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Funds Review,
Department of Finance,
Miesian Plaza,
50-58 Baggot Street Lower,
Dublin 2,
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Ireland.

Response to Funds Sector 2030: A Framework for Open, Resilient & Developing Markets

Dear Sir/Madam

EY welcomes the opportunity to respond to the Department's Consultation regarding its wide-ranging review of the funds sector. We note the objectives of the Review include a) developing a framework within which Ireland can maintain its leading position in fund management and fund servicing and b) ensuring that the sector continues to support economic activity both at the regional and national level in Ireland.

Ireland's funds and asset management industry has evolved into a Global Centre of Excellence for Asset Management since the establishment of the IFSC in the 1980s. It operates within a highly competitive and international environment, characterized by a dynamic and ever-changing regulatory, policy, and political landscape.

The asset management industry finds itself at the intersection of two significant global intergenerational challenges: swiftly evolving demographics and the shift towards sustainable climate policies. Both demand robust responses, and Ireland's expertise, knowledge, and experience can play a pivotal role if we proactively embrace the opportunities presented.

Now is the time to sow the seeds that will benefit this industry over the next 20 to 30 years. Tangible outcomes will include: positive savings and retirement outcomes for investors; further investments into SME's and infrastructure projects which will benefit employment and communities in receipt of same; and direct employment opportunities within the Asset Management Industry in Ireland, both now and in the future.

While we have endeavoured to respond to each of the questions in the consultation, we believe the following areas are key priorities which would see the industry continue to contribute to Irish society and develop:

- Stagnation is one of the most significant risks that the industry faces in Ireland. Establishing a dedicated unit within the Department of Finance to address evolving market dynamics as well as developments in rival jurisdictions would assist in ensuring that funds and asset management industry in Ireland remains well-prepared to promptly respond to changes in investor demands or regulatory requirements.
- Ireland should aspire to establish itself as a global destination of choice for private asset strategies. Achieving this objective will necessitate refinements to existing fund structures while also introducing new ones.
- The funds and asset management industry in Ireland can provide value to the real economy through job creation and employment; investments into Irish SME's and Infrastructure projects; and giving choice to Irish investors, saving towards long-term retirement goals.

The most significant risk to the funds and asset management industry in Ireland is stagnation or decline, should we fail to meet our core purpose – to enable and support global investing and investors. Remaining relevant to the changing needs of investors and the managers who serve them, keeping up to date with international developments in peer jurisdictions is key to addressing this risk. We would like to take this opportunity to acknowledge the Department's efforts to engage with stakeholders on this initiative and we would be delighted to engage with you regarding the contents of this letter.

Yours faithfully

Ernst + Young

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Section 2: Investment funds and asset management landscape

Q1. What policy supports have been most impactful in attracting the funds sector to Ireland and/or the EU in recent decades?

Over 30 years, Ireland has been an attractive destination for the investment funds and asset management industry. Some of the most impactful policy supports that have contributed to this success include:

- A competitive, stable and transparent tax regime, which exempts funds for Corporate Tax and Capital Gains taxes, recognising that the responsibility of the individual investor for such taxes.
- The creation of the International Financial Services Centre ("IFSC") in 1987, which launched a new era of International Financial Services from Ireland. Since then, the funds industry has expanded its footprint right across the Island of Ireland with asset management businesses in each of our four provinces, employing over 17,000 people. Through the asset management industry, Ireland plays a key role in supporting European and Global policy objectives of long-term savings and providing financing (non-bank lending) to small and medium sized enterprises.
- The adoption and implementation of key European Union ("EU") Asset Management Regulations such as UCITS and AIFMD, alongside a regulatory framework for investment funds and the creation of domestic legislation to facilitate investment fund structures in Ireland (for example the Irish Collective Asset-management Vehicle Act, 2015 and the Investment Limited Partnership (Amendment) Act, 2020)

Q2. What characteristics set Ireland apart from other jurisdictions when selecting a fund's domicile?

Ireland is a leading jurisdiction for the establishment and administration of investment funds, offering a range of advantages to fund managers and investors. Some of the key characteristics that set Ireland apart from other jurisdictions include:

- International recognition of Ireland as the third largest Global Fund domicile, with a 30-year track record for the domiciliation and servicing of investment funds.
- A strong regulatory environment, built on principles of openness, transparency and investor protection, with a reputation as a location for robust and efficient regulation.
- A favourable fund tax regime (with double taxation agreements ("DTAs") across 76 countries).
- A well-established asset management ecosystem, where Global Custody Banks, Third-Party Fund Administrators, Asset Managers, Professional Advisors, and FinTech Companies collaborate effortlessly.
- Deep rooted cultural ties with the United States of America and the United Kingdom, with an English-speaking population.
- Ireland's Commitment to European Union membership, enabling Ireland to act as a gateway to Europe for both North American and Asian firms. Post-Brexit, an increasing number of investment managers have chosen Ireland as their headquarters for their European asset management businesses.
- A Common Law legal system, (one of the last remaining common law countries in the EU post-Brexit), which is familiar to firms in based in the US and elsewhere, allows for innovation and evolution as common law's ability to leave the legal code open for interpretation will become increasingly important.

Q3. What are the most important trends evident in the sector?

Some of the most important trends in the funds and asset management industry include:

- We have been witnessing a pronounced barbell effect across the Global Asset Management Industry, with a rise in demand for passive investments on one side and a rise in demand for alternative investments (including private assets such as private equity, private debt, infrastructure funds, real estate funds and hedge funds) on the other. Private assets assist with portfolio diversification and provide a return that is not directly correlated with the markets.
- An increase in non-bank financing - Changing regulatory standards across the banking industry since the financial crisis in 2008 has resulted in private credit fund managers providing credit that may previously been extended by the banking sector.

- A rise in investor demand for Environmental Social and Governance (ESG) products and investing, which we expect will be a dominant feature into the future. The recently published European Long Term Investment Fund ("ELTIF") 2.0 framework is expected to accelerate this, and enable retail investors to participate in, and benefit from, the green transition in Europe and across the world.
- A rise in long term savings - with changing demographics, we have seen the responsibility of pensions and long-term savings begin to shift from the collective (i.e., governments and employers) to individuals, a trend that will only increase as aging populations put pressure on the finances of governments around the world. An increased focused on Financial Literacy across Irish savers and investors, should therefore be actioned in this regard and we welcome the Department of Finances consultation on Ireland's "National Financial Literacy Strategy".
- Technological changes across all aspects of the asset management value chain, improving operational metrics and the end clients' user experience through automation (including the use of Robotics), artificial intelligence, blockchain and cloud computing.

Q4. What are the key risks and challenges for the sector in the medium- to long-term and how can they be managed?

Some possible key risks and challenges for the funds and asset management sector in the medium to long term are:

- Stagnation – It is important to understand and appreciate how quickly investor trends and demands change and to ensure that the necessary government resources are readily available to support the industry in Ireland, thereby preserving Ireland's appeal as a Global Center of Excellence for Asset Management.
- Competition vis a vis other competing fund jurisdictions – Ireland needs to continuously monitor trends and opportunities to enhance the eco-system that we currently have, for example, the UK government are presently working to incentivise asset management jobs back into the UK; with their most recent budget providing for tax or grant aids for the creation of such roles.
- Innovation in the sector – the antidote to stagnation is innovation and ensuring that the Industry in Ireland has the right suite of products to support differing assets classes and investors' needs is crucial.
- Talent and Skills – Looking forward the government (alongside industry) should continue to support Third Level educators ensuring they work towards an educational framework, that provides learning outcomes for students to gain the skills needed across the sector, particularly in newly evolving areas such as ESG, AI, digital assets and risk management, whilst also promoting regional development across the island of Ireland.
- During the pandemic, the funds and asset management industry in Ireland demonstrated it's resilience and ability to work remotely, which highlighted the virtual and mobile aspects of certain roles, that could be fulfilled from other locations. Ensuring Ireland retains it's significance as a Global Centre of Excellence for Asset Management through continued innovation and focus will alleviate any potential concerns in this regard.
- Inconsistent implementation of EU directives when being transposed into national law has created differences across Europe, placing countries at a competitive disadvantage where there are different or more onerous regulatory regimes.

In maintaining our competitiveness, we should also be mindful how other provisions within the Finance Act might impact on investment funds and maintain exemptions for such as a matter of course, cementing the certainty of the domicile from a tax point of view.

Ireland's ability to manage these challenges and position itself for the future will inextricably be linked to how Legislature, the Department of Finance and the Central Bank of Ireland can work together to support the growth of the industry in Ireland, being mindful that we compete against other countries for the same scope of jobs and services.

Q5. What are the key opportunities for the sector in the medium- to long-term and how can they be delivered?

To capture the next wave of opportunities, the industry in Ireland needs to evolve and innovate its fund product structures to support EU and Global objectives, to facilitate international investing and support the evolving needs of investors.

Given the value the industry brings to wider society, be that by managing pension assets and protecting for retirements, or levels of jobs created, we have a responsibility to protect Ireland's competitive position which means ensuring that we have an environment that is open, transparent, and competitive for international firms to conduct businesses from Ireland. Some key opportunities for the funds and asset management sector over the medium to long term include:

- **ESG & ELTIF's**
  As noted in our response to Question 3, ESG investing is accelerating, and we expect this to be a dominant feature for investment funds into the future. The recently published ELTIF 2.0 framework is expected to accelerate this, and enable retail investors to participate in, and benefit from, the green transition in Europe and across the world.

- **Private Assets**
  Over the past 15 years, we have witnessed significant global growth in Private Asset Funds including private (including asset classes such as private equity, private debt, infrastructure, real estate and hedge funds). The introduction of new fund product offerings such as an indirectly regulated Alternative Investment Fund ("AIF") and an ELTIF 2.0 regime would significantly improve Ireland's attractiveness as a funds domicile for private assets.

- **Technological Changes**
  As we will note in our response Question 6, we are witnessing technological changes across all aspects of the asset management value chain. Building strategic partnerships and collaborations with other industry players, such as fintech firms, banks, insurers and platforms, to create synergies and value-added services.

  The use of technology will serve to enrich and enhance the end investors customer experience and can serve to guide them towards more tailored portfolio outcomes. As the responsibility for pensions and long-term savings continues its shift from the collective (employers) to individuals, innovations such as these will need to be supported through a holistic approach to improving financial literacy across the country.

  Given the highly functioning asset management eco-system that is in place in Ireland (as outlined in our response to Question 2), significant opportunities exist for Ireland to be at the forefront of such technology changes.

Q6. How will technological change and innovation influence the sector's future development?

Technological advances including Robotic Process Automation ("RPA"), Cloud Computing and Artificial Intelligence ("AI") have the potential to disrupt and transform the entire asset management value chain.

Alongside such technological advances and opportunities are cybersecurity threats that the industry must continually protect itself against.

The world has become much smaller over the last 30 years and our ability to work and interact virtually can serve to displace some of the near shore advantages that may have been in our favour in the past. During the recent pandemic, the funds and asset management industry in Ireland demonstrated it's resilience and ability to work remotely, which highlighted the virtual and mobile aspects of certain roles, that could be fulfilled from other locations. Ensuring Ireland retains it's significance as a Global Centre of Excellence for Asset Management through continued innovation and focus will alleviate any potential concerns in this regard.

Q7. How best can Ireland position itself in the future as a location of choice for EU and international firms?

As set out in the response drafted by Irish Funds, we agree that Ireland can best position itself in the future as a location of choice for EU and International firms through:

- A policy and regulatory environment which is internationally renowned for its responsive and adaptive nature.
- A full set of regulated product structures to support public and private asset strategies investing across geography, credit rating, liquidity, time horizon and risk return trade off.
- A suite of products and structures for professional investors which benefit from a regulated provider even if the product structure itself is not directly regulated.
- technology capabilities and data platforms which allow full interoperability with various intermediary models and automated/digitised GUI's and API's.
- The highest level of certainty (as regards requirements and timelines) for authorisations of:
  - Investment firms
  - Investment products
  - services
  - individuals

Q8. How can Ireland best support the growth and development of the market for ESG products and the transition to carbon neutrality?

To support the growth and development of the market for ESG products and the transition to carbon neutrality, Ireland has embarked upon achieving a minimum baseline level of sustainable finance knowledge and skills across all levels and functions in the industry through various training providers and should continue to focus on developing specialist training in certain areas (e.g., risk management) or targeted shorter duration courses for senior level management. Dedicated focus should continue developing additional specialist courses to help position Ireland as a centre of excellence for sustainable finance, and it will be important to ensure there is a range of available courses to suit all levels of seniority and expertise.

To ensure an uptake of the courses and roles, it is necessary to increase awareness of specific ESG requirements for roles and relevant training courses and funding available. A specific area that requires focus and investment is ESG talent with data and computer science skills. There is a short supply of persons with this specific but very necessary set of skills. We believe Ireland is well positioned to develop a global niche and positioning via the development of specialised MSc degrees in green data science for finance. We suggest investment in supporting the third-level sector to initially introduce ESG modules to data science courses would be a good start and this could be used to build up to full courses in time. Additionally, the industry could develop on existing work done by Skillnet as well as ISFCOE. There are several new emerging graduate courses (e.g., Smurfit Sustainable Finance) that could collaborate with asset managers to have industry co-sponsored courses and internship placements that result in knowledge sharing and practical implementation of sustainable strategies for businesses. Providing further incentives would ensure greater uptake.

As discussed elsewhere in our response, Ireland’s high personal tax rates are likely to remain an impediment to such key employees deciding to move to Ireland. We have set out specific suggestions on how this situation could be improved.

As a global trend, investors (and in particular European investors) are targeting ESG funds, Ireland needs to be competitive to ensure a strong environment for, and supply of, ESG products and professionals are domiciled here.

To create incentives to domicile ESG focused products here:

- Double taxation agreements could be reviewed over foreign withholding taxes charged on ESG investments held which serve to boost the yield on the products (similar to US Equity focused exchanged traded funds),
- Consider ways and means to attract one of the global agency ESG offices to open or move an existing head office function to Ireland
- Full implementation of the revised ELTIF regime, which has been tailored to help channel long-term investments, and is well placed to help finance the green and digital transitions.

- Third-level courses should tailored and targeted to develop a knowledge base of ESG professionals from the ground up
- Skilled visa requirements could be tailored to help incentivise executive level individuals in the ESG space to base themselves in Ireland

To accelerate the demand for ESG products from Irish domiciled investors, incentives could be put in place, such as:

- Changing the thresholds for pension contributions made by Irish tax residents into ESG funds to incentivise them to invest in such products;
- Consideration of specialised capital gains tax rates applied to ESG Investments;
- Consideration of specialised pay related social insurance (“PRSI”) or universal social charge (“USC”) rates on gains earned from ESG Investments.

Regulatory application and action through such incentives would be a key enabler for ESG funds demand, and create a value add.

Locally, we suggest incentivising pension investors to go into ESG funds. Retail shareholding in Ireland is remarkably small, with most people only gaining exposure to capital markets through pensions. A targeted incentive here given the long-term nature of pensions is worth exploring. If the same incentive applied to international schemes, it would encourage further investment in Irish domiciled funds.

In addition to tax solutions, we suggest a focus on ‘Green Projects’. We believe the Government could provide a more favourable approach to ESG by providing a more supportive landscape to facilitate demand and interest for such projects. This could be further achieved through looking at the development and growth of grants for green product development and innovation. The new ILP fund structure could be more widely promoted as a structure to facilitate private equity investments in sustainable projects as many of the projects will be held within private companies.

Q9. For the NBFI sector, those investment funds providing credit intermediation, what are the key opportunities for the sector in the medium- to long-term and how can they be delivered?

Changing regulatory standards across the banking industry since the financial crisis in 2008 has resulted in private credit part-replacing credit that may otherwise have been extended by the banking sector.

According to a report and related research prepared by the European Alternatives Credit Council titled “Financing European Business”, approximately 50% of business debt financing in Europe is provided by non-bank lenders (compared with 80% in the USA). The disintermediation of the banking sector and growth of non-bank lenders is one of the single biggest trends in the European economy during the last decade. In the "direct lending space”, non-bank lenders are currently providing $242bn of finance to more than 4,000 European businesses'. This lending activity has grown from only $39bn 10 years ago, with the market growing at a compound annual growth rate of 20% over that time period. SMEs and mid-market companies are the main beneficiaries of the growth in non-bank lending, which allows them to access new and more diverse sources of finance.

Ireland has been servicing private credit funds (NBFI Sector) for many years and has built up a robust knowledge base and related experience required in servicing such businesses.

This experience, alongside continued innovation in the funds structures available for Irish Funds may allow Ireland to both embrace and scale the NBFI opportunity and in turn increase the flow of finance from capital markets to European small and medium enterprises.

Section 3: The regulatory and supervisory framework

Q10. How important is an effective regulatory framework for Ireland to maintain its status as a leading funds domicile?

An effective regulatory environment is the cornerstone on which the asset management industry is built and the Central Bank of Ireland alongside the Asset Management Industry in Ireland have made important contributions to developing international industry practices.

Q11. Taking account of the European and international aspect of the Irish framework and key EU files such as Capital Markets Union (CMU) and the Retail Investment Strategy, what improvements could be made to the legislative, regulatory and supervisory framework?

To maintain Ireland's status as a Global Centre of Excellence for Asset Management, specifically for alternative investments, we do need a suitable choice of products that are Regulated and Unregulated which allow the asset manager and investor a choice when establishing the most suitable structure to execute their desired investment programs.

For the avoidance of doubt, Unregulated Structures would be indirectly Regulated through the appointment of an EU Regulated Alternative Investment Fund Manager, operating under the regulatory requirements of AIFMD.

Q12. What elements of EU policy, including CMU policy, are most relevant to the growth and development of the funds and asset management sector in Ireland and why?

As set out in the response drafted by Irish Funds, we agree that following elements of EU policy, including Capital Markets Union ("CMU") policy, are most relevant to the growth and development of the funds and asset management sector in Ireland:

- The ELTIF is considered to be a significant growth area. We believe it is critical to permit regulated vehicles to be used for ELTIF funds. We need timely implementation; we support the CBI recently announced steps of implementation and advocate for an EU harmonised implementation approach.
- AIFMD II could also prove to initiate growth in the loans market. We need to harmonise the Irish loan origination regime to the regulatory standard set down in AIFMD II. There needs to be greater differentiation between loan origination strategies, which should attract these regulations and the provision of credit within private equity.
- Sustainable Finance considered in Q. 8.
- Digital Finance is a significant growth area with various initiatives being developed within the EU. We believe however that QIAIFs should be allowed to seek direct exposure.
- Macroprudential policy ensures the fund sector is more resilient to stresses and less likely to amplify adverse shocks which is welcomed. However, it will be necessary to ensure the tools implemented are sensible and properly calibrated to balance the risks with the need for the growth and development of the funds sector in Ireland and Europe. It is important that the CBI's approach is consistent with the approach taken

Q13. What peer jurisdictions, most notably from other EU jurisdictions are most relevant? Outline the reasons why.

Luxembourg is Ireland's most significant peer jurisdiction within the Europe Union. 27% of all assets under management in European UCITS and AIF products are domiciled in Luxembourg (versus 19% domiciled in Ireland). Like Ireland, Luxembourg attracts significant global capital through UCITS and AIF's and has attracted some of the largest financial services businesses to the Grand Duchy to establish a very successful asset management regime, which is focused on the cross-border market, with 91% of assets under management in Lux products held by foreign investors (versus 92% of assets under management in Irish products held by foreign investors). Collectively, Ireland and Luxembourg make up 95% of the total cross-border fund market in Europe at end 2021. The development of an unregulated AIF product, particularly in Luxembourg, has resulted in significant growth in private asset strategies domiciling products, and could play out as a competitive advantage for Luxembourg over Ireland as we see the global trend towards alternative investment in private markets grow over the medium term.

Germany, France, and the United Kingdom round out the top 5 jurisdictions for European fund domiciles, with a primary focus on their respective domestic markets. 30% of investors into Irish funds are based in the United Kingdom, so any changes made by the FCA to the fund regime while it is looking to overhaul rules governing the asset management industry in a bid to keep the UK attractive to international money managers may significantly impact on investment into Irish Funds. Furthermore, similar to Luxembourg, the UK and Switzerland have developed an unregulated AIF product, which is proving gaining traction and success.

With a track record of over 30 years, 19% of all assets under management in European UCITS and AIF products are domiciled in Ireland, 92% of which belong to foreign domiciled investors. Over this period, the asset management and funds industry has matured significantly and employs over 17,000 people in Ireland.

Whilst the fund framework in Ireland compares very favourably against peer jurisdictions, the industry is not static. To remain relevant and competitive, we need to continually innovate and evolve in order to maintain our position and within the global asset management eco-system.

Q14. How does the funds framework in Ireland compare to those other jurisdictions?

On an overall basis, Ireland compares favourably against other fund jurisdictions. However, our time to market with respect to the development of new products to meet the changing needs of investors and investment managers could be improved, as this reduces the attractiveness of the jurisdiction, where certainty of product, authorisation and approval is paramount when setting out to raise capital for an investment fund.

Q15. Are there any updates or changes needed to the current legislation governing the legal structures used to establish investment funds?

Enhancements to real estate funds

Ireland is not currently a popular domicile for pan European / global real estate funds. Contributing factors from a tax perspective include the lack of a participation exemption for non-Irish source dividends and the restriction of the substantial shareholding exemption from capital gains tax to trading entities.

We note that the Minister for Finance has announced a roadmap and a technical consultation for the introduction of a participation exemption in Ireland. The extension of this exemption, or the substantial shareholding exemption to exempt gains from the sale of shares in a non-Irish land rich property company from Irish capital gains tax, would be a valuable measure in making the regime more comparable to other European Fund locations and could play an important role in increasing the number of real estate funds domiciled in Ireland.

As set out in the response drafted by Irish Funds, we agree that following updates or changes to current legislation governing the legal structures used to establish Irish Funds would promote the growth and development of the sector in Ireland:

In the context of regulated vehicles, a major revision to the ILP legislation was undertaken recently. A number of minor matters exist outside of primary legislation and should be addressed. In summary amendments should be considered in respect of the acceptable accounting standards that may be used by ILPs, an amendment to revenue guidance is required to afford ILPs the same exemption from Dividend Withholding Tax ("DWT") available to all other Irish regulated funds; and the reverse-anti-hybrid rules should be updated to better reflect industry practices.

In the context of unregulated vehicles, we believe the Irish unregulated fund offering needs to be significantly enhanced through the establishment of a new unregulated product regime and by making improvements to existing unregulated fund structures. Accordingly, we approach this section in two parts (a) the establishment of a new unregulated product regime and (b) enhancements to existing unregulated vehicles.

(a) The establishment of a new unregulated product regime

We believe that consideration should be given to introducing a regime permitting the use of unregulated fund structures established under legislation governing existing regulated fund structures (i.e., ICAV, investment company ILP, CCF, and UT) where they are subject to management by an AIFM. Such entities would be subject to indirect regulation through the regulation of the AIFM by the CBI but the product itself would not be directly regulated. This would be equivalent to the Luxembourg RAIF regime.

(b) Enhancements to existing unregulated vehicles.

There are currently three unregulated fund options available in Ireland, each of which have considerable challenges and need to be addressed.

- Unregulated unit trust structures are not available (other than for sale to pension funds/charities).
- The unauthorised fixed capital company has several significant limitations as an investment vehicle including the fact that, by definition, does not benefit from the variable capital mechanism, thereby making it less attractive as an investment vehicle.
- The 1907 LP represents the most commonly adopted Irish unregulated fund structure. However, structuring problems arise in the context of the 1907 LP and is not a sufficiently appealing option for fund managers to attract wider use.

In addition, as a general point, there is no VAT exemption on management services, which is currently available to regulated funds and we believe this should be extended to the unregulated vehicles.

Q16. How do the Irish legal structures compare to the vehicles available in other jurisdictions?

On an overall basis, Ireland compares favourably against other fund jurisdictions.

As noted in question 15 above, to ensure the ILP can compete globally, minor improvements are required to ensure that the structure meets the needs of Global Finance.

In addition, and as noted in our response to question 13 and similar to what is in place in other fund domiciles, Ireland should have a Unregulated Fund regime available for asset managers.

For the avoidance of doubt, Unregulated Structures could be indirectly Regulated through the appointment of an EU Regulated Alternative Investment Fund Manager, operating under the regulatory requirements of AIFMD.

Q17. Are there investment or financing vehicles that are currently unregulated but that should be regulated in the future? If your answer is yes, please explain how these entities should be regulated and the rationale for doing so.

As set out in the response drafted by Irish Funds, there are a number of legal structures which can be, and are, used as an unregulated channel for investment or financing purposes in Ireland, including Limited Partnerships formed pursuant to the Limited Partnerships Act 1907, trusts such as Exempt Unit Trusts, fixed capital Limited Companies formed pursuant to the Companies Act 2014.

We agree that there is a need for 'unregulated' fund structures in Ireland, but as explained in our response above, such AIFs can be viewed as indirectly regulated under AIFMD and thus subject to, inter alia, regulatory monitoring and macro-prudential requirements.

Q18. Unregulated vehicles are not subject to the same restrictions, requirements and reporting obligations as regulated ones. Does this pose a risk to investors or to the wider financial system?

As noted above, unregulated Structures would be indirectly Regulated through the appointment of an EU Regulated Alternative Investment Fund Manager, operating under the regulatory requirements of AIFMD.

Building a better working world

Section 4: Assessing the impact of the funds sector

Q19. Where relevant, detail how your organisation, or the wider sector, contributes to the economy with particular reference to employment, revenues and regional development.

The asset manager industry has played a significant role in creating high value jobs in Ireland, directly employing over 17,000 people.

In EY in Ireland, our Wealth and Asset Management practice is composed of 300 dedicated professionals across four service lines – Assurance, Tax, Consulting and Strategy and Transactions, who are based in Dublin and Cork.

Q20. What role can the sector play in deepening Ireland's capital markets and, in particular, supporting retail investors access to investment opportunities and domestic SME's access to finance? What measures can be taken or supported (if underway) to meet this objective?

The primary focus and role of the asset management industry, both globally and in Ireland, has been to facilitate international finance and investing, serving the needs of institutional investors who have been charged with the responsibility to manage, protect and grow pensions and savings right across the world.

To support retail investors access to investment opportunities in Irish funds, there needs to be strong investor protection and empowerment and digital access to make the process of investing easier and understandable. Supporting financial literacy across all facets of Irish Society will also be crucial.

Furthermore, investors in Irish regulated funds are deemed to dispose of and reacquire their units in a fund after the passing of each eight-year period of ownership, which triggers a tax liability without the receipt of any disposal proceeds, acting as a deterrent for Irish investors to invest into Irish regulated funds, as well as a deterrent to international asset management firms to promote and market such funds to Irish Investors as practical complexities exist managing tax aspects associated with these rules.

In terms of domestic SMEs, there are key opportunities for Irish funds in the non-bank financial intermediation space, which is critical in the context of growth in private debt, and the asset management industry plays a key role increasing this flow of finance from capital markets to European small and medium enterprises. A global trend has been seen with asset managers focusing investments into private markets and infrastructure, as well as asset managers stepped into the corporate lending gap left by the banking sector. As we have outlined earlier, some aspects of the regime in Ireland should be improved to enable the Irish asset management to unlock it's potential in helping domestic SME's access finance:

- Review the leverage restrictions in place for loan origination funds, which is placing Ireland at a competitive disadvantage to other jurisdictions in Europe
- Full implementation of the ELTIF regime, will enable the flow of capital to European and global corporate business
- A review of the section 110 framework, and the ability to distribute these products to a wider pool of investors
- A review of the framework of structures for this, in both the regulated and unregulated vehicles, similar to other leading investment fund jurisdictions in Europe

These changes would enhance the ability of asset managers to support government initiatives, infrastructure and SME's, which also link into investing opportunities for the domestic investor market.

Q21. What role can the sector play in meeting wider Government policy objectives in areas such as investment in domestic enterprises and infrastructure? What measures can be taken or supported (if underway) to meet these objectives?

Traditionally, governments have taken central responsibility for investing in infrastructure and supporting domestic enterprise, and large-scale capital spending programs have long been the way for governments across the world to push forward economic cycles. Now and in the past, essential infrastructure was typically budgeted for through government capital spending programs and financed using a combination of income and debt, i.e., tax revenue receipts and government bonds.

However, in times of rising interest rates or high government debt, ambitions in these areas can be tempered by rising debt levels and using alternative sources of funds may be merited.

The Asset Management Industry could be a potential source of support for government initiatives through listed infrastructure funds and establishment of private asset funds that are focused on specific projects. Private equity also has an important role to play in supporting government policy objectives in areas such as investment in domestic enterprises and infrastructure.

The challenge the asset management industry faces however is the fund structure itself and we have identified a number of suggestions to refining such structures throughout this response. Identifying asset types that work would also warrant consideration as the income generation and pay-back of investment would need to be modelled upfront so as to provide a meaningful return to investors.

A mixed government strategy could be to borrow money from international markets and use this to seed or invest in infrastructure funds that are professionally managed and where accountability and oversight are clearly defined.

There are numerous examples of essential infrastructure in government initiatives that would fit into these considerations, including housing, healthcare, broadband and green energy initiatives.

Q22. What role can the sector play in meeting wider Government policy objectives in areas such as pensions and long-term savings? What measures can be taken or supported (if underway) to meet these objectives?

Ireland is a global centre of excellence for asset management and has become the one of the largest centres for investment funds in the world (2nd in Europe, and 3rd globally).

The industry in Ireland is however largely focused on the cross-border market, with 92% of assets under management in Irish products held by foreign investors.

We have not leveraged from the expertise on our doorstep to create demand side incentives, designed to foster a culture of investing and long-term saving among the domestic Irish investors. We welcome the Department of Finance's consultation on the country's "National Financial Literacy Strategy" and believe fresh thinking will create more confidence in planning for positive savings and retirement outcomes.

Other demand side initiatives that might be considered to improving resident investor demand into Irish Funds include:

- Increasing thresholds for pension contributions made by Irish tax residents into ESG funds;
- Consideration of a special capital gains tax rates applied to ESG Investments;
- Consideration of PRSI or USC rates on gains earned from ESG Investments;
- Removal of the "deemed disposal" rule after 8 years of being invested in a regulated Irish Fund
- A review of the tax discrepancy between exchange traded funds (any gains charged as income) versus individual stocks traded on exchange (any gains charged as capital gains)

Q23. What role does the sector play in supporting investment in the economy and the savings needs of investors in the EU, and outside the EU, where relevant?

The primary role of the asset management industry is to protect, manage and grow the savings of individuals and institutions.

The Irish funds industry is largely positioned towards international investors and therefore provides significant support to the savings needs of investors in the EU, and outside the EU. For example, 92% of assets under management in Irish products held by foreign investors, largely institutional investors including overseas institutional investors and pension schemes.

The assets and capital that exists Irish funds have wide ranging positive impacts on the Global and European economy, helping savers and investors secure their financial future, to funding SME's and to assisting governments to meet their strategic objectives.

Section 5: Taxation of investment products

Q24. For an Irish investor, as set out above, tax legislation separately classes investments as:

a) Irish bank accounts
b) EU/EEA bank accounts
c) Other bank accounts
d) Dividends from companies
e) Capital gains on the sale of shares in companies
f) Irish life products (new basis)
g) Irish life products (old basis)
h) Foreign life products
i) Irish funds
j) EU/EEA/OECD equivalent funds
k) EU/EEA/OECD non-equivalent funds
l) Other distributing funds
m) Other non-distributing funds
n) Personal Portfolio Investment products

Taking account of the different nature of the investment products, is this an appropriate way to class investments for the purposes of taxing the returns on those investments? Does the differing tax treatment of different investments drive investor behaviour, and if so how? Do you propose an alternative method / methods of classifying investment products?

The appropriateness of classifying investments for tax purposes largely depends on the goals of the tax system and the principles it aims to uphold. Typically, tax systems aim to achieve fairness, revenue generation, and economic growth. The classification should align with these objectives. For example, long-term investments may receive preferential tax treatment to incentivise individuals and businesses to invest over a longer date time horizon.

The investment market has expanded exponentially over recent years with a wide array of funds and platforms now available to investors. Diverse and international investment portfolios are now accessible to a broad cohort of taxpayers including both professional investors and retail investors. However, the tax treatment of returns on investments is complex with differing tax treatment applying depending on several factors. Discussed further in response to Q27.

Q25. The return on certain investments is taxed through the operation of a withholding tax at source, while others must be self-assessed by the investor. In either case, the tax may be a final liability tax, or it may be an amount against which reliefs and credits are allowed.

a) Is it desirable that, where possible, taxes are:
i. deducted at source; and
ii. final liability taxes? Or
b) Is it desirable that:
i. taxes are self-assessed; and
ii. taxed at a marginal rate with reliefs and credits available against investment returns, meaning taxpayers would have to file a tax return each year.

Do the answers to a) and b) differ for different types of investment product or different types of taxpayer?

Please see our response above in question 27.

Q26. If any investment returns continue to be taxed on a final liability basis what link, if any, should there be between the rate of DIRT and the rate of tax applied to other investment products? Should consideration be given to reintroducing a “non-standard” rate to any products?

Please see response above in question 27.

Q27. Are there places where the taxation of investment income and gains need to be simplified or modernised? For example, in relation to the taxation of ETFs, the old basis of taxation for life products, or harmonising the exemptions from IUT and LAET.

(A) Overview

The Report of the Commission for Taxation and Welfare included a recommendation[1] for a review and proposal for changes with the goals of simplification and harmonisation where possible. The Commission noted that regard should be had to maintaining Ireland's international competitiveness and ability to attract capital investment.

(B) Reform of IUT

With respect to question 25 and question 27, IUT should be moved to a self-assessment basis. Ireland is a major international hub for international regulated cross border funds the investors in which are predominately international. The IUT regime is complex and overly onerous. In our view there is no doubt that it would benefit from simplification and modernisation. Notwithstanding the administrative burden in places on funds, we are of the view that is a barrier both for Irish investors to invest into Irish domiciled funds and for Irish funds (that are not ETFs) to attract Irish taxable investors.

We propose that consideration is given to changing the existing regime to link it to the Common Reporting Standard (CRS) reporting regime with the CRS regime extended (for investors in funds) to include Irish residents. Thus, where investors have provided their correct CRS information to the fund, exemption from IUT would apply. Irish investors in such funds could safely be exempted on the basis that details of all their income and gains earned from the fund would be reported to the Revenue Commissioners by the fund and such taxes could then be collected through self-assessment. Individuals are already required to include all this information on their tax returns so there should be no increased burden from the taxpayer's perspective. However, it would allow the funds and asset management industry to refine the currently inefficient infrastructure required to service what is, in effect, a small element of the funds and asset management industry i.e., the relatively small proportion of Irish investors. Implementation of these changes would need to be made in a manner that ensures that Irish corporate funds remain tax resident, and liable to tax, in Ireland. Further section 891c of the TCA should be considered to avoid duplicate reporting.

In instances where this information is readily available, it can be used to pre-populate tax returns for affected individuals.

(C) 8 Year Deemed Disposal and ELTIFs

With respect to questions 25 and 27, investors into Irish regulated funds are deemed to dispose of and reacquire their units in a fund after the passing of each eight-year period of ownership[2]. This triggers a tax liability without the receipt of any disposal proceeds (with credit given for this tax against tax on income and gains subsequently received/realised). This 8-year deemed disposal rule should be removed.

When initially introduced, this rule was justified on the basis that it provided a basis to prevent continuous deferral of taxation. However, that environment was one in which there were generous pension limits. In the current environment, Irish investors are frequently seeking (and indeed to avoid certain high tax provisions required) to hold long term, diverse and well managed assets outside of their pension assets. The 8-year deemed disposal disrupts this and causes investors to need to liquidate their assets in order to discharge tax. This may be at a time when they do not need to liquidate and indeed may be disrupting the type of long-term saving which was intended.

This removal is especially significant in respect of an investment entity that has a long-term investment nature. In the context of the promotion of ELTIFs, and ESG investment, there is currently no ability or motivation (beyond morality) for an Irish investor to choose such products. Indeed, in the context of an ELTIF, by their nature, ESG type products may be less liquid and longer term than traditional investments. Consideration should be given to developing the ELTIF for these purposes by allowing favourable tax treatment for qualifying 'sustainable investments' held by an ELTIF.

[1] www.gov.ie/en/publication/7fbeb-report-of-the-commission/, Section 6.3.2

[2] Chapter 1A, Part 27, Taxes Consolidation Act 1997

In addition to removing the 8-year deemed disposal, other incentives might include:

- Reduced rates of tax on distributions and other returns from an ELTIF holding qualifying investments
- Reduced capital gains tax rates for longer term holdings of an ELTIF holding qualifying investments

(D) Distinction between fund types

With respect to questions 24 and 27, much of the complexity in funds taxation stems from the distinctions between different forms of funds which are economically similar. In brief, if a person invests into a fund which tracks an equity index such as the NASDAQ, the taxation impact depends almost entirely upon factors which are not related to economic performance:

- The return on an Irish fund will be taxed at 41% in line with the IUT regime.
- The return on an EU/EEA/OECD fund, which is viewed as equivalent to Irish fund is similarly taxed.
- The return on an EU/EEA/OECD Fund, which is not viewed as equivalent, is subject to different tax rules with income being taxed at marginal rates and gains being taxed under the capital gains tax regime.
- The returns on non-EU/EEA/OECD Fund are taxed under one of several additional set of rules.

As set out in Revenue's guidance[3], the analysis required to reach a view on the tax position requires an examination of legal and regulatory factors. In a global marketplace, where retail funds are widely available, this inevitably creates confusion and complexity and tax arbitrage.

By way of example, for several years, a tax distinction existed between Irish and EU based Exchange Traded Funds and those based in other jurisdictions. Prior to 2022, the latter were viewed as subject to capital gains tax on disposal. In 2022, Revenue withdrew that guidance, which led to confusion amongst practitioners and those invested in non-EU ETFs. We discuss elsewhere in our response the question of attracting and retaining talent. In this regard, it is worth noting that where a foreign resident relocates to Ireland, they face the prospect of having to conduct an audit of their investments to determine how they are classed under the various product classifications.

This is an unattractive and off-putting factor which may affect their decision about location. Moreover, the situation is not improved for non-domiciled persons who may be entitled to the remittance regime in respect of offshore income and gains so long as they are not remitted to Ireland because the remittance basis is not applicable to offshore funds.

Given the complexity, consideration should be given to a broader review of the regime. The taxation treatment of these entities should, it is suggested, not depend upon the nuances of their regulatory treatment, nor whether the jurisdiction they are based in is a member of the OECD or not, but on whether they are in fact 'funds'.

In this regard, the AIF regime provides a wide and clear definition of what constitutes a fund. Since the advent of AIFMD, all funds, advisors and regulators will necessarily have become familiar with the definition which is as follows:

> *Any form of collective investment undertakings which: …*
> *raise capital from a number of investors;*
> *with a view to investing it in accordance with a defined investment policy;*
> *for the benefit of those investors.*

This would necessarily exclude non-AIFs, such as holding companies, commercial enterprises and other forms of investment, which are not properly within the scope of the current rules anyway. It would align the regulatory and tax position.

All Irish AIFs which qualify as investment undertakings would remain subject to the IUT regime (noting our suggestion regarding reform of this regime), as would all AIFs which are based in EU and double tax treaty countries.

[3] Tax and Duties Manual 27-04-01

It is unclear what policy objective is served by imposing higher rates of tax on non-EU/EEA/OECD AIFs. The original policy may have been based on a desire to penalise investments in non-transparent jurisdictions. However, that aim could be better preserved by imposing the more penal rates of tax on jurisdictions which are on the EU list of non-cooperative jurisdictions, given that all other fund domiciles are now party to international information sharing agreements. If they are not based in a non-cooperative jurisdiction, then we would consider that the normal (i.e., 41%) regime should apply to them.

The treatment of tax transparent funds should remain as it currently stands, with investors taxed on the underlying gains and losses arising to the fund.

(E) PPIU Rules

With respect to question 24 and question 27, the Personal Portfolio Investment Undertaking (PPIU) rules apply should be reviewed in the context of attracting and encouraging an investment management community in Ireland. The rules were introduced many years ago, before this was a realistic proposition and are now, in the context of a professional investment management sector in Ireland outdated.

In broad terms a PPIU is defined as a fund held by individual investors where the selection of some or all the assets held by the fund is influenced by the investor or a person connected with the investor. A higher rate of tax is imposed on income and gains arising from Irish or offshore funds to Irish individual investors who come within this definition of a PPIU.

In many instances, individual investment managers are required by investors to invest in the funds they manage. This is not done for tax avoidance reasons, but to ensure that managers have ‘skin in the game’ concerning the investments. The PPIU rules potentially apply because the manager has a role in selecting the funds’ investments, notwithstanding that in so doing they are obliged to deal with the fund in compliance with applicable law. The rules do not apply to all funds, and in particular do not apply to funds which are not based in EU/EEA/OECD jurisdictions, or, where the fund is so domiciled in the EU/EEA/OECD, they are not treated as equivalent to Irish funds.

The Revenue Guidance[4] reflects the breadth of these provisions by providing that:

> Revenue would not take the view that a manager or director of a fund who invests in the fund and who might have had a role in selecting assets for the fund comes within the provisions so long as the fund is a public one and the directors’ or manager’s holding in it is comparable with the investment held by other unit holders in the fund.

In a similar context (relating to IREFs), Revenue’s Guidance[5] notes, that where:

> An employee of the fund manager of an IREF acquires units in that IREF in his/her personal capacity. In his/her capacity as an employee of the fund manager, the employee is involved in the selection of properties to be invested in by the IREF. However, in undertaking his/her employment duties, the individual acts for the benefit of all investors in the IREF and cannot make selections which are designed to benefit him/her personally to a greater extent than any of the other investors. In these circumstances, the IREF should not be a PPIREF with respect to that individual.

We would suggest that the PPIU rules are now outdated. In a regulated funds context, where an investment professional is acting in the course of their duties, they should not be required to rely upon Revenue guidance to mitigate the impact of overly broad anti-avoidance provisions. In our view, the PPIU provisions should be reformed to put the above-mentioned guidance on a statutory footing and exempt investment professionals from the provisions.

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[4] Tax and Duty Manual 27-01A-02

[5] Tax and Duty Manual 27-01b-02

(F) Tax Rates

With respect to question 26, as indicated in prior submissions from us to the Department of Finance, we consider that there is merit in investigating changes to rates to those applied currently.

We recommend, at a minimum, alignment with the rate of DIRT, currently 33%, which is also the rate of tax for capital gains.

(G) Rate Arbitrage

With respect to question 26, there is, as highlighted in the Consultation Paper, a variance between capital gains tax and DIRT. These rate arbitrages can impact behaviour.

An Irish investor wishing to invest in a single strategy now has several ways to achieve that. It is rational that an investor would choose the rate, which is lowest for them, even if that were to expose them to greater risk or complexity. A person who wishes to get access to real estate has several choices including:

- Invest directly, where they will be subject to income tax (at up to 55%) on rental profits and capital gains tax at 33% on capital gains;
- Invest in a public company (such as an Irish REIT, or a non-Irish real estate investment company (such as UK Land Securities)) where they will be taxed to income on dividends or capital gains on sales;
- Invest in a regulated fund, where they will be taxed to 41% on all returns.

If a person wanted to invest in small-cap securities, there can be a similar pattern drawn:

- Invest directly, via a wealth manager, in a series of small-cap companies, where disposals will be subject to capital gains tax;
- Invest via a listed company (a number of such entities exist) and be subject to capital gains tax on disposals;
- Invest via a regulated fund and be taxed at 41%.

The above measures give credence to the fact that tax differentials can impact investor behaviour. The simplicity of the exit tax regime to Irish funds is admirable, but strong consideration should be given to an alignment of rates to prevent tax being distortive to the investment process. In this regard, and as noted, there is merit in lowering the rate applicable to long term holdings, to incentivise investment in products such as ELTIFs and to better align the rates applicable to investment funds with those of capital gains tax and DIRT. Thus, we recommend, at a minimum, alignment with the rate of DIRT, currently 33%, which is also the rate of tax for capital gains. Again, certain product types could be incentivised with reduced rate of tax to attract investment in areas that are of strategic importance.

Q28. Given the differences in the data reported to the Revenue Commissioners under international reporting standards when compared to domestic reporting obligations, should additional reporting be introduced to, for example, facilitate the pre-population of tax returns where tax liabilities are to be self-assessed?

We would generally be supportive of the Revenue Commissioners implementing a system of pre-population of tax returns where tax liabilities are to be self-assessed. However, given the complexity of the existing categorisations of offshore funds, we would not be supportive of placing additional burdens on those facilitating reporting if it entailed them having to determine these classifications. If a simplified regime were adopted, this might better facilitate this approach.

Q29. Where investments in investment undertakings, life policies or offshore funds give rise to a loss, no relief is available against other income. Where an individual has a gain on one such product and a loss on others, that loss may not be offset against the gain on a similar product. Is it desirable that loss relief, or a limited form of loss relief, be introduced for investments in these products? Note that reliefs cannot be given where the tax is a final liability tax deducted at source.

Irish investors are frequently faced with the inability to offset losses between investment products. This produces unfair results.

The perceived unfairness in this is evident in that the taxpayer will suffer tax on all gains or distributions but derive no relief from losses. This has the potential to impact behaviour. In capital gains tax, the ability to offset losses against gains is inherent, but in other forms of investment activity, principally for these purposes, investment funds, it is not provided for in legislation.

Q30. Are there differences within the regimes (e.g., in relation to who can make a declaration under LAET compared to those who may make a declaration under IUT) which should be addressed?

We have no particular comments on LAET but, as a general matter, we can see the logic in having conformity across different types of investment products.

Q31. How should derivative products which mirror the performance of regulated investment products be taxed? Should they be taxed at the same rate as the investment product they mirror or should they be taxed under first principles?

We have no particular comments on such products but, as a general matter, we can see the logic in having conformity on tax rates and tax treatment across different types of investment products.

Q32. Are any additional anti-avoidance rules required for any of the measures suggested in answer to previous questions?

Robust anti-avoidance rules are an important part of modern tax legislation albeit it is important to ensure that they are not over-broad in reach and do not impose an excessive burden on persons they are not targeted at.

Section 6: The role of the REIT and IREF regimes in the Irish property market

Q33. Are there aspects of the way in which property funds are taxed, or defined, that could be aligned with other existing standards, for example, the recent changes in the CBI's macro prudential measures for property funds?

Leverage limits for IREFs were introduced in the tax code in 2019 to curtail perceived excessive leverage in IREF entities. IREFs are now, however, also subject to the regulatory limits set down in the macroprudential policy framework for Irish Property Funds published by the Central Bank of Ireland in November 2022.

Whilst acknowledging adjustment to the leverage limits applicable to IREFs for tax purposes is primarily a policy matter for Government, it is noted that leverage limits for fund regimes in peer jurisdictions are typically aligned to regulatory rules, rather than set through separate rules in the tax code. Noting the complexity of the specific tax provisions and some of the ongoing interpretative issues encountered by IREFs with regard to their application (see below), there is a *prima facie* case to be made for aligning these rules in the interests of simplification.

Q34. IREFs invest in property of all descriptions, as developers, financiers and landlords. Do IREFs, and the regime as it is currently designed, support investment in housing policy objectives?

Institutional investment has been a major source of funding for the residential property sector over the last number of years, and a lot of the investment has been via IREF entities.

It is clear, therefore, that IREFs have played a significant role in boosting supply or residential accommodation, particularly in relation to apartments, where there have been question marks around viability in the absence of the underwriting provided by institutional forward purchase arrangements.

It is noted that IREF structures can also facilitate co-investment opportunities involving State entities to invest in the provision of residential accommodation.

Amongst the most important issues for large scale institutional investors when deploying capital are confidence in the stability of a particular (tax) regime and a relative certainty around medium to long term taxation treatment underpinning that regime. With this front of mind, any reassessment of the IREF regime should accordingly be focused on enhancing and simplifying the existing IREF provisions (rather than replacing the regime/making wholescale changes) but noting that such enhancement/simplifications are an important facet of increasing the efficacy of the regime.

Q35. How does the IREF regime compare to property fund regimes in other comparable EU jurisdictions?

The broad principal of the taxation of property funds internationally is:

- non-taxation (tax neutrality) at the level of property funds.
- the application of a withholding tax to distributions from that fund (this a common one in peer jurisdictions; for example, withholding tax is 20% in UK).
- the imposition of income / corporate tax as relevant on domestic residents in receipt of distributions from property funds, with a credit for any withholding tax incurred by those residents.
- Some level of exemption for non-residents (typically depending on tax status, tax residence etc.) – depending on local taxation policy with regard to the taxation of non-residents on property located in that jurisdiction (with withholding tax applying to investors who don't meet relevant criteria).

From the perspective of international investors, potential exemption from the withholding tax in a given jurisdiction is therefore an important consideration.

Ireland provides a relatively narrow range of exemption from IREF WHT for non-resident investors (in line with long standing Irish policy with regard to taxation of non-residents in respect of property). While this is in line with the approach in some jurisdictions (e.g., the UK), it is disadvantageous relative to others. There is a question as to whether the exemptions could be extended (say to encompass non-EU based institutional investors in double tax treaty jurisdictions, sovereign wealth funds etc.).

Q36. Are there aspects of the IREF regime that are not operating as intended or that are acting as an impediment to investment?

As outlined previously, one of the key issues for international investors is relative certainty around the operation of the IREF regime. Certain elements of the IREF legislation are highly complex and can be difficult to interpret in practice, notwithstanding the good faith endeavours by the Revenue Commissioners to address by way of guidance. In particular, the application of the leverage limitation rules (including elements of the third-party debt exclusion rules) and tests for establishing equivalence between an EU entity and its Irish equivalent (for the purposes of applying exemption from IREF WHT) can be quite uncertain. Furthermore, there can be (understandable) delays in getting rulings from Revenue which results in a lack of clarity for investors into Ireland.

We would recommend a continued focus on simplifying the regime and accompanying guidance (e.g., see comments above on possible alignment of leverage limitation rules with the CBI Macroprudential policy guidelines) and building greater efficiencies into relevant advance clearance provisions (in particular with regard to response timelines).

Q37. We invite comment in relation to the tax treatment of IREFs, in particular in relation to the following:

- The tax rate applicable to both resident and non-resident investors
- The tax exemptions that apply to certain categories of investors
- The tax rate applicable at the level of the fund
- The overall tax treatment of IREFS – should an alternative mechanism be considered?

(A) The tax rate applicable to both resident and non-resident investors

As noted above, the main issue in terms of the rate and the application of IREF WHT rate is stability and relative certainty for investors (both domestic and international). Investments made through IREF vehicles are typically made with a view to holding assets over the long term. In this regard, it is critical for investors in these types of vehicles that they understand the tax treatment likely to be applicable over their investment horizon.

(B) The tax exemptions that apply to certain categories of investors

As highlighted above, there is a question as to whether the exemptions available should be extended to non-EU/EEA based funds (including UK funds), and sovereign wealth funds.

(C) The tax rate applicable at the level of the fund

Broadly, the fundamental rationale of the regime is tax neutrality at the level of the fund and that should clearly be retained. See comments above in relation to leverage limitation rules, and with regard to simplification of the regime at Q36.

(D) The overall tax treatment of IREFs – should an alternative mechanism be considered?

We do not have a firm view on any particular alternative. As noted above, our key message is the importance of stability and certainty for investors with regard to their long-term tax position under any Irish fund-based regime, so that there can be confidence from a fund industry perspective that the Irish fund product compares favourably with peer jurisdictions (e.g., Luxembourg, UK). If it is determined that an alternative regime should be implemented, we recommend that engagement with stakeholders is critical to ensure the appropriate design of any new regime.

Q38. REITs invest in property as landlords and as developers of property to hold for rent. Do REITs, and the regime as it is currently designed, support investment in housing policy objectives?

REITs are intended to allow access to investing in property by retail investors and in this context, in a well-functioning environment, can provide an alternative source of capital funding to support the development of residential accommodation in Ireland, as well as facilitating a greater degree of "public" ownership of residential property in Ireland.

Q39. While REITs are a structure used in many jurisdictions for collective investment in property, Ireland now has only one remaining REIT. Are there aspects of the REIT regime that are not operating as intended or that are acting as an impediment to investment?

The original REIT legislation provided for a rebasing of assets to their market value for CGT purposes where a REIT left the REIT regime (and therefore avoid any latent capital gains tax exposure during the period of ownership by a qualifying REIT). However, Finance Act 2019 provided that a rebasing would not be available where the entity leaving the REIT regime has been operating as a REIT for less than 15 years prior to its cessation. This rule may be regarded as a significant disincentive for a REIT to establish itself in Ireland.

In addition, Finance Act 2019 introduced a measure requiring a distribution or reinvestment of the "net proceeds" of a disposal of a rental property i.e., the sale proceeds received less any amounts used to repay specified debt used to acquire, enhance or develop the property. Any portion of the net proceeds not distributed / reinvested within a two-year window (plus a deemed period of 12 months preceding the disposal) is potentially subject to corporation tax at 25%. Furthermore, where the proceeds are distributed, DWT (at 25%) will apply on the distribution to non-residents, albeit with treaty relief potentially available.

By requiring the distribution of the "net proceeds" within a relatively short timeframe, rather than limiting this to the distribution of any gain realised only, this provision limits the ability of the REIT to retain funds for future investment and represents a notable restriction on the operation of any REIT in Ireland.

Furthermore, we note the condition that a REIT's leverage may not exceed 50% of the market value of its assets. Given the inverse relationship between property prices and interest rates, and in the context of rising global interest rates, this condition may discourage investment in Irish property by a REIT. This could be amended such that the leverage ratio is based on 50% of the cost of the assets.

Q40. How does Ireland's REIT regime compare to REIT regimes in other jurisdictions?

Within Europe, the UK has the largest number of REITs and the largest value of commercial real estate held by REITs. The UK undertook a similar consultation in recent years, and pursuant to that has changed some of the key requirements of their REIT regime in order to make their regime more attractive. These changes included a relaxation of the requirement to be listed / admitted to trading on a recognised stock exchange where:

- Institutional investors hold at least 70% of the ordinary share capital of the REIT; or
- The REIT is owned by a collective investment scheme limited partnership and the 'genuine diversity of ownership' condition (which considers whether the fund is marketed to new investors) is satisfied.

There may be limited room for vehicles with onerous listing requirements in an Irish market context; following the UK lead in this area is something which could be considered. The UK also loosened some of the rules around the requirement for a REIT to be a non-close company; adopting similar changes in Ireland could enhance the attractiveness of the Irish REIT regime.

In that consultation exercise, many respondents supported broadening the definition of qualifying assets for the UK REIT regime to reflect the evolution of the real estate investment industry e.g. assets suggested for inclusion include property backed debt (to allow UK mortgage REITs); operational income from infrastructure assets; and renewable energy assets and the technology and other infrastructure needed to enable the transition to net zero. In an Irish context, widening the classes of qualifying real estate assets could enhance the attractiveness of the REIT regime here.

Currently, where a REIT makes a distribution to a "holder of excessive rights", it may be chargeable to corporation tax on that amount. A "holder of excessive rights" is a person who is entitled, directly or indirectly, to at least 10 per cent of the property income dividend distribution, or who is entitled to or controls directly or indirectly, at least 10 per cent of the share capital of or voting rights in the REIT. There is a limited exemption for a "qualifying investor" (i.e. an investment undertaking, a pension scheme, a life assurance company, a charity or NAMA) which is not regarded as a holder of excessive rights. The definition of "qualifying investor" is restrictive when compared to the UK equivalent. In the UK, a majority of REITs are owned by institutional investors, which are regarded as "qualifying investors" for the purposes of the equivalent UK provision; the narrow Irish definition in this regard may ultimately discourage the establishment of REITs in Ireland.

Ireland's REIT regime is also an outlier in that an Irish REIT is subject to AIF regulations; many European peer jurisdictions have REITs they do not regard as AIFs.

The reinvestment conditions noted above make an Irish REIT less attractive for shareholders.

Q41. We invite comment on the tax position in relation to REITs, in particular in relation to the following:

- **The standard REIT structure, common internationally, of exemption for qualifying property profits within the REIT subject to a range of conditions including a requirement that a high proportion of the profits (85 per cent in Ireland) be distributed annually for taxation at the level of the shareholder**
- **The tax exemptions that apply to certain categories of investors**
- **The tax rate applicable at the level of the REIT**

(A) The standard REIT structure, common internationally, of exemption for qualifying property profits within the REIT subject to a range of conditions including a requirement that a high proportion of the profits (85 per cent in Ireland) be distributed annually for taxation at the level of the shareholder

A fundamental characteristic of REITs internationally is the removal of a layer of double taxation and annual distribution of most profits arising from the relevant property rental business.

The 85% threshold required by Irish legislation is within the range specified in the REIT legislation of other EU states (e.g. Spain requires an 80% distribution, UK, USA and Germany require 90% while France requires 95%). A limited reduction in this 85% could facilitate reinvestment of profits by Irish REITs without undermining the overall purpose of the regime.

(B) The tax exemptions that apply to certain categories of investors

See comment regarding the definition of a qualifying investor at Q40. We have no other specific comments in relation to the tax treatment of Irish investors in an Irish REIT.

(C) The tax rate applicable at the level of the REIT

REITs are broadly intended to allow for investment in property through an appropriate vehicle without the investor incurring additional taxation compared to a direct investment. This is achieved by providing that a REIT (which meets the qualifying conditions) is not subject to tax in respect of income or gains arising for its property rental business, except in certain circumstances where it carries out significant development in respect of a property and disposes of that property within 3 years. A charge to tax may also arise where the REIT breaches certain conditions of the REIT regime e.g., fails to distribute 85% of its property profits.

Noting the comments above regarding the limitations of the vehicle arising from the obligations of REITs to (a) distribute 85% of rental income annually, (b) distribute the net proceeds of asset sales in a 36 month window and (c) impose CT / CGT where an asset is developed for sale by a REIT, and the potential adverse impact of such limitations, REITs broadly function as originally intended from a policy perspective (i.e. achieving tax neutrality) at the level of REIT.

We note the limitation which seeks to disincentivise REITs from developing assets with a view to realising short term gains, which is a policy matter for Government.

Q42. Should the IREF and REIT regime continue to exist in tandem?

The IREF regime is predominantly focussed on institutional investors, while the REIT regime is predominantly targeted at retail investors as it gives such investors the opportunity to participate in the commercial real estate market through a tax neutral regime without having access to substantial capital. In this regard, notwithstanding that the REIT regime has struggled to gain traction, the underlying purpose of the REIT regime does not necessarily conflict with the IREF regime. Furthermore, shares in a REIT are intended to be liquid, while it is often less straightforward for an investor in an IREF to divest their interest. Therefore, in our view, there remains a compelling rationale for the regimes to continue to exist in tandem.

Q43. Is there an appetite for retail investors to invest in property, if so, what is the best type of vehicle to accommodate such investment?

There remains strong appetite for retail investors to invest in property in an Irish context. Consideration could be given in this regard to introducing specific regulated “retail fund” type products as exist in Germany and other jurisdictions to provide as much flexibility as possible to leverage retail interest in the property sector.

The REIT regime was originally introduced with the rationale of facilitating retail investment in property; as noted previously, if the REIT regime is to be retained, there is a need to make the regime more attractive; in this regard, a relaxation of listing requirements and other changes as made in the UK should be considered.

Building a better working world

Section 7: The role of the Section 110 regime

Q44. What policy objectives should section 110 be supporting?

Section 110 SPVs are used for a wide range of purposes across many sectors including for the securitisation of mortgages by banks, the leasing of aircraft, and the provision of receivables financing to name but a few.

Within the funds and asset management industry, Section 110 SPVs are an essential adjunct to regulated funds and are used in a number of important ways. These include:

i. **Fund investment subsidiaries for collateral purposes:** Section 110 SPVs are frequently used by Irish regulated funds as tax neutral SPVs through which to make investments. For example, investors may want to leverage their investment made through an Irish fund by having the fund borrow funds from a third-party lender. That third-party lender may wish to have the secured assets segregated into a special purpose entity. Section 110 SPVs fulfil this role, by being established as a subsidiary of the Irish regulated fund. The Section 110 SPV borrows the funds from the third-party lender and grants security over the secured assets, returning the net income to the Irish regulated fund.

ii. **Investment into Irish funds:** Section 110 SPVs are used as vehicles through which investors invest in Irish regulated funds. For example, some investors have a regulatory or legal preferences to make their investments in return for debt securities. In these cases, an investment fund manager can establish a Section 110 SPV, which issues bonds to the investor in question and uses the funds to invest in the Irish regulated fund.

iii. **Warehousing assets**: Section 110 SPVs are also frequently used to 'warehouse' assets that are earmarked to be acquired by Irish regulated funds. For example, it can often be the case that investors / the fund manager has identified an asset to be acquired for an Irish regulated fund, but the fund has yet to be authorised and launched. In these cases, a Section 110 SPV can quickly be established to acquire and hold the asset until the Irish regulated fund is authorised and launched, at which point the asset is transferred to the Irish regulated fund.

iv. **Alternative investment vehicles:** Section 110 SPVs are established as alternative investment vehicles to the main fund in some cases. By way of background, in many private fund structures, investors may require / desire that the fund manager establish what is known as an 'alternative investment vehicle' in parallel to the main fund to accommodate the legal, regulatory or other requirements of certain investors, so that those particular investors invest in the 'alternative investment vehicle', instead of the main fund (but on economically similar terms). Section 110 SPVs are established by international fund managers as alternative investment vehicles to main funds established as Irish regulated funds.

v. **Investment into EU markets:** Most international fund managers will have fund ranges established elsewhere in the world (e.g., North America) for investors domiciled in those other regions. Many of those funds will look to invest in European investments. International fund managers will, in the case of private equity and private credit investments, typically look to establish an EU investment vehicle through which to make such EU investments. Such fund managers will always wish to establish such EU investment vehicles in the same jurisdiction as their EU regulated fund ranges, as they will typically have established relationships, and operations, in such jurisdictions. Other EU fund domicile jurisdictions do offer EU investment vehicles in addition to their regulated fund offering, and it is therefore critical that Ireland also offers a suitable EU investment vehicle for such fund managers. Section 110 SPVs have met this requirement for many years, and it is of paramount importance that Ireland continues to offer such a suitable SPV for investment purposes. Therefore, one of the key policy objectives that section 110 should support is that Ireland has a tax neutral SPV that meets the needs for international investors. The UK and leading EU fund jurisdictions are taking steps to offer, and improve, their tax neutral SPVs and Ireland needs to maintain, and improve, its offering.

vi. **Standalone investment vehicles:** In some cases, investors will want to invest in a unregulated vehicle. This may be due to the size of the deal or other specific deal attributes. The Section 110 SPV can serve this investor need. As noted above, fund managers will tend to establish such SPVs in the same jurisdiction as their other products. Therefore, it is critical that Ireland also offers a suitable unregulated investment vehicle for such fund managers. Section 110 SPVs have met this requirement for many years, and it is of paramount importance that Ireland continues to offer such a suitable SPV for investment purposes

Therefore, from a policy perspective, Section 110 companies are needed to support the development and growth of Ireland as a leading funds domicile. In particular, they serve as a critical support to the promotion and development of Ireland as an international fund domicile, a preferred jurisdiction for international investors, and private assets centre of excellence.

In part, this is because the offering of a tax neutral SPV structure is a fundamental component within any assessment of a domicile's fund servicing capabilities. In this regard, there is a trend among international fund managers to choose one jurisdiction for both their primary fund and SPV jurisdiction (or at least one European jurisdiction as their platform in Europe). This is driven by a number of factors including legal and operational reasons. It is also driven by ongoing changes from a tax perspective driven by the OECD's BEPS (Base erosion and Profit Shifting) initiative. For example, Action 9[6] of that original plan addresses "Risks and capital: Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members". The plan includes the adoption of transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. It also addresses the need for rules to require "alignment of returns with value creation". This very much points to having legal entities and associated substance (such as managers) in the same jurisdiction. Moreover, while the Section 110 SPV regime is not regulated, the need to have substance in the same jurisdiction is being driven by regulators (e.g., the CBI's CP86 consultation[7]).

However, a jurisdiction which allows a manager to achieve these objectives must also satisfy the needs of the investor community which the manager seeks to attract. Accordingly, when one assesses a jurisdiction for their needs, one is not looking at the fund regulatory/legal structural options in isolation, rather, one has to consider the fund regime together with the effectiveness of the SPV regime, which can in turn make investment returns considerably less or more attractive, depending on its SPV efficiency.

If Ireland did not have the Section 110 regime available to international fund managers, the unavoidable result would be that international investors would eschew Irish unregulated vehicles and, as a result, international fund managers would look to other (EU) jurisdictions for both their regulated funds and their SPVs, as both go increasingly hand-in-hand.

(A) Current Concerns with respect to Section 110 SPVs

The Public Consultation observes concerns raised about the role of section 110 SPVs within the Irish property market. We believe these concerns have been addressed through tax changes introduced to the section 110 regime for 'specified mortgages' known as the Specified Property Business Rules (the SPB Rules) and in addition, it is important to note that only a few Section 110 SPVs hold investments in the Irish property market. The majority of Section 110 SPVs have no connection with the Irish property market whatsoever and are instead investing in international assets. In the event that Government believes that the SPB Rules do not adequately address these concerns and deem further changes to be required, we recommend stakeholder involvement with respect to design and implementation of the new regime is considered. This will ensure that the new regime is in accordance with policy intention and does not adversely affect the rest of the Irish funds and asset management industry.

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[6] Action Plan on Base Erosion and Profit Shifting (OECD, 2013)

[7] https://www.centralbank.ie/news-media/press-releases/central-bank-publishes-outcome-of-thematic-review-of-fund-management-companies-20-october-2020

(B) Importance of the Section 110 SPV

There are currently more than 3,000 Irish Section 110 SPVs holding assets of more than €1 trillion[8]. The aspect of the fund industry provides a substantial amount of local employment for Irish service providers such as administrators, lawyers, accountants, managers, etc. In turn, these businesses and their employees contribute significant amounts to the exchequer through corporation tax, income tax, and social security contributions. Moreover, most SPVs will incur Irish VAT which accrues to the benefit of the Irish exchequer.

We believe the Section 110 SPV represents an essential part of Ireland's offering to international investors and fund managers and in the event, Ireland did not maintain this regime, investors and fund managers, would not only look to other jurisdictions to facilitate the SPV necessity, but they would look to other jurisdictions to facilitate their entire European fund presence. Consequently, Ireland would lose the direct employment and tax revenues associated with the formation and operation of such SPVs, it would also lose the much larger network effect of offering both the necessary regulated fund environment combined with the associated SPV infrastructure.

Q45. What changes are needed, if any, to ensure the section 110 regime meets those policy objectives?

To maintain Ireland's success as an international investment funds and asset management sector, and to ensure Ireland remains resilient and an example of international best practice for investment funds, Ireland needs to have a more enhanced tax neutral SPV vehicle. A well-functioning tax neutral SPV vehicle is a critical attribute of any considered and comprehensive infrastructural offering to international fund managers.
We believe there are three categories of changes that are needed to ensure that the Section 110 SPV regime meets the policy objective of ensuring that Ireland has a tax neutral SPV that meets the requirements of international investment fund managers:

1) Introduction of appropriate tax exemption;
2) Consolidation of anti-avoidance rules; and
3) Refinement of the Section 110 SPV operational requirements.

[8] Source: Atlantic Star Consulting Irish SPV Report Q1-2023

Building a better working world

Section 8: General Questions

Q46. In addition to the matters covered in this public consultation, are there other issues relevant to the Terms of Reference, which you wish to bring to the attention of the Department? Yes / No

None

Q47. If you have answered "yes", please provide a brief summary of those issues, providing any information or references to material that you consider relevant to the Terms of Reference and the Department's work

N/A

Q48. This consultation is necessarily wide-ranging. As we would not be able to take forward all proposals immediately, what do you think the top 3 priority proposals should be for government implementation and why?

We believe the following should be the key priorities for the industry:

1. The establishment of a dedicated unit within the Department of Finance to address evolving market dynamics as well as developments in rival jurisdictions would assist in ensuring that funds and asset management industry in Ireland remains well-prepared to promptly respond to changes in investor demands or regulatory requirements.
2. Ireland should aspire to establish itself as a global destination of choice for private asset strategies. Achieving this objective will necessitate refinements to existing fund structures while also introducing new ones.
3. The funds and asset management industry in Ireland can provide value to the real economy through job creation and employment; investments into Irish SME's and Infrastructure projects; and giving choice to Irish investors, saving towards long-term retirement goals. Maintaining appropriate tax measures will play a crucial role in contributing to this objective.