of the shadow banking sector;
- (3) Regulation of 'section 110' firms;
- (4 (a) tax payments for 'section 110' FVC's
- (b) Tax payments for Cerebus subsidiaries ('section 110' firms that purchased distressed property loans;
- (5) Conclusion.

The Development of ‘s. 110’ firms in Ireland

- One of Irelands leading law firms (Matheson) states:-
- “In recent years Ireland has become the jurisdiction of choice for the establishment of special purpose vehicles (SPVs)”.

- In a further comment they state:-
- “As the market has become more sophisticated, Ireland as a jurisdiction has constantly responded, in terms of its legal and tax framework, in order to continue to position itself as the location of choice for SPVs.

- Another source (FS Taxation) states that the definition of qualifying assets which a ‘section 110’ company may manage “is regularly expanded by the Irish revenue”

- The main reason why Ireland has “become the jurisdiction of choice” is “The special tax regime for SPV’s in Ireland - what is termed a “section 110” company (‘section 110’ refers to 110 of Irish Taxes Consolidated Act 1997).
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The Tax Benefits

- **The ‘special tax regime’ means in effect tax on profits are zero or near zero.**

- The tax benefits have been described as follows (McCann Fitzgerald):-
- “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.
- Furthermore, no minimum taxable profits are required to be left in Ireland” (McCann Fitzgerald, 2012).
- Taxable profits can be ‘eliminated’ by allowing deductions from income .
- For example: management charges, portfolio charges, etc. and most important interest paid including profit participating interest.
- This effectively means that profit distributions are treated as a tax deduction, rather than a distribution of after tax profits.
- Such a deduction has been described as “unique” in Irish tax legislation (Davy Stockbrokers)

The Tax Benefits

- The use of 'Section 110' companies in a corporate structure is similar to the tax reduction strategies described in the Lux leaks case but one key difference is that "no special tax rulings or tax authorisations are required".
- Hence 'section 110' companies cannot be subject to EU competition investigations on illegal State aid as in the case of Luxembourg and Fiat.
- In the Lux leaks case tax haven type features emerges through "opaque administrative practices" in relation to granting Advance tax agreements (ATA's) coupled with secrecy.
- In contrast to the Lux leaks cases 's. 110' firms are not subsidiaries but rather structured as independent firms owned by a trust and in more recent years a "charitable trust" – described as an "orphan structure".
- In both cases firms have no employees, fixed assets, with secretarial services provided by a specialist firm such as Structured Finance Management, or Bedell Trust.

Data on FVC's

- Many of the 'section 110' companies set up were 'off balance' sheet vehicles of banks.
- Hence following the Financial Crisis the ECB required Central Banks to collect information on financial firms.
- More recently the Irish Central Bank was required to collect information on all 'section 110' companies .
- Gross assets held by 'section 110' companies are large.
- Central Bank data shows that for Q4 2015, 820 FVC's held €431.1 billion in assets.
- Down from a peak of €574.8 billion in Q4 2010.
- FVC assets have varied between 21 and 24% of the EU total over the period 2010-2015.

- The ECB (but not the Irish Central Bank) publishes lists of securities issued by these firms on a quarterly basis.
- This list was examined for the fourth quarter of each year to produce a unique list of FVC's that existed in ECB data base over the period 2009-2015.
- In total 1396 'section 110' companies were identified.
- Table (1) gives some summary data about FVC's.
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Data on FVC's

	No. Of securities Issued[1]	No. of FVC's estimated from ECB data	Aggregate assets of FVC's (ECB)	Total euro area[3]
Q4 2009	907	907	538.2	2369.6
Q4 2010	4521	770	576.1	2360.6
Q4 2011	4036	716	499.6	2269.0
Q4 2012	3801	712	441.9	2042.0
Q4 2013	4121	722	418.5	1917.5
Q4 2014	4327	745	402.8	1848.1
Q4 2015	5273	823	432.1	1826.7
Q4 2016				
Unique FVC's		1396		

Data on FVC's

The Central Bank has also published data from 2015 on non-financial 'section 110' firms as shown below

	Q4 2012[2] No.	Gross assets[4]	Q4 2015[2] No.	Gross assets €Billion
Central Bank Data for no. of FVC 's	700	441.9	820	431.1
Estimates from ECB data for FVC 's	712		823	
Central Bank Data for non FVC's[1]	600		822	324.0
Total no. of 'section 110' firms	1300		1642	755.1

Longevity

- There has been some discussion of the short term nature of ‘vulture funds’ established as ‘section 110’ firms.
- Longevity has also been discussed in relation to FVC’s.
- The underlying assumption being that short term investments are more speculative and risky than longer term investments.
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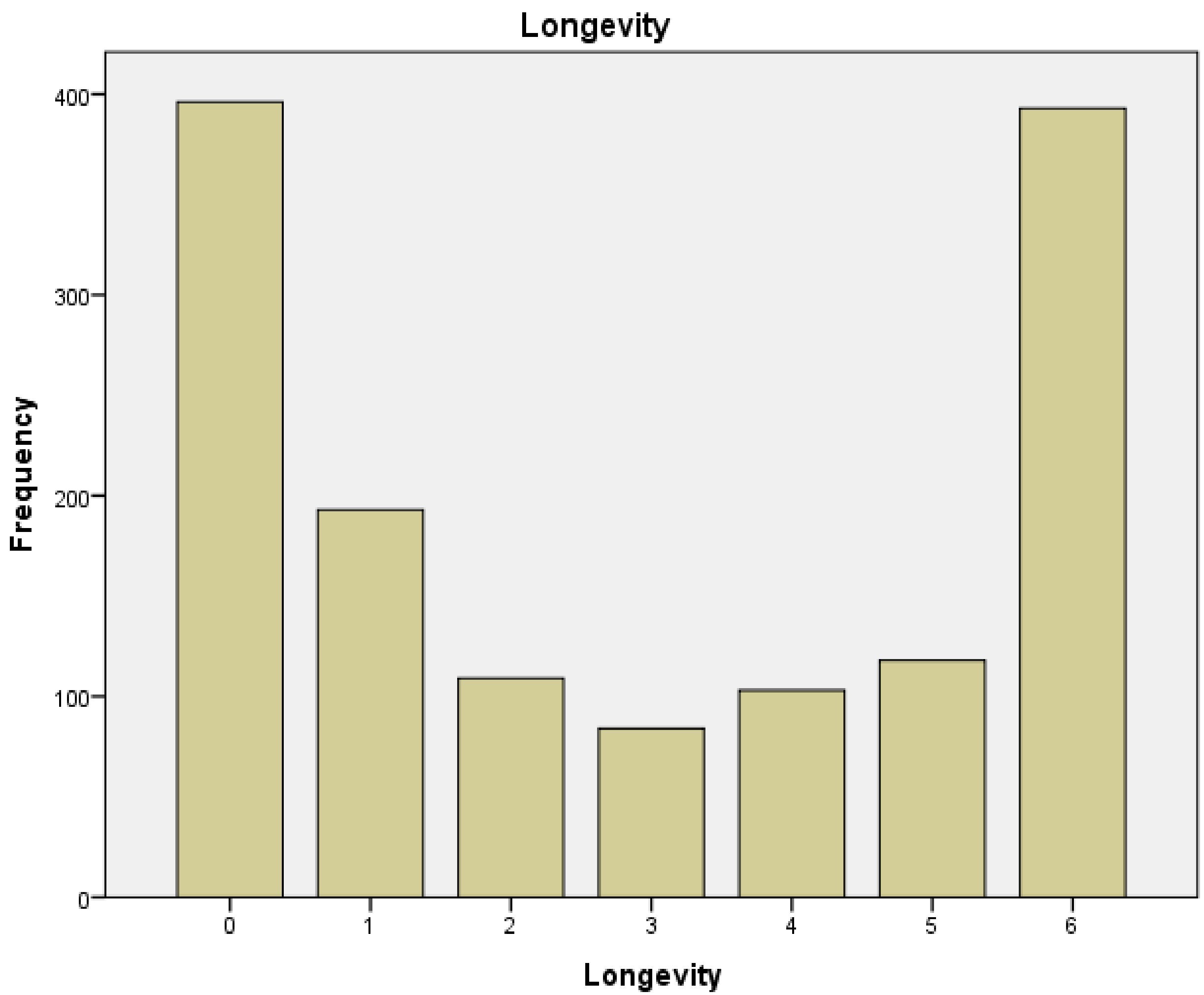
- A longevity analysis using end of December data points was undertaken for FVC’s for the period 2009-2015.
- The graph below shows the number of periods that firms in ECB lists appeared.
- There are two main groupings –firms that appear for just one period and firms that appear for all six periods.
- This distribution is also likely to reflect the financial crisis and increased liquidations at the beginning of the period.

Longevity



Non Financial FVC's

- A list of non-financial FVC's is not in the public domain.
- Over 500 nonfinancial 'section 110' firms were identified
- In answer to a P.Q. in Jan 2016 it was stated that the total number of 'section 110 firms established since 1997 was 2144 (excluding those liquidated).

- **This implies that there are 2144 'section 110' firms trading.**
- **Yet Central Bank data identifies 1642 'section 110' firms.**

- Number of 'section 110' firms established is likely to be far larger than 2144.
- Our research found 1396 unique firms in the ECB data base between Q4 2009 and Q4 2015.
- CB estimates that there were 822 Non FVC 'section 110' in Q 4 2015.
- Adding these (1396 + 822) gives a number of identified 'section 110' firms of 2218 - 74 more than given in Dail reply from revenue data.
- A further 82 'section 110'were identified that were dissolved/liquidated in the period up until December 2015, and hence cannot be included in ECB estimates.
- Number of 'section 110' firms established since 1997 is likely to be to be at least 2303.
- Further research is likely to increase this number to over 2500.

some data anomalies

- The gap between Revenue data and Central Bank data may be due to:-
- A number of ‘section 110’ firms that have all the appearances of a securitisation vehicle but do not feature in ECB/ Central Bank lists.
- Table (3) shows some an example of omitted ‘section 110’ FVC’s in ECB/Central Bank Data.
- All firms have ‘Atlas Reinsurance’ in title.
- Two were omitted from ECB/CB lists because they were dissolved prior to 2009.
- One may have been omitted because a liquidator had been appointed, but two other firms state they are ‘section 110’ firms and are engaged in issuing variable rate notes quoted on the Irish Stock Exchange.

Case Study: Atlas Reinsurance

Name of firm	Company Number	Ownership	ECB Data Base	Evidence for 'section 110' FVC [1]	Year Establish.	Year dissolved
Atlas Reinsurance X Ltd	533546		Yes	Issues participating notes quoted on Irish Stock exchange. States s. 110 in accounts.	2013	active
Atlas Reinsurance Public Limited Company	316312	Owned by 3 independent companies	no	Special purpose securitisation vehicle, Annual accounts 2002. Not stated to be s. 110 in accounts	1999	2007
Atlas Reinsurance II PLC s. 110	351126	Owned by 3 independent companies	no	Special purpose securitisation vehicle Section 110 from Annual accounts 2003.	2001	2007
Atlas Reinsurance III Public Ltd	430874		no	Issued variable notes listed on Irish Stock Exchange. Prospectus p. 23	2006	2011
Atlas Reinsurance IV Public Limited	448511		no	Issued variable notes listed on Irish Stock Exchange Prospectus p. 23	2007	2013
Atlas Reinsurance VII Limited [2]	517967		no	Issued variable notes listed on Irish Stock Exchange Prospectus p. 52	2012	active

Some data anomalies

- A number of the firms listed do not state that they are ‘section 110’ in their accounts, but do so in a prospectus.
- One possible reason for their omission from ECB data is that although described in the prospectus as engaged in securitisation and as a ‘section 110’ firm, they are not in fact an FVC ‘section 110’ firm.
- An examintion of our own data base of non ECB listed firms identified as ‘s. 110’, found several that both issued a prospectus and indicated in their accounts that they were ‘section 110’ firms .
- An example was also found of a firm listed in ECB data as a ‘section 110’ FVC that did not file accounts but is described in a prospectus as a ‘section 110’ firm (example 9).
- There are also several examples of firms that were listed in the ECB data base that have issued a prospectus, and state in their accounts that they are ‘section 110’ firms.
- As all prospectuses are must be sent to the Central Bank for approval their omission from FVC lists appears anomalous.

The Formal Structure of FVC/'Section 110' regulation

- The main regulation of s.110 firms is undertaken by the Revenue Commissioners and the Central Bank.

- Legislation establishing 110 firms' is mostly focused on the type of activities that 's. 110 firms' may engage in.

- An exception is section 21 of the 2016 Finance Act which states that:_
- "a company must inform the Revenue Commissioners in writing of its intention to be a section 110 company within 8 weeks of acquiring qualifying assets of 10 million" (Explanatory Memorandum Finance Bill 2016, p. 4).

- **This is an interesting requirement as it implies that prior to this amendment firms were operating and registered as 'section 110' firms before receiving revenue authorization.**

- The question arises, given that firms may have issued securities quoted on the Irish Stock Exchange and entered various contracts assuming 'section 110,' tax benefits, was whether granting 'section 110' status was automatic.

The Formal Structure of FVC/'Section 110' regulation

- 'Section 110' legislation requires a form notifying the Revenue of a firm's "intention to be a s. 110 company".

- This form seeks minimal information for example, the name and address of the company secretary.

- Revenue receives annual tax returns and a copy of the annual report and accounts, but there is no evidence of any analysis of this data.

- In contrast the Central Bank requires a great deal more information.
- For example "an FVC must register within one week of taking up business with the euro-area National Central Bank where it is resident" (Central Bank, 2014, p.3.
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- Data is collected on a quarterly basis starting in Q4 2009.

- A guidance note on this regulation from the EC B states:-

- "Regulation ECB/2008/30 of 19 December 2008 establishes a set of statistical reporting requirements for financial vehicle corporations (FVCs).
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Data Collected by Central Bank

- Central Bank requirements for data collection state that:-
- “The FVC return can be thought of as similar to a set of financial accounts for a company”.
- Further details of information to be provided lists :-
- Interest payable on loans;
- Interest payable on debt securities;
- Financial services fees and commissions;
- Capital and exchange gains and losses both realised and unrealised;
- Other expenditure/operating costs.

- **Thus it would appear that a topic of current exceptional interest in relation to tax payments is not collected by the regulato**r.

- It is also not clear whether a figure for profit before tax can be identified from data collected.

The Regulation of non-FVC ‘section 110’

- Since July 2015, reporting requirements were extended to all ‘s.110’ firms.
- A Central Bank document states:-
- “The extension of quarterly reporting requirements to this new population was primarily to address data gaps in the Irish financial system, and to enhance statistical analysis and regulatory oversight of the sector”.
- The dates for submission of returns and data requirements for these residual ‘section 110’ firms is identical to that required for FVC’s.
- Key information on tax paid payments is not collected.

Regulation in Practice

- As of 2011, Revenue were unable to state if there had been any audits of s.110 companies (P.Q. 4th May 2011. No. 9954/11).
- There were no meetings between the regulator and Revenue in relation to section 110 companies until legislation in 2013,when two meetings took place in 2015, between the Regulator (Central Bank) and Revenue.

- At the same the Financial Stability Board (FSB) (2015, p. 51) in discussing the non-bank financial sector in Ireland states:-
- "FVCs lie on or outside of the regulatory perimeter depending on the nature of their activities".

- Davy Stockbrokers favorably cites "unregulated section 110 company" as a vehicle for owning distressed assets..
- The same firm in refering to the benefits of an Irish location states that financial "services regulation is not generally applicable" .
- Another source (Burke, 2012) states "A section 110 company is unregulated.
- The same source in comparing different investment vehicles states that :- Another positive of the Section 110 Company is that there are no regulatory restrictions regarding lending as is the case with a QIF (Qualifying Investor Fund).

The Tax Regime and 'Tax neutrality'?

- A major law firm, Matheson refers to "a very successful [tax] regime" which has put Ireland in the forefront" of securitisation transactions (Matheson, 2011).
- PWc state 'Section 110' is at the heart of Ireland's structured finance regime.... it is widely used and internationally regarded"

- Several advisory firms have described Section 110 Companies to be "tax neutral" (Dillon Eustace).
- Tax neutrality effectively means that income minus tax deductions results in zero profits and zero tax. A phrase also used by the regulator.
- PWC states that with appropriate structuring "the effective tax rate can be close to zero"
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Tax expenditures ?

- Given the value of the 'section 110' tax regime and its widespread use, it is of interest that there is no estimate of the cost in terms of tax expenditures (http://www.revenue.ie/en/about/statistics/costs-expenditures.html).

- In response to a query about tax foregone as result of 'section 110' and other measures the Minister of Finance stated:-
- **that no tax was foregone as "the securitization industry would not be here in the first instance"** (PQ 22nd May 2012 no. 25501/12).

- Perhaps because of this viewpoint nether the Revenue nor Central Bank collect data on tax payments .

- In order to explore this issue further data was examined for a random sample of 82 FVC's extracted from ECB data for Q3 2011.
- Three firms did not produce any accounts for 2010 resulting in a sample of 79. Table (4) below shows data on tax distributions for 2010.

Distribution of Tax payments for 79 FVC's for 2009 and 2010

	Pretax profits 2009	Pretax profits 2010	Tax payments
Profits = €0	29	27	0
Profits < € 1000	11	9	
Profits = €1000	9	10	€ 250
Profits > €1000 but < €10,000	9	9	
Profits > €10,000	9	9	
Reported a loss (6 firms > €200,000)	9	15	
No. Of firms	76	79	

Some characteristics of zero profit firms

Twenty three firms were identified that reported zero profits in 2009 and for all subsequent period for which accounts were produced.
One firm (Glacier Securities) was included that first produced accounts in 2010 and reported zero profits until 2014 when the firm was put into voluntary liquidation.
For the group as a whole for all years gross income amounted to €9.521 billion, interest income €3.227 billion, 'interest paid' € 1.445 billion, pretax profit and tax are zero

Eur million

Year	N	Gross assets		Interest Received		Gross Income	
		Mean	Median	Mean	Median	Mean	Median
2015	7	221.167	218.546	4.213	2.295	10.878	7.826
2014	15	242.085	223.692	7.642	4.099	16.430	8.426
2013	19	384.031	285.986	10.219	4.872	38.184	14.802
2012	24	390.547	209.279	14.104	6.282	35.450	21.965
2011	24	423.867	308.493	21.564	11.023	31.298	15.892
2010	24	463.139	359.574	16.031	11.737	30.459	11.886
2009	23	309.106	204.775	20.759	16.192	36.853	21.879

Cerebus: A Case Study of Cerebus subsidiaries

- Most assets are held outside ROI.
- The Table shows that income (interest income and other income) as a % of gross assets increased from 7% in 2013 to 28% in 2015.
- Tax paid as a % of interest income varied between 0.00001% and 0.048%, and fees for tax advice are twice the amount of tax paid.
- Interest expense and management fees are the largest deduction

N	Year	Gross Assets	Interest Income	Other Income	Interest Expense	Management fees	Profit	Current tax[1]	Fees for tax advice
3	2015	890.398	65.115	0.00	27.530	24.821	70.777	0.00208	0.0095
6	2014	2068.34	239.769	23.735	192.82	7.898	-27.043	0.1169	0.0191
6	2013	895.12	208.852	45.264	50.177	3.103	6.306	0.00208	0.0195
	sum		513.735		408	219.36	50.04	0.024	0.0482

Asset Structure for Four Cerebus Subsidiaries as first reported in 2014

- Asset structure, interest paid and received are all different, but pretax profits are almost identical.
- This illustrates the administered nature of profits declared.
- Raises issues of whether income received, prices charged for services and interest paid were at 'arms length' or involved an element of 'profit switching' and resulting in tax losses in Ireland and elsewhere.

Name	Gross assets	share capital	Interest income	Other income	Interest Expense	Manage. fee	Arrange. fee	Commit. fee	Profit	Tax Charge
Avon P.	237.1	0.0001	19.452	19.061	25.723	4.248	1.953		0.007789	0.001947
Chestnut P.	273.8	0.0001	3.07	2.832	4.01	1.542	1.881		0.007788	0.001947
Eagle P.	1187.8	0.0001	111.766	1.1547	61.78	31.183	5.526	5.541	0.007789	0.001947
Thames P.	34.374	0.0001	31.337	0	28.051	2.026			0.007788	0.001855

Conclusion

- ‘Section 110’ have minimal economic impact in Ireland.
- Most domestic payments are to Irish corporate service providers, auditors, and locally provided legal services.
- no employees.
- Pay minimal amounts of corporation tax .
- The vast bulk of assets are owned outside Ireland.
- They thus pose a substantial risk of tax losses in other jurisdictions.
- They are subject to ‘light touch regulation’ and form a substantial part of the shadow banking sector with consequent risks.
- They deserve a great deal more attention and research.