An Roinn Airgeadais
Department of Finance

Real Estate Investment Trusts, Irish Real Estate Funds and Section 110 Companies as they invest in the Irish Property Market

Tax Strategy Group – 19/02

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Contents

Introduction

1. This paper has arisen from a commitment given during Dáil debates on Finance Bill 2018. Following discussions on the various collective investment structures used to invest in Irish property assets, and of the anti-avoidance measures introduced in Finance Bill 2016, Minister Donohoe committed that officials in the Department of Finance would conduct a review of Real Estate Investment Trusts, Irish Real Estate Funds and Section 110 companies as they invest in the Irish property market.

2. This paper sets out each of the above investment structures in detail, to provide clarity on the individual features of each structure. It also collates and presents available data from Revenue and the Central Bank of Ireland to generate a picture of their activities in the Irish market.

3. The focus of recent commentary on the presence of institutional investors in the property market has been on activities in the residential segment of the property market. It is suggested that institutional investors may be buying up property that would otherwise be available to individual home-buyers. This paper therefore also considers available data on landlords and tenancies in the State, and on institutional investment in the housing market.

4. It is intended that the paper will form a basis for future policy discussions in institutional investors in the Irish property market. It therefore presents the available information on the investment structures and property market without seeking to draw conclusions or recommendations.

Real Estate Investment Trusts (REITs)

5. REITs are an internationally recognised investment model, having originated in the USA in the 1960s. Aspects of the REIT model have now spread to become a globally recognised investment standard in over 35 countries worldwide, including the majority of the world's developed investment jurisdictions.

6. A table comparing key features of REIT regimes in 11 countries is contained in Appendix 1. The EPRA Global REIT Survey 2018 indicates that 13 EU countries have REIT regimes, with Poland also set to introduce a REIT regime in 2019[1].

7. The tax regime for the operation of Real Estate Investment Trusts (REIT) in Ireland was introduced in Finance Act 2013, which inserted Part 25A into the Taxes Consolidation Act 1997.

8. A REIT is a quoted company, used as a collective investment vehicle to hold rental property. A REIT generally has a diverse ownership requirement, so no one person or group of connected persons can control the REIT. A REIT is exempt from corporation tax on qualifying income and gains from rental property, subject to a high profit distribution requirement to shareholders. In Ireland this requirement is set at 85% of rental profits.

9. A REIT is structured to provide after-tax returns to investors similar to direct investment in rental property. This is achieved by eliminating the double layer of taxation at corporate and shareholder level which would otherwise apply if this activity were to be undertaken by a property rental company.

10. REITs are intended to provide risk diversification, therefore a REIT must hold at least three properties and carry on a business of letting property. No one property may account for more than 40% of the total value of the property in the REIT. The REIT must derive at least 75% of its profits from property rental and as stated must distribute at least 85% of its rental profits to shareholders.

[1] http://prodapp.epra.com/media/Global-REIT-Survey_Web_20180830_1535727364551.pdf

11. A profit:financing ratio is also imposed to limit borrowings within REITs, to protect against over-leveraging. A ratio of at least 1.25:1 must be maintained between the income of the property rental business (before deduction of financing costs) and the financing costs of the property rental business.

12. REITs are specifically designed to focus on the long-term holding of income-producing property, they are not intended to be used as property development vehicles. Therefore if a REIT acquires an asset for the purposes of its property rental business and, following that acquisition, develops that asset to the extent that the cost of development exceeds 30% of the market value of the asset at the time the development commenced, and subsequently disposes of the asset within three years, any gain will be subject to tax within the REIT.

13. It is also not intended that REITs should be used to hold cash or other non-property investments for any length of time. Therefore where a REIT raises proceeds, for example from the sale of a property or from an issue of shares, the proceeds must be invested in assets of the property rental business within two years. If this does not occur, any subsequent profits arising from the proceeds will not qualify as REIT property profits and the proceeds will be treated as assets of the residual business, which could potentially affect the company's qualification as a REIT under other criteria.

Policy Rationale

14. One of the primary reasons for the introduction of the REIT regime in 2013 was to attract new sources of non-bank financing to the Irish property market, at a time when the market was stagnating due to the fiscal crisis and property market crash. It was intended to reduce dependence on bank financing in the property market and free up available bank financing for use in other industries.

15. The limited availability of investment capital from the banking sector was a significant structural issue following the financial crisis. These difficulties were particularly pronounced in Ireland due to a strong reliance on bank financing over other sources of capital investment.

16. The REIT structure was viewed as a practical model to introduce international capital to the property market as the REIT model is recognised and understood by institutional investors throughout the world.

17. Prior to the introduction of the REIT regime, investment in property via corporate vehicles was not generally attractive due to the double layer of taxation that applies to profits earned in a company and then paid out to shareholders in the form of dividends. Corporation tax at the higher, non-trading, rate of 25% is payable by companies on rental profits with capital gains tax applying to the disposal of rental properties, and shareholders are taxable on dividends paid from the after-tax profits of the company.

18. REITs were designed to remove this double layer of taxation that otherwise applies to property investment via corporate vehicles. Subject to meeting a number of criteria, including a requirement to distribute annually at least 85% of rental profits to its shareholders, a REIT may qualify for an exemption from tax on qualifying income and gains within the REIT. This ensures a regular income flow from the REIT to its shareholders, making REIT investments suitable as a long-term investment alternative to traditional pension funds, equity shares and direct property investment.

19. The lack of a suitable method for collective investment, particularly for smaller investors, also led to structural issues in the property market. Prior to the introduction of the REIT regime, the average Irish residential landlord owned between 1.6 and 2.1 properties, and less than 1.25% owned 10 or more properties[2]. These figures indicated a significant concentration of risk in one or two buy-to-let properties for the majority of residential landlords. Risks inherent in this model of investment affect both landlords and tenants, and include:
    - Impaired security of tenure for tenants, as a change in the landlord's personal or financial circumstances could result in a need to sell the property or occupy it for personal use.
    - Inconsistent standards and lack of professional property management in the residential property market, with some landlords being unable or unwilling to engage with their tenants.

[2] The Daft.ie Rental Report: an Analysis of Recent Trends in the Irish Rental Market 2012 Q3

- Debt sustainability risk for landlords with one or two heavily mortgaged properties, where a failure to let the property, a failure of tenants to pay rent or an adverse movement in interest rates could result relatively quickly in payment default.
- Investment risk, with the impact of a fall in the property value being magnified by the mortgage borrowings meaning that any original equity could be wiped out and further losses incurred.
- Lack of liquidity for investors, who would have to re-mortgage or sell the property in order to access capital.
- Investors without the means (including borrowings) to acquire a whole property were unable to invest, limiting the ability of the less wealthy to benefit from property market gains.

Benefits of the REIT regime

20. REITs facilitate collective investment in property therefore providing the benefits of risk diversification to investors of all sizes. This in turn brings new sources of capital into the Irish property market and contributes to reducing dependence on bank financing, therefore freeing up available bank financing for use in other industries.

21. REITs provide a number of benefits to both small and large investors, including:
    - Liquid investment – listed shares can be sold far more easily, more quickly, and at lower cost than a sale of an investment property.
    - Income producing investment – regular dividend streams are produced due to distribution requirement on the REIT company.
    - REITs provide access to investment in real estate without buying property directly. The minimum investment is the price of a single share in the REIT, so it is accessible to small investors in addition to large institutional investors.
    - A REIT allows an investor to participate in both the rental returns (via the distribution requirement) and the capital gains (via the appreciation of share value) of the property market.
    - It also allows wider access to returns from investment grade commercial property that previously were restricted to large institutional investors only.

- The investor can diversify their risk by investing in a REIT holding a variety of properties, in contrast to concentrating risk in the purchase of an individual rental property.
- As public limited companies, REITs have a transparent structure with strong corporate governance and reporting standards.

22. REITs can also be beneficial through the promotion of professional management in a residential property market which has traditionally been dominated by small, individual landlords, often with high mortgage borrowings against the property. REIT regimes are also intended to be beneficial to tenants by improving stability of tenure as REITs are designed for long-term property investment, which should reduce the likelihood of a tenancy being terminated as a result of the landlord choosing (or needing) to sell the property.

Taxation

23. A REIT is exempt from corporation tax on qualifying income and gains from rental property subject to a number of criteria. As such, when discussing taxation in relation to REITs in Ireland, the focus should be on the shareholder as this is where the income is taxed.

Irish REIT Investors:

24. Individuals are liable to tax at their marginal rates on dividends received. Corporates are liable to tax at 25% and institutional portfolio investors are liable to tax on REIT dividends at 12.5%, this being the rate generally applicable to trading income. Dividend Withholding Tax (DWT) at the standard rate of 20% is deducted by the REIT from dividends paid to shareholders and is available as a credit against tax liabilities.

Non Resident Investors:

25. Dividend Withholding Tax (DWT) at the standard rate of 20% will also be deducted by the REIT from dividends paid to non-resident shareholders.

26. Foreign investors resident in a country with which Ireland has a double tax treaty may be able to reclaim some of this DWT under the relevant tax treaty. Tax treaty

rates on dividends vary from treaty to treaty, but the most common rate applicable to small shareholdings would be 15% - this means that Ireland would retain taxing rights of 15% on dividends paid from Ireland.

27. It is a requirement of the REIT legislation that REITs must not be closely held (broadly speaking, under the control of 5 or fewer individuals and their associates). Special rules also apply where a dividend is paid to a shareholder who owns more than 10% of the REIT shares, these shareholders are known as "holders of excessive rights". Where a REIT makes a distribution to a holder of excessive rights, the distribution will be treated as an amount of income liable to tax in the hands of the REIT.

Exemptions from Dividend Withholding Tax:

28. As noted above, DWT provisions apply to distributions from a REIT. As is the case with other dividends subject to DWT, certain categories of investors such as pension schemes, life assurance companies and charities are exempt from the dividend withholding tax provided the appropriate declarations are in place.

REITs in the Irish Property Market:

29. There are currently four REITs operating in the Irish property market. Green REIT plc, Hibernia REIT plc, and I-RES REIT plc were all incorporated following the introduction of the REIT legislation in 2013. Yew Grove REIT plc is the most recent entrant to the Irish market having been incorporated in April 2018.[3] It is important to note that Green REIT plc has recently announced its intention to cease its operations in the Irish market[4].

30. Information in relation to the activities of REITs in the Irish market is available publically through each respective REIT's published accounts in their annual reports. The following information has been drawn from the 2018 published accounts of the aforementioned four REITs. It should be noted that they do not all have the same accounting year end, so there is some variation in the time period covered by each set of accounts.

[3] CORE, a property company focused on warehouse and logistics properties mainly in the greater Dublin area, has publicly announced its intention to become a REIT, but a planned IPO in 2018 did not proceed.
[4] https://www.independent.ie/business/commercial-property/green-reit-puts-itself-up-for-sale-the-groups-portfolio-is-worth-1-5bn-38015348.html

31. Based on information published in the annual reports, the total value of property held by REITs in the Irish market is €3.732 billion, 28% of which is residential while 72% is commercial[5]. In terms of the residential property market, I-RES REIT and Hibernia REIT are the only REITs active in this space. 96%[6] of the I-RES portfolio is made up of residential property with 4% representing development land or properties under development. Approximately 11% of the Hibernia portfolio represents residential property[7]. The entirety of the I-RES stock is located in Dublin.

32. According to CSO data, there are approximately 126,000 apartments in Dublin and 210,000 apartments nationally. Therefore the I-RES portfolio of 2,679 apartments represents approximately 2.13% of apartment stock in Dublin and approximately 1.28% of apartment stock nationally. In terms of Hibernia REIT, the residential element of the portfolio consists of 326 apartments with all of the properties located in Dublin. This represents 0.25% of Dublin rental stock and 0.15% of national rental stock. In total, these figures indicate that REITs have approximately 1.43% of national apartment stock.[8]

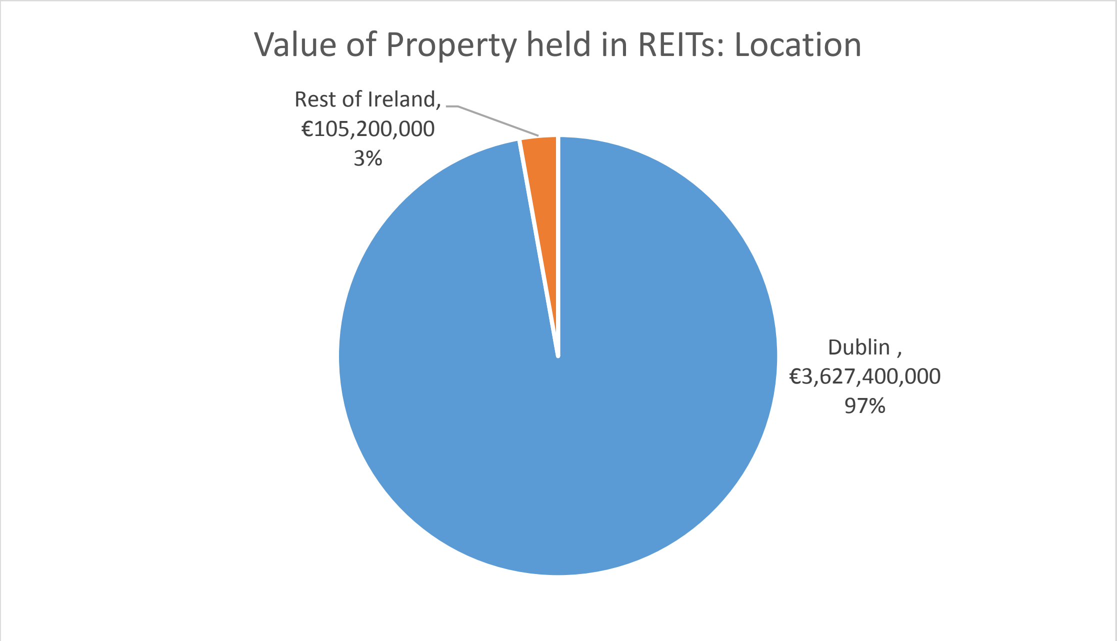
33. In terms of commercial property, the entirety of the Green REIT[9] and Yew Grove portfolios consist of commercial property while 89% of the Hibernia REIT portfolio is made up of commercial stock. The majority of Green REIT's portfolio is located in Dublin, with one property located in Cork. The entirety of Hibernia's commercial portfolio is located in Dublin. In terms of Yew Grove REIT, 66% of its portfolio is in Dublin and 34% is in the rest of Ireland[10]. Yew Grove REIT and Green REIT are the only REITs with assets outside of Dublin.

[5] REIT Annual Reports 2018
[6] https://investorrelations.iresreit.ie/~/media/Files/I/IRES-IR/presentations/annual-report-2018.pdf
[7] https://www.hiberniareit.com/~/media/Files/H/Hibernia-Reit-V2/reports-and-presentations/hibr-29147-ar2018-web.pdf
[8] CSO data
[9] https://www.greenreitplc.com/reports-presentations/
[10] http://www.ygreit.com/~/media/Files/Y/Yew-Tree-Commercial/reports-and-presentations/2018-annual-report.pdf

Table 1: REIT Property Breakdown

Property Breakdown[11]				
	Green REIT number (value)	Hibernia REIT number (value)	I-RES number (value)	Yew Grove number (value)
Residential	0	326[12] (€138m)	2,679[13] (€921.3m)	0
Commercial	17 (€1.424bn)	29 (€1.171bn)	0	14 (€77.9m)
Location				
Dublin	16	32	2,679	7
Cork	1			1
Kildare				1
Donegal				1
Westmeath				1
Offaly				1
Kerry				1
Laois				1

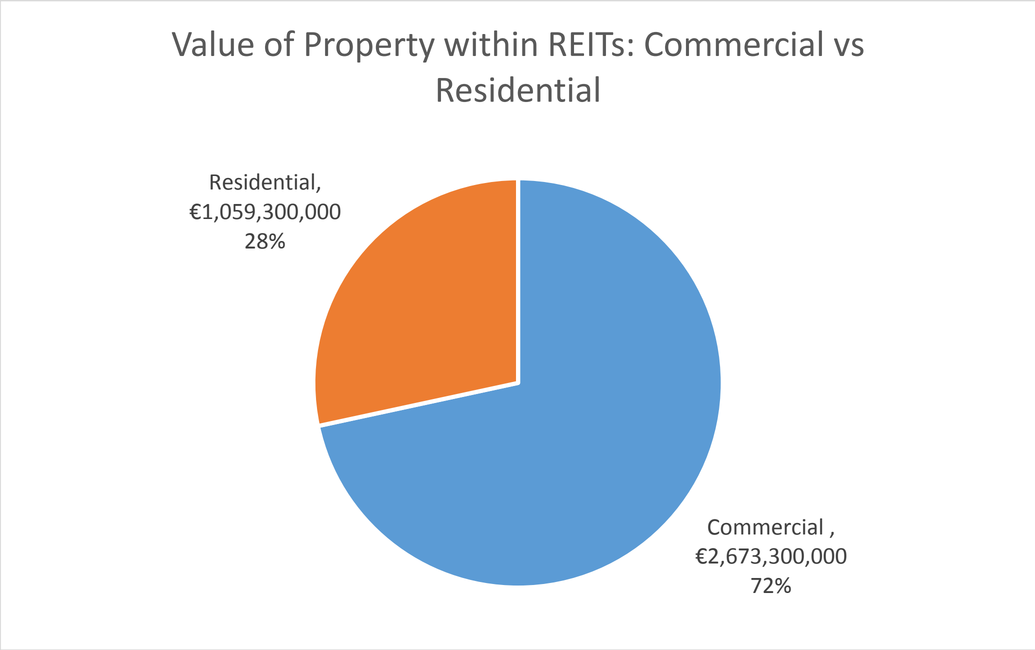
Figure 1: Value of property in REITs by location



[14]

[11] Company Annual Reports 2018
[12] The residential element comprises of 326 apartments which are part of 3 residential developments.
[13] All of which are apartments.
[14] REIT Annual Reports 2018

Figure 2: Commercial vs Residential Property in REITs

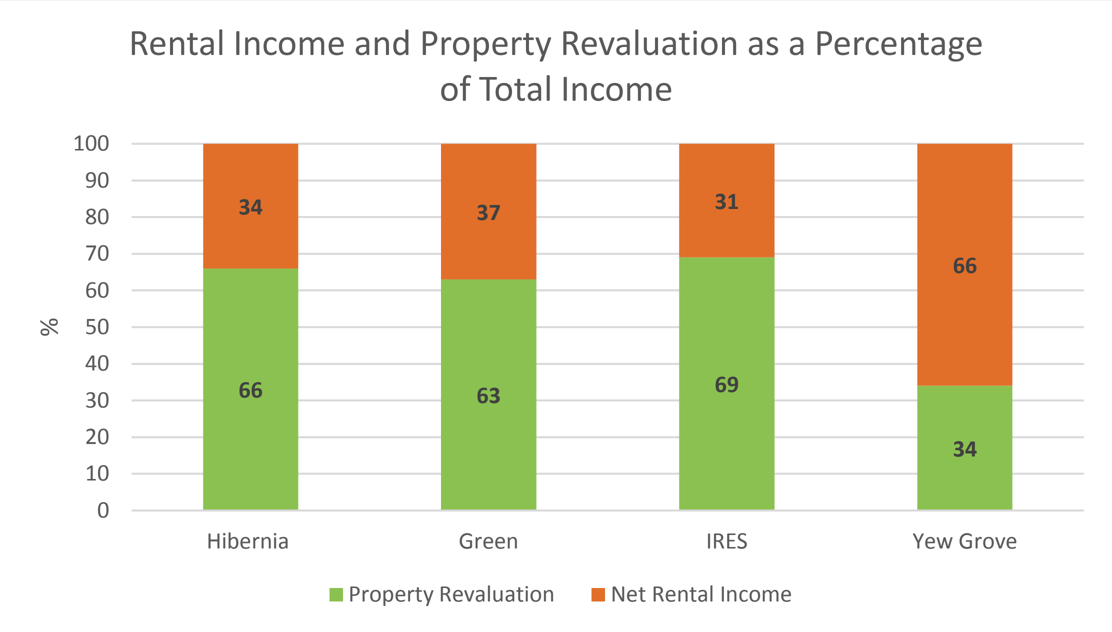


[15]

34. The following graph, which has been compiled from data published in the 2018 annual reports of the four REITs, sets out the split of income and gains within REITs in 2018. The gains largely relate to unrealised gains in the value of rental properties held by the REITs.

[15] Data gathered from the 2018 Annual Reports of each REIT:
Green REIT https://www.greenreitplc.com/reports/green-reit-plc-annual-report-2018/. Hibernia REIT https://www.hiberniareit.com/~/media/Files/H/Hibernia-Reit-V2/reports-and-presentations/hibr-29147-ar2018-web.pdf. I Res REIT https://investorrelations.iresreit.ie/~/media/Files/I/IRES-IR/presentations/annual-report-2018.pdf. Yew Grove http://www.ygreit.com/~/media/Files/Y/Yew-Tree-Commercial/reports-and-presentations/2018-annual-report.pdf

Figure 3: REIT Rental Income and Property Revaluation



[16]

35. As has been stated a requirement of the REIT legislation is to pay out 85% of rental profits in dividends annually. According to published accounts, all REITs are currently exceeding this threshold. According to the 2018 accounts Hibernia paid 108%, Green REIT paid 100%, I-RES 86% and Yew Grove 91%.[17]

36. The table below sets out the details of dividends paid by REITs in the years 2015 to 2018 as per their published accounts. The last column shows the Dividend Withholding Tax collected in respect of dividend payments by the Revenue Commissioners. It should be noted that the year of payment and year of DWT collection may not directly correlate as annual reports are compiled on an accounting year-end basis rather than a calendar basis.

[16] Data gathered from the 2018 Annual Reports of each REIT:
Green REIT https://www.greenreitplc.com/reports/green-reit-plc-annual-report-2018/. Hibernia REIT https://www.hiberniareit.com/~/media/Files/H/Hibernia-Reit-V2/reports-and-presentations/hibr-29147-ar2018-web.pdf. I Res REIT https://investorrelations.iresreit.ie/~/media/Files/I/IRES-IR/presentations/annual-report-2018.pdf. Yew Grove http://www.ygreit.com/~/media/Files/Y/Yew-Tree-Commercial/reports-and-presentations/2018-annual-report.pdf
[17] Data gathered from the 2018 Annual Reports of each REIT

Table 2: Dividends paid by REITs

Dividends paid by REITs[18]						
Year	**Green REIT**	**Hibernia REIT**	**I Res REIT**	**Yew Grove**	**Total**	**DWT paid[19]**
2015	€6.14m	€2.01m	€1.80m	-	€9.95m	€4.0m
2016	€10.67m	€8.12m	€13.14m	-	€31.93m	€7.8m
2017	€31.32m	€10.62m	€30.88m	-	€72.82m	€11.8m
2018	€52.57m	€17.66m	€22.54m	€0.72m	€93.49m	€12.4m

[18] Company Annual Reports 2018
[19] Parliamentary Question 77, 18th April 2019. https://www.oireachtas.ie/en/debates/question/2019-04-18/77/#pq_77

Irish Real Estate Funds

Taxation of Funds

37. In order to understand the IREF regime it is necessary to first outline how funds in Ireland are generally taxed. The normal tax treatment afforded to most Irish collective investment funds is that the monies invested are allowed to grow on a tax-free basis within the fund. This mechanism is known as the "Gross-Roll Up" regime. The surplus is taxed at the level of the investor upon receipt of distributions from the fund, rather than at the level of the fund. This is standard international practice for collective investment funds.

38. Investors are subject to tax in their home jurisdiction on distributions received from the investment fund. In order to ensure that the appropriate tax is collected from Irish investors, funds are obliged to operate an exit tax regime and remit the tax deducted in this manner to Revenue. In the case of non-resident investors, their liability to tax on distributions or gains from the fund will be determined in their home jurisdiction. Therefore the exit tax does not apply in the case of unit holders who are non-resident.

39. The broad rationale for exempting such funds from direct taxation is to facilitate individuals to invest collectively. If funds were not exempt, there would be double taxation as there would be taxation both within the fund and in the hands of the investor on distribution. Most OECD countries now have a tax system that provides for neutrality between direct investments and investments through a Collective Investment Vehicle or Fund.

Irish Real Estate Funds

40. Section 23 of the Finance Act 2016 introduced a new tax regime for funds that hold IREF assets.

41. An investment undertaking in which 25% or more of the value of the assets is derived from IREF assets, or where it is reasonable to consider that the main purpose or one of the main purposes of the investment undertaking is to acquire IREF assets or to carry on IREF business, is considered to be an IREF.

42. An IREF must deduct a 20% withholding tax on certain property distributions. In some circumstances a refund of some or all of this withholding tax can be claimed under double taxation treaties. However if a unit holder holds more than 10% of the assets of the IREF, any payment from the IREF is regarded as from immovable property and the withholding tax deducted will not be reduced.

Policy Rationale

43. The section was introduced to address the use of certain fund vehicles to invest in Irish property by non-resident investors, in a manner whereby a charge to Irish tax was being avoided on profits arising from Irish real estate. The IREF regime was introduced to protect the Irish tax base as far as profits from Irish property was concerned.

44. The purpose of the 25% threshold is to ensure that a fund only becomes an IREF where a material part of the portfolio consists of Irish property assets. Where property is not a material part, i.e. under 25%, this will not be an IREF as a fund with a property holding of this size was deemed not be of primary concern in terms of erosion of the Irish tax base.

45. From a regulatory perspective, as funds have always been in a position to hold some property, it was deemed unnecessary to deter funds completely from investing in Irish property.

46. In addition to the 25% threshold there is a 'main purpose' test. If one of the main purposes of the fund is to acquire Irish real estate, then it will be an IREF regardless of whether or not it derives 25% of its value from Irish real estate. This is an anti-avoidance provision which will catch funds one of the main purposes of which is to acquire Irish real estate, but who try to manage their assets to stay below the 25% threshold.

47. Investment structures that may be subject to IREF tax are ICAVs (Irish Collective Asset-management Vehicles), investment companies (PLCs), and unit trusts. ICAVs, PLCs and unit trusts can be regulated either as UCITS or Alternative Investment Funds (AIFs). UCITS funds have diversification and liquidity requirements and are usually widely held retail funds. Therefore the 2016 measures were targeted at ICAVs, PLCs and unit trusts authorised as AIFs.

IREF Assets and Business

48. IREF assets are:
    i. land in the State, minerals in the State or any rights, interests or other assets in relation to mining or minerals or the searching for minerals, exploration or exploitation rights in a designated area;
    ii. shares in a REIT;
    iii. shares deriving their value or greater part of their value from (i) or (ii);
    iv. specified mortgages, and
    v. units in an investment undertaking which meets the definition of an IREF.

49. The profits or gains realised from any business involving IREF assets are regarded as IREF business, the profits of which are subject to the IREF withholding tax on distribution.

Taxation

Irish Resident Investors

50. Irish resident investors are not subject to the IREF withholding tax as they are already subject to exit tax on income/gains from funds.

Non-Resident Investors

51. Non-resident unit holders are subject to the IREF withholding tax at a rate of 20% on payments in respect of an IREF taxable event. The IREF deducts the withholding tax from the payment and the unit holder receives a net payment.

52. In some circumstances the withholding tax can be reduced by double taxation treaties. However if a unit holder holds more than 10% of the assets of the IREF, any payment from the IREF is regarded as from immovable property and the withholding tax deducted cannot be reduced.

53. Exemptions from the withholding tax are provided for:
    - Irish or EU/EEA pension funds, life assurance businesses or Investment Undertakings that are not Personal Portfolio IREFs (see below).
    - Section 110 securitisation companies – however as will be discussed later in the paper such companies are subject to the Finance Act 2016 amendments to

s.110 which restrict the ability of such companies to take a tax deduction for profit dependent interest on profits derived from Irish property.

- Charities entitled to an exemption from Irish tax.
- Irish credit unions.

54. Pension funds, life assurance companies, charities and credit unions are exempt from the amendment as is the norm for such bodies across the tax acts. Income or gains of pension funds and life assurance companies are taxed at the investor level on payment of pension benefits or policy benefits.

55. Section 110 companies which hold units in an IREF are subject to the Finance Act 2016 amendments to s.110 which restrict the ability of such companies to take a tax deduction for profit dependent interest on profits derived from Irish property. The s.110 amendments and the IREF regime operate on a 'last man standing' basis in terms of where the tax changes are implemented.

Personal Portfolio IREF

56. In many cases funds are widely held, which means that the investors are passive and have no influence over when properties held by the Fund are disposed of. A Personal Portfolio IREF is one in which the IREF assets or the IREF business may be selected or influenced by a unit-holder or by anyone connected with that unit-holder.

57. The Personal Portfolio IREF definition is drafted to include control by:
    - the unit holder,
    - a person acting on behalf of the unit holder,
    - a person connected with the unit holder,
    - a person connected with a person acting on behalf of the unit holder,
    - the unit holder and a person connected with the unit holder, or
    - a person acting on behalf of both the unit holder and a person connected with the unit holder.

58. Where a fund is considered to be a Personal Portfolio IREF, the exemption from IREF withholding tax for investment undertakings does not apply.

Withholding Tax

59. 20% is the standard rate of income tax. It is the rate of dividend withholding tax that applies to distributions by Irish companies and it is the rate of withholding that applies to dividends from REITs.

60. The 20% IREF withholding tax is a full and final liability. The income subject to the withholding tax cannot be reduced by any expenses or losses and the rate of tax can only be reduced by a double tax treaty where the unit holder is an investor who holds less than 10% of the units in a fund. If a unit holder holds more than 10% of the assets of the IREF, any payment from the IREF is regarded as from immovable property and, as previously stated, the withholding tax deducted will not be reduced.

Taxable Event

61. IREFs pay tax on the occurrence of an IREF taxable event. An IREF taxable event occurs when a unit holder receives value for the accrued profits of the IREF. In most cases this will be:
    i. on the making of a cash or a non-cash distribution to a unit holder; or
    ii. on the cancellation, redemption or repurchase of units from a unit holder;

62. Other methods by which value can be realised and which therefore trigger the IREF withholding tax are:
    i. any exchange by a unit holder of units in one sub-fund of the IREF for units in another sub-fund of the IREF;
    ii. the issuing of units as paid-up unless new consideration has been received by the IREF;
    iii. the IREF ceasing to be an IREF or an investment undertaking.

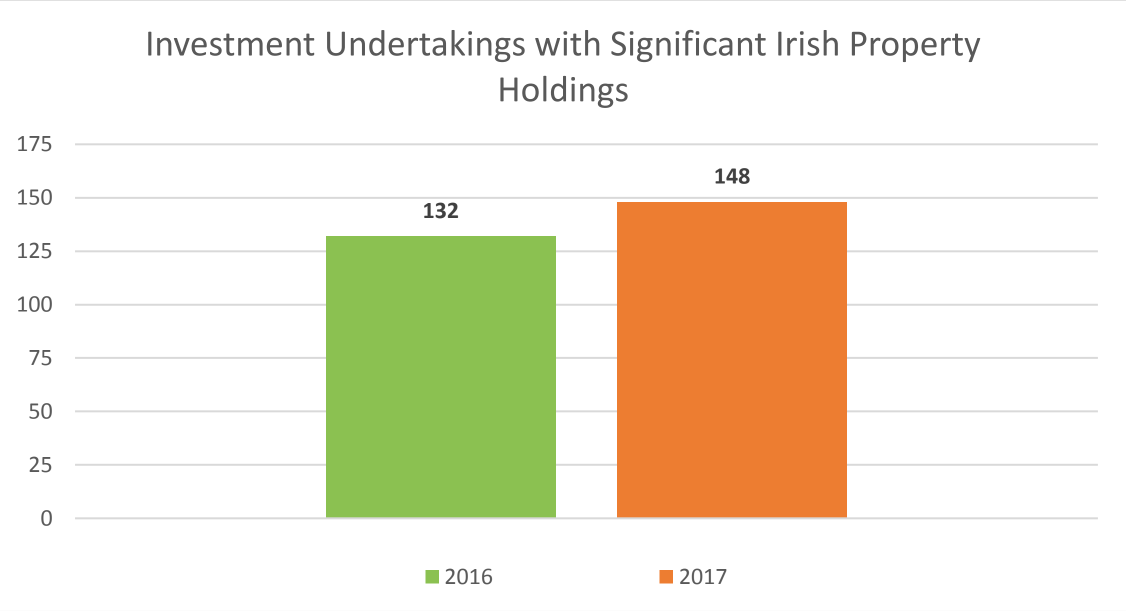
IREF Activity in the Irish Property Market

63. In terms of activity in the Irish property market it is difficult to get an accurate picture at this moment due to the IREF legislation being in its infancy. The following data represents a snapshot of activity so far through data provided by the Revenue Commissioners and the Central Bank.

64. Upon the introduction of the regime in 2016, Central Bank data indicate that 132 investment undertakings held significant amounts of Irish property, such that the investment undertakings exceeded the 25% threshold and were therefore taxable under the IREF framework. This number increased by 12% to 148 in 2017.

65. In this regard it should be noted that Central Bank authorised fund vehicles may have one or more sub-funds with segregated liability. In drafting the IREF tax legislation, a decision was taken to identify IREFs at sub-fund level, to ensure that the IREF provisions could not be avoided by holding a property sub-fund in an investment undertaking with other non-property funds to dilute the percentage of Irish property assets.

Figure 4: Number of Investment Undertakings with Significant Irish Property Holdings



[20]

66. IREFs are obliged to submit a return to Revenue and pay over IREF withholding tax due on the happening of a taxable event. IREFs with a year-end between January and June must file in the following January, and those with a year-end between July and December must file in the following July. IREFs are also now required, by regulations enacted in September 2018, to file financial statements with Revenue for each accounting period.

[20] Central Bank data

67. The IREF return requests a large volume of information to be provided by the fund including value, type and geographic location of property. 51 IREFs provided a return to the Revenue Commissioners by 31 July 2018 for the accounting period that ended in the second half 2017. Data provided in the returns in relation to the aforementioned information was outlined in Revenue's Corporation Tax 2018 payments and 2017 returns paper and it is set out in the table below.

Table 3: Value of IREF Assets 2017 (partial dataset)

Value of IREF Assets 2017[21]	
Asset Description	**Value**
Residential – Dublin	€618.4m
Residential – Leinster (excluding Dublin)	€52.5m
Residential – Ulster	€116m
Residential – Munster	€33.8m
Residential – Connacht	€14.8m
Retail	€2,082.5m
Commercial	€3,794.4m
Mixed use	€55.6m
Development land	€448.9m
Other	€235.9m
Shares in a REIT	€98m
Other shares	€171.5m
Units in an IREF	€76.2m
Total	**€7,798.4m**

68. As outlined above, in accordance with Revenue data, the value of assets within the 51 IREFs who submitted returns within the period was approximately €7.8 billion. As IREFs are required to file an IREF tax return only where they have a taxable event in a particular year, not all IREFs will have made returns for these years, therefore Table 3 represents a partial data-set of IREF property holdings.

69. Regulations enacted in September 2018 provide that IREFs must file financial statements with Revenue for each accounting period. The first return date for such financial statements was 30th January 2019, and returns were due from all IREFs

[21] https://www.revenue.ie/en/corporate/documents/research/ct-analysis-2019.pdf

with accounting periods ending in 2017 and up to end June 2018. As a result, Revenue should now have received financial statements from all IREFs.

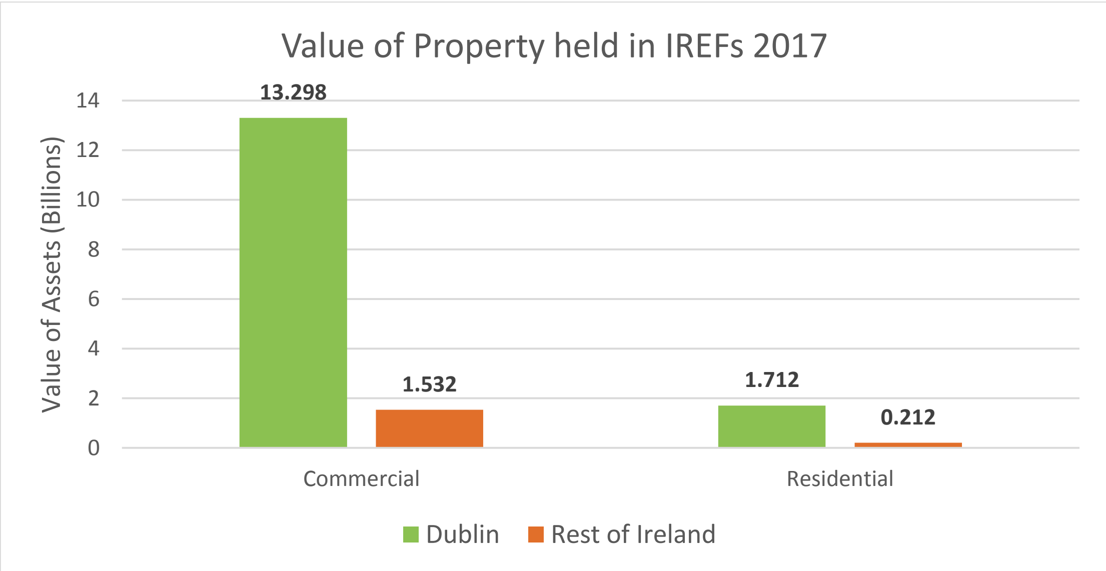
70. The information contained in the financial statements is currently being reviewed and analysed by Revenue. Once this analysis is completed, Revenue will be in a position to provide information on the value of Irish real estate held by all IREFs.

<u>Data provided by the Central Bank</u>

71. Based on data provided by the Central Bank, it is estimated that the value of property held within the full population of IREFs was in the region of €16,753m at the end of 2017.

72. Approximately 89% of property held by IREFs is commercial property and 11% residential. 90% of the total value is estimated to be in Dublin, with the remaining 10% located in the rest of Ireland.

Figure 5: Value of Property Held in IREFs 2017



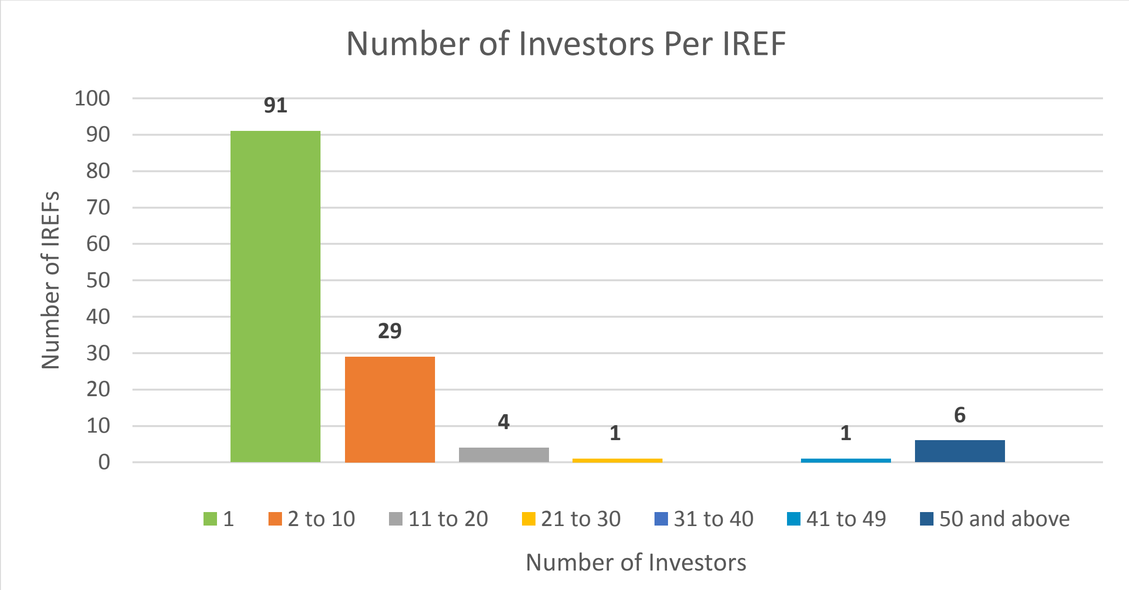
[22]

73. As of quarter 4 in 2016, 91 of the 132 funds had 1 investor. This is the most recent period for which this type of data is available. However this category may be misleading as this does not necessarily mean the sole investor is an individual, this

[22] Central Bank data

category may also include a single investor which itself is a collective investment vehicle such as a pension fund or insurance corporation for example.

Figure 6: Number of Investors Per IREF



[23]

74. Table 4 shows that, as of 2017, there were an estimated 1,858 investors in IREFs according to Central Bank data. The largest category in terms of volume is registered under nominee account/holding company, accounting for 1,294 of the total figure. The largest equity investment however comes from Pension Funds/Insurance Corporations. Of the pension funds, 84% are Irish and 16% are non-resident.

Table 4: Categories of Investors

[23] Central Bank data

Categories of Investors[24]				
	2016		2017	
Category of Investors	**No. of Investors**	**Sum of Equity**	**No. of Investors**	**Sum of Equity**
Insurance Corporation / Pension Fund	163	€2,545,338,928	159	€2,760,787,704
➢ **of which are Irish Pension Funds**	131	€1,699,412,633	122	€1,642,216,581
➢ **of which are non-Irish Pension funds**	24	€120,035,453	24	€283,954,735
Investment Fund	19	€421,427,812	21	€599,483,271
Nominee Account / Holding Company	1,324	€1,631,765,067	1,294	€1,311,563,489
Other[25]	245	€1,014,889,046	284	€1,251,365,225
Property Investment Co. / Alternative	92	€2,478,886,450	100	€2,583,877,144

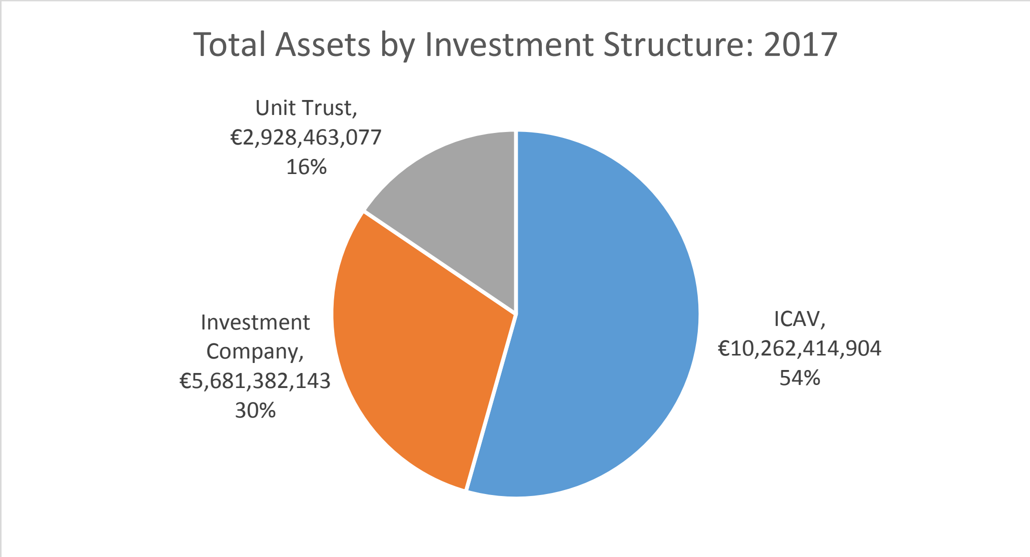
75. As noted above, the IREF tax framework can apply to investment undertakings structured as ICAVs, Investment Companies and Unit trusts. As of 2017, the ICAV was the most popular structure followed by Investment companies and lastly Unit Trusts. It is important to note that the ICAVs, Investment Companies and Unit Trusts referenced in this paper have 25% or more of Irish property in the fund. Therefore they are designated IREFs and are taxed under the IREF legislation.

It should be noted that although the below chart in

76. Figure 7 represents structures that are currently taxable under the IREF framework, it is the total asset value of the entities that is represented therefore the value encompasses assets other than Irish property.

[24] Central Bank data
[25] The “other” category includes government, households, banks, charities and non-financial corporations.

Figure 7: Total Assets by Investment Structure 2017



[26]

IREF Withholding Tax

77. The IREF regime came into effect for accounting periods beginning on or after 1 January 2017. The first returns of IREF taxable events were therefore due in July 2018, in respect of taxable events that occurred in 2017 for IREFs with 31-December accounting year-ends. Following initial examination of the IREF financial statements received by Revenue in January 2019 it has been confirmed that the majority of IREFs have a December year-end.

78. For IREFs with other year-ends, returns of IREF taxable events were not due until January 2019. For example, a fund with a June year-end would have come within the IREF regime from its accounting period beginning 1 July 2017 and ending 30 June 2018. Taxable events in the year ended 30 June 2018 were liable to be returned in January 2019.

79. As noted above, the majority of IREFs have December year-ends, therefore an accurate reflection of IREF withholding tax collected in respect of 2018 will not be available until after the 30th July 2019 filing deadline, when returns for IREFs with accounting periods ending between 1 July and 31 December 2018 will be due.

[26] Data provided by the Central Bank

Table 5: IREF Tax Returns 2017

IREF Tax Returns 2017[27]	
Value of IREF taxable events	€649.4m
Number of Returns received	51
IREF Withholding Tax deducted	€9m

80. The table above concerns IREF tax returns that were due by 31 July 2018, for taxable events which occurred during 2017. It should be noted that the “value of taxable events” figure is derived from the net asset value at redemption of IREF units and it therefore includes both the investor’s original capital and any profit earned on the units. For example – an investor subscribes €100,000 for units in an ICAV fund that invests in Irish property and is therefore subject to IREF rules. Two years later, the fund redeems the investor’s units at a net asset value of €120,000. The “value of taxable event” is €120,000, but the IREF withholding tax applies only to the profit earned of €20,000, not to the original capital of €100,000.

81. As set out above, some taxable events will also be exempt from the IREF withholding tax, for example where the holder is a qualifying pension fund.

82. It is not possible, from the returns filed, to provide a further breakdown of IREF taxable events between gains, returns of capital and payments to investors exempt from IREF withholding tax. Work is under way to review available data and to determine methods to ensure more detailed data is provided in future returns.

[27] https://www.revenue.ie/en/corporate/documents/research/ct-analysis-2019.pdf

Section 110

83. Section 110 vehicles get their name from Section 110 of the Taxes Consolidation Act 1997. The purpose of section 110 is to provide a regime for the taxation of special purpose companies set up to securitise assets. Securitisation regimes are intended to create a tax neutral regime for bona-fide securitisation purposes.

84. The Section 110 regime in its current form was inserted by Section 48 Finance Act 2003 and applies to all transactions entered into on or after the 6th February 2003.

85. The regime was designed to improve Ireland's offering as a location for the conduct of financial services. The financial services industry now makes use of these securitisations as a support to financial intermediation. Such financing is useful for the productive economy as it can underpin the supply of finance to industries and companies in Ireland, Europe and further afield.

Securitisation

86. Securitisation is the process by which finance is raised in capital markets based on the intrinsic credit strength of assets or other sources of cash flow, independent of the creditworthiness of the original owner of the assets. Securitisation is an integral part of the global financial services industry.

87. Securitisation is one type of structured financial product. Securitisations involve the repackaging and diversification of risk. Securitisation is one of the most common forms of structured financial product and involves the creation of tradeable securities out of an income stream or projected future income stream generated by financial assets.

88. It is accepted that having the option for more diversified sources of financing is good for investment and business. It is also important for financial stability in the economy.

89. Securitisation allows banks to raise capital and to share risk and, by providing a repackaging and resale market for corporate debt, it lowers the cost of debt financing.

90. The ability to securitise assets is an important component of the overall funding strategy of the Irish banks. The drivers for banks to securitise assets are to raise funding at an efficient level (alongside other sources of funding such as retail and corporate deposits); to facilitate the passing of an efficient cost of funds to their borrowers; and continue to lend competitively.

91. Securitisation of assets increases the total level of funding of banks providing additional credit availability for the Irish economy. It is also a necessary tool to enable the banks access liquidity from the European Central Bank if and when required.

Taxation

92. A section 110 company will be taxed on all of its income, after deduction of costs which include interest paid on loan notes. Generally s.110 companies therefore do not have significant taxable profits, and the lenders will be taxed on the interest earned on their loan notes in accordance with the rules in their jurisdiction.

93. In a traditional securitisation, the performance of the investment is linked only to that of the underlying assets. Investors who have purchased securities issued by the company will receive repayments on these securities based on the income from the underlying assets with no recourse to the seller. Different tranches with varying risk/return profiles will be offered to different investors, depending on their investment objectives.

94. Since the s.110 special purpose vehicle (SPV) only exists to provide a ring-fenced investment structure, it is generally acceptable for it to be tax-neutral; that is, it should not result in more tax than the investors would face if they had bought the qualifying assets directly.

Section 110 and Mortgages

95. During 2016, issues arose in relation to the use of the regime by international investors to reduce their Irish tax liabilities in respect of investments into Irish property-backed assets. The section 110 regime generally cannot be used to hold

real assets (such as property) but it can be used to hold financial assets such as property-related debt (such as mortgages).

96. Section 22 of the Finance Act 2016 amended section 110 to address such concerns. It restricts the use of the section 110 regime to minimise Irish tax liabilities on certain distressed debt transactions which are secured over, or derive their value from, an interest in Irish land. The core effect of the amendment removes the possibility for section 110 companies to use what are known as 'profit participating notes,' or PPNs, to sweep distressed debt profits deriving their value from Irish land out of the company in a way that ensures little or no Irish tax liability arises.

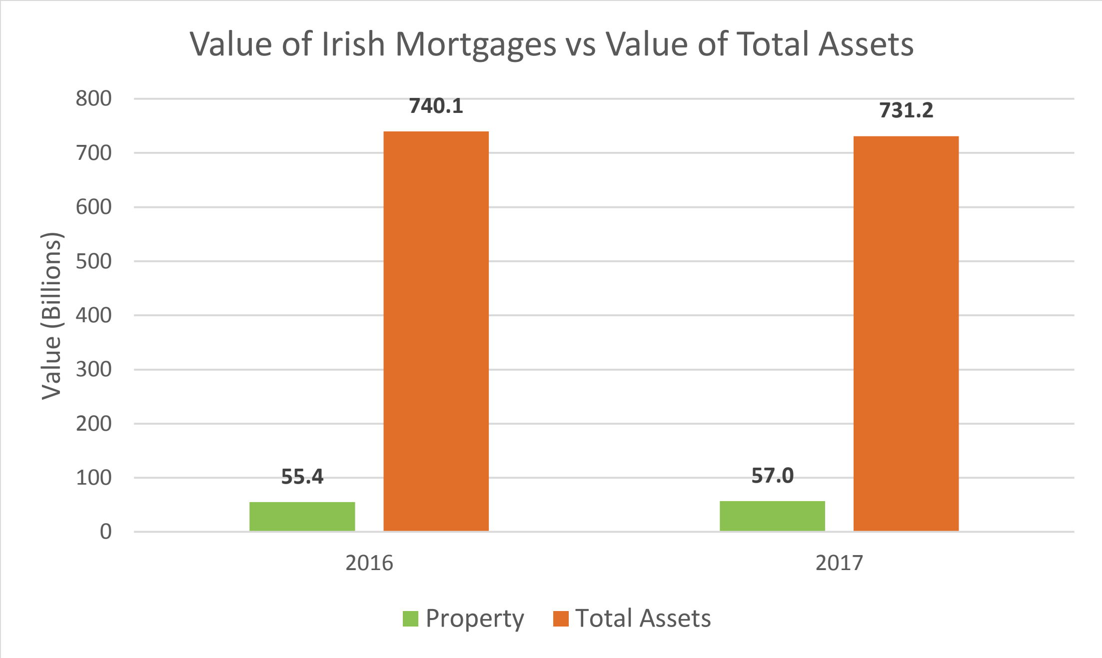
97. This was achieved by treating the holding of Irish mortgages as a separate business in respect of which the s.110 company is not entitled to a tax deduction for the coupon on the PPN. The amendment applies to profits arising on or after 06 September 2016.

Activity in the Irish Mortgage Market

98. According to data provided by the Central Bank, as of 2017 there were 2,077 Financial Vehicle Corporations (FVCs) and Special Purpose Vehicles (SPVs) in operation in Ireland with a total asset value of €732 billion. 72 of these vehicles held mortgages over Irish property, the total value of which was approximately €57 billion. Therefore Irish mortgages represented approximately 8% of the total value of assets within these vehicles. It should be noted that the majority of securitisations are undertaken by Irish banks.

99. While it is not possible to state with certainty that all FVCs and SPVs have elected to be taxed under section 110, it is expected that the figures are representative of the significant majority.

Figure 8: Proportion of Irish property-based securitisations to total asset value within FVCs and SPVs



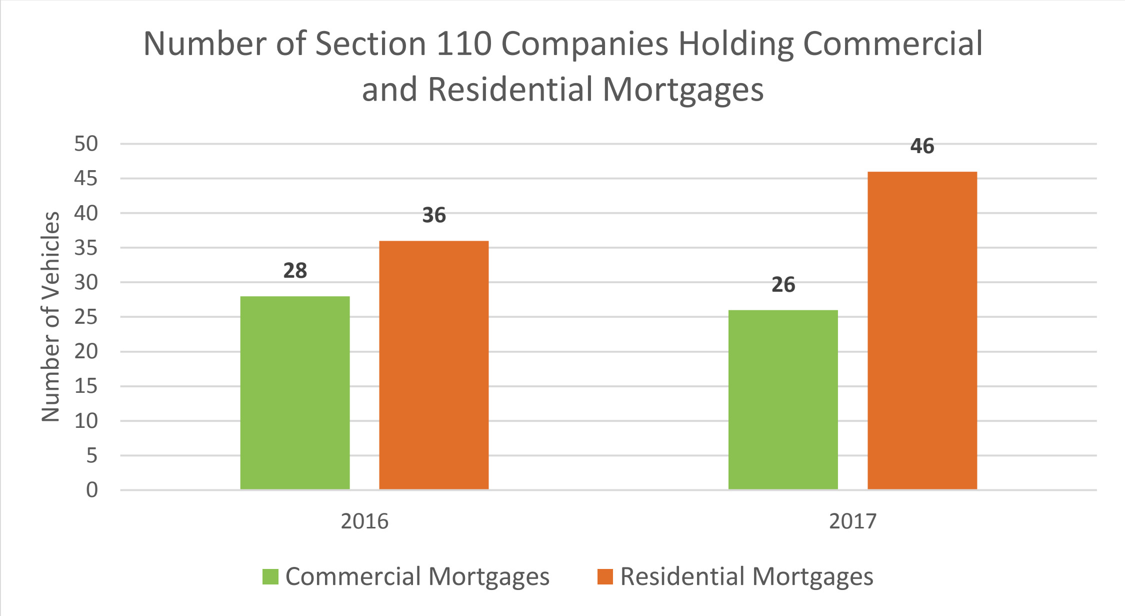
[28]

100. In relation to Commercial Mortgage Backed Securitisations (CMBS), data provided by the Central Bank shows that 26 section 110 vehicles were involved in such securitisations in 2017, a decrease of 2 on the 2016 figures, however, the value of CMBS within section 110's increased by €3.9 billion in this period.

101. In terms of Residential Mortgage Backed Securitisations (RMBS), the number of section 110s involved in such securitisations increased from 36 to 46 between 2016 and 2017, but the total value decreased by €2.4 billion for this period.

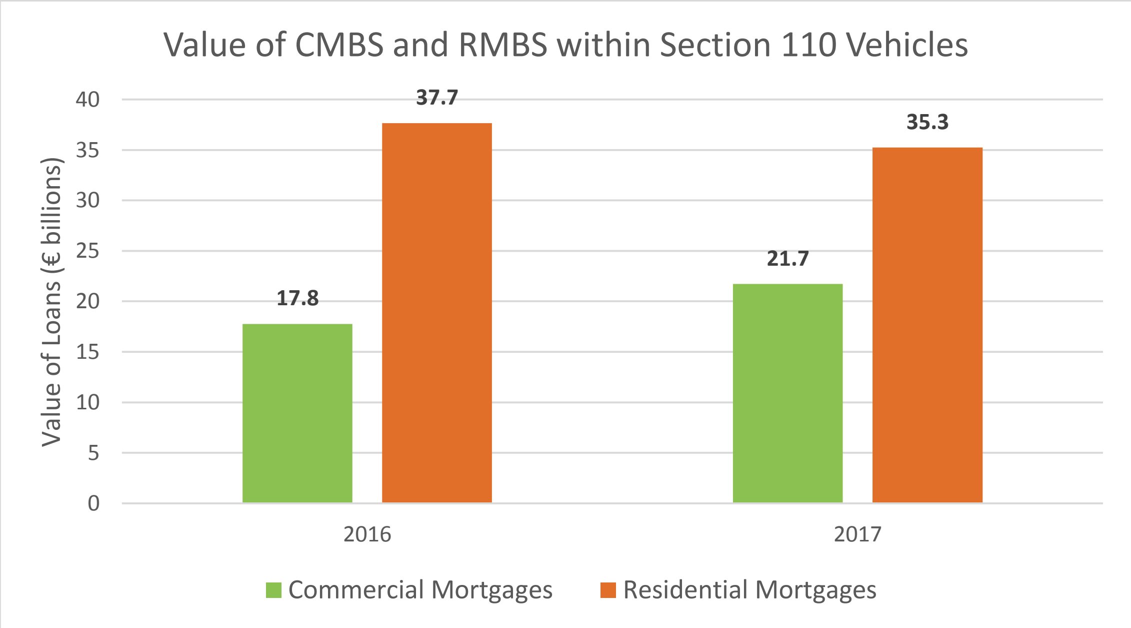
[28] Data provided by the Central Bank

Figure 9: Number of Section 110 Companies Holding Commercial and Residential Mortgages



[29]

Figure 10: Value of Commercial Mortgage Backed Securitisations and Residential Mortgage Backed Securitisations within Section 110 Vehicles.



[30]

[29] Data provided by the Central Bank
[30] Data provided by the Central Bank

102. Below is information regarding notifications of "Qualifying Company" for the purposes of Section 110 and the number of registrations ceased.

Table 6: Section 110 Notifications

Section 110 Notifications[31]		
Year	**No. of Notifications Received**	**No. of Registrations Ceased**
Cumulative to 2015	2,886	1,192
2016	478	22
2017	382	1
2018	471	1
Total	**4,217**	**1,216**

103. The Finance Act 2016 amendments to section 110 were designed to be deterrent in nature. The success of such measures is the reduction in the activity taking place rather than an increase in tax raised. During 2017 and 2018, 39 companies decided to elect out of the section 110 regime and be taxed instead in the same manner as all other companies. If a company elects out of section 110, it is not ceasing registration but may take another form and become a trading company for example. The 2015 figures in Table 6 represent notifications and ceased registrations for section 110 companies for the years up to and including 2015

Exchequer Contribution

Table 7: Taxes Paid by Section 110 Companies

Taxes paid by Section 110 Companies[32]			
Year	**CT**	**VAT**	**Payroll Taxes**
2015	€65m	€16.4m	€1.4m
2016	€199m	€11.2m	€3.4m
2017	€128m	€14.8m	€2.3m
2018	€87m	€12.1m	€4.6m
Total	**€479m**	**€54.5m**	**€11.7m**

[31] https://www.revenue.ie/en/corporate/documents/research/ct-analysis-2019.pdf
[32] Statistics and Economic Research Branch, Office of the Revenue Commissioners

Residential Rental Property Market

104. As noted in the introduction, there has been a recent focus on the activities of institutional investors in the residential property market. Concerns expressed include that such investors may be driving increases in rental prices, or that new-build developments are being purchased in their entirety for the rental market by investors, crowding owner-occupier purchasers out of the market.

105. This paper therefore considers available information in respect of the residential property market.

Residential Tenancies

106. Historically the Irish residential property market has been dominated by small scale landlords with a small number of tenancies. The Daft rental report for Q3 2012 stated that *"The average Irish landlord has between 1.6 and 2.1 properties … and less than 1.25% has ten or more properties, reflecting an undeveloped and amateur market."*[33]

107. More recent data from the Residential Tenancies Board, set out below in Table 8, shows that the rented residential sector is still dominated by small landlords. It should be noted that the figures below relate to tenancies rather than properties and it is possible that multiple tenancies could relate to a single property (e.g. a house-share where each tenant registers a separate tenancy).[34]

108. Table 8 shows that the majority (over 70%) of landlords registered a single rental tenancy, with over 96% of landlords registering 5 tenancies or less. Landlords with 5 tenancies or less account for almost 72% of all registered tenancies. The top 21 landlords account for 3.11% of all registered tenancies.

[33] https://www.daft.ie/report/Daft-Rental-Report-Q3-2012.pdf
[34] Purpose Built Student Accommodation is not currently under the remit of the RTB and therefore is not included in this data.

Table 8: Tenancies per Landlord, May 2019

Individual and Company Landlords May 2019						
Number of Tenancies	**Unique Individual Landlords**	**Unique Corporate Landlords**	**Total number unique landlords**	**Total number of private tenancies registered**	**% of Landlords by number of Tenancies**	**% of Registered Tenancies**
1	118,554	3,691	122,245	114,222	70.37%	36.78%
2	27,050	918	27,968	52,265	16.10%	16.83%
3	9,316	436	9,752	27,336	5.61%	8.80%
4	4,347	272	4,619	17,264	2.66%	5.56%
5	2,390	186	2,576	12,035	1.48%	3.87%
6	1,480	142	1,622	9,093	0.93%	2.93%
7	927	108	1,035	6,770	0.60%	2.18%
8	650	70	720	5,382	0.41%	1.73%
9	459	63	522	4,390	0.30%	1.41%
10 - 20	1,563	343	1,906	23,461	1.10%	7.55%
20 - 50	385	200	585	16,188	0.34%	5.21%
50 - 100	57	62	119	7,747	0.07%	2.49%
100 - 200	11	27	38	4,775	0.02%	1.54%
200+	2	19	21	9,652	0.01%	3.11%
Totals	**167,191**	**6,537**	**173,728**	**310,580**	**100%**	**100%**

Comparing this table to a similar dataset from May 2017, as shown in

109. Table 9, it can be seen that the total number of landlords with registered tenancies has decreased from 177,677 in 2017 to 173,728 in 2019, a decrease of just over 2%. The numbers of both individual and corporate (i.e. non-individual) landlords have decreased, with the decrease in individual landlords being spread across all categories from those with just one tenancy to those with 20+ tenancies. While the number of corporate landlords has decreased overall, there were increases in the numbers with one to four tenancies and decreases in the numbers with five to 20+ tenancies.

110. The percentage of landlords with 20 or more tenancies has decreased from 0.52% in 2017 to 0.43% in 2019.

Table 9: Tenancies per Landlord, May 2017

Number of Tenancies per Landlord May 2017[35]				
No. of Tenancies	**Individual Landlords**	**Corporate Landlords**	**Total Landlords**	**% of Landlords**
1	120,485	3,375	123,860	69.71%
2	27,677	898	28,575	16.08%
3	9,975	416	10,391	5.85%
4	4,597	257	4,854	2.73%
5	2,491	188	2,679	1.51%
6	1,563	163	1,726	0.97%
7	1,022	116	1,138	0.64%
8	677	82	759	0.43%
9	521	70	591	0.33%
10-20	1,792	385	2,177	1.23%
20+	541	386	927	0.52%
Total	**171,341**	**6,336**	**177,677**	**100.00**

111. Information on the number of tenancies for each category of landlord above was not available in the 2017 dataset, however the Residential Tenancies Board were able to provide the following information in respect of the total number of registered tenancies in the years 2015 to 2018, as set out in Table 10 below.

Table 10: Number of Registered Tenancies and Landlords, 2015 to 2018

Number of Tenancies and Landlords Registered with the RTB at Year-end				
	2015	**2016**	**2017**	**2018**
No. of registered private rented tenancies	319,609	319,822	313,002	307,348
No. of registered AHB tenancies[36]	n/a	n/a	26,445	29,542
No. of landlords	170,282	175,250	174,001	173,197

[35] Data provided by the Residential Tenancies Board
[36] It only became a requirement for AHBs to register tenancies with the RTB at the end of 2016

Institutional Investment in the Housing Market

112. The Department of Finance published a paper titled '*Institutional Investment in the Housing Market*' in February this year.[37] The paper is based on CSO data up to 2017, the most recently available data at the time the analysis was undertaken. It shows that the purchasing activity of institutional investors represents a small proportion of the housing market overall. On a national level, they also remain a significant minority of landlords.

113. However, the paper acknowledges that such investors do play an increasingly important role in the private rented sector. While there may be a perception that institutional investors are purchasing large amounts of housing stock, the data in the paper show that their activity has been limited in the context of the overall housing market and largely confined to Dublin apartments.

114. According to the paper, the growth of institutional investment is the result of a structural change in the market, citing a number of factors including post-crisis capacity constraints in the financial and construction sectors; long-term societal changes such as increasing urbanisation and changing tenure profile; and a desire to avoid previous mistakes by improving spatial and urban planning. This changed environment has resulted in significant market dislocation and an imbalance between the demand and supply of suitable housing, particularly in the rental sector.

115. The paper advises that institutional investment in apartments is likely to be the driving force behind a significant recent increase in the number of apartment units granted planning permission in Dublin. In the twelve months to Q1 2019, 68 per cent of units that were granted planning permission in Dublin were apartments, a total of 5,919 units. As a comparison, in the same period only 2,485 apartments were completed nationally and 1,869 in Dublin.

116. Increased building activity in the apartment sector is a very positive development, both in terms of boosting overall supply and in relation to the National Planning Framework, which specifically targets more compact growth. However as

[37] https://www.gov.ie/en/publication/0e942b-institutional-investment-in-the-housing-market/

the paper concludes such investment can only be one aspect of a multi-pronged response to addressing current issues in the market.

Institutional Investors – Forward Funding Model

117. As noted in the introduction, some concerns in relation to the activities of institutional investors in the residential market relate to such investors block-purchasing units that would otherwise be available to owner-occupiers to purchase.

118. In this context, it is worth noting that institutional investors are engaged in partnerships and forward purchase contracts with developers and building contractors, i.e. they are funding or part-funding the property development. In the absence of such funding from institutional investors it is likely that such projects would be delayed while other sources of funding (such as bank finance) are sourced, or potentially may not take place if such funding is not available.

Reflections for TSG Discussion

119. Members of the Tax Strategy Group may wish to reflect on the following considerations:

- As illustrated in the data above, the role of institutional investors in the residential property market is minor, but it is growing, particularly in the urban apartment market segment.

- An investment strategy which includes the purchase (including by forward-funding) of an entire apartment block or development inevitably creates an impression that the investment is disproportionate to other activities in the market, particularly the activities of private homebuyers. However this needs to be seen against a background of still muted supply in the property market and a continuing shortage of rented residential accommodation.

- A number of different investment structures are used by market participants.
    - One of these, the REIT framework, was deliberately introduced in 2013 to facilitate more institutional investment and the attraction of non-bank capital to the market.
    - Other tax provisions, such as the IREF regime and amendments to section 110, are the result of policy interventions to ensure taxing rights are maintained when other investment structures are used to invest in the Irish property market.

- There are limitations in the available data due to the limited number of REITs in the market and to the relatively short period of time in which the IREF provisions have been in operation.

- It is a policy area that will continue to be monitored closely and, as with all tax regimes, the Government always reserves the right to introduce amendments to address policy concerns or objectives as needed.

Appendix 1 – International REIT Comparison

	Tax Treatment of REIT Income		Tax Treatment of Capital Gains		Distributions required by the REIT		
Country[38]	**Qualifying Income**	**Non-Qualifying Income**	**Qualifying Assets**	**Non-Qualifying Assets**	**WHT Rate**	**Distribution of Income**	**Distribution of Gains**
Australia	Exempt (Transparent)	Exempt (Transparent)	Exempt (Transparent)	Exempt (Transparent)	Treaty Rate	100%	100%
Belgium	Exempt	Taxable	Exempt	Taxable	25%	80%	0% provided reinvested within 4 years
Canada	Exempt effectively (Taxable but can deduct distributions)	-	Exempt effectively (Taxable on 50% of gain but can deduct distributions)	-	25% on income and 0% on gains	No minimum (But in effect 100%)	No minimum (But in effect 50% requirement)
France	Exempt	Taxable	Exempt	-	5%	95%	60%
Germany	Exempt	Exempt	Exempt	Exempt	26%	90%	50% - 2 years to reinvest the balance
Netherlands	0%	0%	Exempt	-	15%	100%	N/a
Singapore	Exempt	-	Exempt	-	17%	100%	-
Spain	0%	-	0%	-	19%	80%	50% - 3 years to reinvest the balance
UK	Exempt	Taxable	Exempt	Taxable	20%	90%	0%
USA	Exempt	-	Exempt	-	10% - 30%	90%	0%
Ireland	Exempt	Taxable	Exempt	Taxable	20%	85%	0%

[38] Source: KPMG

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