

Notes for Guidance - Taxes Consolidation Act 1997

Finance Act 2018 edition

Part 28

Purchase and Sale of Securities

December 2018



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PART 28 PURCHASE AND SALE OF SECURITIES

CHAPTER 1 *Purchase and sale of securities*

Overview

Chapter 1 of **Part 28** is primarily directed against a practice known as “bond washing” which could otherwise be practised by dealers in securities or exempt bodies. Without these provisions, a “loss” could be created by the purchase of a security “cum div” (where the price reflects the accumulated interest payable on the security) and its subsequent sale “ex div” (where the price does not reflect the accumulated interest on the securities). Shortly before interest on a security is paid the security goes “ex div”. The register of the security is closed and the person who was the registered owner immediately before that time receives the interest payment. The person who purchases the security in the “ex div” period does not receive the interest payment and the purchase price reflects this.

The Chapter also provides for specific tax treatment for exchanges of shares held as trading stock as well as securities exchanged under the Exchange Programme in Irish Government bonds, initiated by the National Treasury Management Agency.

748 Interpretation and application (*Chapter 1*)

Summary

This section contains definitions used in **Chapter 1** and **Schedule 21**. It also provides that, subject to a number of exceptions, the provisions apply to a person who purchases a security “cum div”, sells it “ex div” and receives the interest/distribution from the security. The provisions do not apply where the securities have been held, generally for over 6 months, and in certain limited circumstances, with the agreement of the Revenue Commissioners, a period of over 1 month will suffice.

Details

“distribution” has the same meaning as in the Corporation Tax Acts. (1)

“interest” includes distributions and other dividends.

“gross interest” means the distribution together with the tax credit

“net interest” means the distribution without the tax credit.

“person” includes a body of persons and trustees of a trust or fund.

“securities” includes stocks and shares. Securities are similar if they have the same rights and entitlements as the originals.

These definitions apply also for the purposes of **Schedule 21**.

This Chapter applies to the purchase of securities by a person (in the Chapter called the “first buyer”) and their subsequent sale by the first buyer, where the transaction results in interest being paid to the first buyer. (2)

The Chapter does not apply if the securities are held for over — (3)

- 6 months (the reference in the provision is to the first buyer “taking steps to dispose of the securities” – see below), or

- 1 month and in the opinion of the Revenue Commissioners the sale and purchase are at market price and no prior arrangement or agreement for the sale is in place.

The reference to “taking steps to dispose of the securities” in **subsection (3)** is to be construed as a reference to — (5)

- the acquisition of an option to sell the securities, if the securities were sold as a result of the exercise of such an option, and
- the sale of the securities, in any other case.

The order in which securities acquired at different times are sold is determined on a “last in, first out” (LIFO) basis. It is also provided that the person selling similar securities cannot be under any greater liability to tax than if the original securities were sold. (6)

At the commencement of a trade securities are deemed to be sold by the previous owner at market price and acquired by the new owner at the same price. Where participants in a trade change but the trade itself continues, the new participants are deemed to have done all the actions that the predecessors did. (7)

749 Dealers in securities

Summary

This section provides that where the first buyer is a dealer in securities, the purchase price of any securities acquired by the first buyer is reduced by the interest element contained within that price. This element is calculated in accordance with **Schedule 21**. The section contains a number of exceptions to this rule and also provides that a transaction is not caught by both the anti-bondwashing provisions of this Chapter and the anti-dividend stripping provisions in **Chapter 2** of this Part.

Details

General rule

Subject to the other provisions of this section, where the first buyer is a dealer in securities, the purchase price of any securities acquired by the first buyer is reduced by an appropriate amount of the interest element contained within that price when computing the profits arising from, or loss sustained in, the trade. This appropriate amount in respect of the interest is calculated in accordance with **Schedule 21**. (1)

Irish Stock exchange members

If in the opinion of the Revenue Commissioners, the first buyer is a genuine discount house or a member of the Irish Stock exchange as a dealer the reduction in the acquisition price of any securities acquired by the first buyer provided for by **subsection (1)** is not to apply. (2)

Overseas securities

The general rule in **subsection (1)** will not apply for a chargeable period in relation to short-term purchases of overseas securities (purchased on or after 1 January 2003) if: (2A)(a)

- those securities are purchased by a dealer in securities in the ordinary course of the dealer trade,
- the interest payable in respect of all such overseas securities to which this Chapter applies is brought in as a trading receipt in computing the dealer’s profits for the chargeable period, and
- the dealer elects in writing, by the specified return date for the chargeable period in question, that credit for any foreign tax on that interest which might otherwise be due by virtue of **Part 14** or **35** or **Schedule 24** is not to be allowed.

“overseas securities” is defined as securities issued by a government of a territory outside the State, by a foreign local authority, foreign local government, foreign public authority, or any other body of persons not resident in the State. (2A)(b)

“specified return date for the chargeable period”: this is the return filing date and has the same meaning as in *section 959A*.

Effect of election under subsection (2A)

Where an election is made in accordance with *subsection (2A)(a)(ii)* then: (2B)

- credit for foreign tax shall not be allowed, notwithstanding the provisions of *Parts 14 and 35* and *Schedule 24* which provide for such a credit,
- the election is to be included in the return which the dealer makes for self-assessment purposes under *Chapter 3 of Part 41A*, and
- the election is to have effect only for the chargeable period for which it is made. Therefore, an annual election is required with the annual self-assessment return.

Irish Government securities

The provisions of *subsection (1)* will also not apply for a chargeable period in relation to short-term purchases of Irish Government securities (which are not chargeable assets for the purposes of the Capital Gains Tax Acts by virtue of *section 607*) if those securities are purchased by a dealer in securities in the ordinary course of the dealer’s trade and the interest payable in respect of all such securities to which this Chapter applies is brought in as a trading receipt in computing the dealer’s profits for the chargeable period. This provision also applies as respects securities purchased on or after 1 January 2003. (2C)

Interaction with Chapter 2

The section ensures that a transaction is not caught by both the anti-bondwashing provisions of this Chapter and the anti-dividend stripping provisions in *Chapter 2* of this Part. (3)

750 Persons entitled to exemption

This section is aimed at preventing bond-washing by exempt bodies such as exempt approved pension schemes and charities. It debars a claim for exemption on an interest receipt (calculated in accordance with *Schedule 21*) in so far as that receipt comes within these general provisions. Any tax due to be paid cannot be set off against tax (if any) deducted from annual payments under *section 238*, and is not allowed as a charge on income for corporation tax purposes.

751 Traders other than dealers in securities

Summary

This section contains provisions corresponding to those against dividend-stripping (*sections 752 and 753*) and ensures that measures against “cum div” and “ex div” dealings also apply to non-financial entities.

Details

In determining any tax repayment due to a person who is not a dealer in securities in respect of any trading income, any interest computed in accordance with *Schedule 21* and any tax paid on that interest is to be disregarded. In addition, these provisions are carried through for corporation tax purposes. (1)

There is also provision to prevent a company, not engaged in a financial trade, from (2)

setting off tax paid on such interest received against any withholding tax deducted under **section 238** on any annual payments made by it.

751A Exchange of shares held as trading stock

Summary

This section is concerned with a financial trader who exchanges shares held as trading stock for other shares where the exchange is brought about by a takeover or merger involving the company which issued the shares held by the trader. Under the existing capital gains tax code such an exchange is not treated as giving rise to a capital gains tax liability. This liability is deferred until the replacement shares are disposed of.

This section provides a similar deferral of tax liability under the income tax and corporation tax codes which apply to financial traders.

Details

Definitions

“new holding” is the new securities held after the exchange. (1)

“original shares” is the shares held before the exchange.

Application

Subsections (4) and (5) are applied solely to persons assessable on the profits of a trade of dealing in securities under Case I of Schedule D. (2)

The section is applied to the same kind of exchanges as **sections 584 to 587** would apply if the person concerned was not assessable under Case I of Schedule D. These sections contain the comparable capital gains tax provisions. There is one exclusion namely the Exchange Programme in Irish Government bonds which is being initiated by the National Treasury Management Agency and which is taxed under special rules (**section 751B**). (3)

Tax treatment

In computing the profits assessable to tax under Case I of Schedule D — (4)

- the exchange is not regarded as a disposal, and
- the original shares and new holding are treated as the same asset.

This treatment is qualified in circumstances where cash or some other consideration may also change hands in addition to the share exchange. The proportion of the value of the total transaction which represents this consideration is considered a taxable receipt and only the balance is subject to the special rules. (5)

These rules are applied with the necessary modifications in the tax computation of the life fund of life assurance companies. There are specific rules associated with the taxation of life assurance companies. Their tax liability cannot, however, be less than the liability which would arise if they were chargeable to tax under Case I. This is known as the notional Case I computation. If such a situation were likely to arise, the taxable amount is adjusted by reducing the amount of management expenses of the company which are deductible. The purpose of this subsection is to ensure that in making the notional Case I computation the provisions of this section will apply. (6)

751B Exchange of Irish Government bonds

Summary

The section provides special tax treatment for the Exchange Programme in Irish

Government bonds which has been initiated by the National Treasury Management Agency (NTMA). The purpose of the programme is to redeem existing bonds, which may be trading in the market at a substantial premium because of the high interest rate attaching to them, for an amount of equal value of newly issued securities reflecting the current lower rates of interest. This provision defers the capital gains tax liability arising on the exchange of the securities until the earlier of either the sale or redemption of the new securities. The tax will then be due but calculated at the tax rate prevailing at the date of the exchange. It is the tax, not the gain, which is carried forward. Because the exchange may take place part way through an interest payment period, the interest accrued up to that time is chargeable to tax immediately and only the balance of the tax liability is deferred.

The provision has relevance for traders in securities such as banks and general insurance companies as well as life assurance companies and collective funds. Individuals are exempt from capital gains tax on the disposal of Government bonds.

Details

Definitions

“chargeable period” is an accounting period in the case of a company and a year of assessment for any other person. (1)

“the exchange” is the exchange of securities under the Exchange Programme in Irish Government bonds as designated by NTMA.

“investor” is the person exchanging bonds under the exchange programme.

“last payment day” is the last day interest on the bonds was paid subject to the qualification that if the old securities were bought at or soon after issue then strictly speaking there has been no last payment date. The definition deems the date of issue of the securities to be the last payment date in those circumstances.

“new securities” and “old securities” are the securities involved in the exchange.

“securities” is all Government and Semi-State securities as defined in *section 36*.

Application

Special rules are provided for taxing — (2)

- financial traders (*subsections (3) and (5)*), and
- non-traders including collective funds and the life funds of life assurance companies (*subsection (6)*).

Tax treatment: financial traders

In the case of financial traders, etc an amount of tax, “the deferred tax”, is calculated according to one of two possible formulae.

Where the investor is chargeable in respect of interest on a “receipts basis” the formula —

$$A - B - C.$$

Where the investor is chargeable in respect of interest on an “accruals basis” the formula —

$$A - B.$$

In both cases —

A is the tax due apart from this section.

- B is the tax due as if the “exchange” was not recognised for tax purposes but, in a case where the investor is charged on an accruals basis, it includes tax on interest accrued in that period.
- C is the tax on accrued interest earned but not yet received by the investor and which is built into A. This is because the market value at the date of exchange includes this accrued interest.

The “receipts basis” means any interest received in a chargeable period is brought into charge in that period.

The “accruals basis” means that interest earned though not necessarily received in a chargeable period is brought into charge. For example, where the chargeable period is a calendar year and interest of €10 is paid on 30 September each year, the amount brought into charge is the interest accrued from 1 January to 30 September in that year (€7.50) plus a further amount of interest accrued between 1 October and 31 December in the same year (€2.50). On an ongoing basis there should not be any material difference in the amounts brought into charge on either basis.

The formula $A - B - C$ produces the correct result for persons assessable on a “receipts basis”, the purpose of which is to isolate what is known as the “clean price” gain (not including any accrued interest), calculate the tax on this and defer this amount of tax.

The alternative formula $A - B$ applies to persons chargeable to tax on interest on an “accruals basis”. The meaning of “B” in this situation is refined to ensure it includes the interest accrued in that chargeable period. In this situation both “A” and “B” contain the tax on interest accrued from the start of that chargeable period or the date of purchase of the old security, whichever is later, to the day the exchange takes place. The difference between A and B in these circumstances is, in fact, the tax on the “clean price” gain. It is, therefore, not necessary to include “C” in this formula. (3)

The calculation of accrued interest referred to in “C” is provided for. (4)

The investor may elect that these provisions apply and consequently the amount of “deferred tax” is excluded from the tax computation for the chargeable period in which the exchange takes place. This tax is deferred until the chargeable period in which the new securities are either disposed of or redeemed, whichever is earlier, and is payable in addition to the other tax due for that chargeable period. The rules of Self Assessment (*Part 41A*) apply accordingly. (5)

Tax treatment: Non-traders

In the case of non-traders — (6)

- If an investor so elects, then, subject to *section 815* (bond washing), the capital gains tax liability is calculated but deferred until either the new securities are sold or redeemed, whichever is earlier.
- *Section 815* applies to the accrued interest and, with the modified use of the section as referred to in *paragraph (b)*, undertakings for collective investment and the life funds of life assurance companies are also included. The bondwashing legislation does not normally apply to undertakings for collective investment or the life funds of life assurance companies because of the special tax treatment which applies to these institutions. However, for the purposes of this exchange programme alone, such institutions are effectively made subject to *section 815* in order that the accrued interest can be charged to tax immediately.

Time limit for elections

The election referred to in *subsections (5) and (6)* must be made within 2 years. This election affords an investor the option of applying this section to a particular transaction (7)

and so defer a tax liability. Otherwise any gain accruing on the exchange is taxed immediately. This latter option might be taken if the investor was likely to make a loss on the transaction.

Cessation

These special tax rules do not apply to bond exchanges which occur after 31 December, 1999.

CHAPTER 2

Purchases of shares by financial concerns and persons exempted from tax, and restriction on relief for losses by repayment of tax in case of dividends paid out of accumulated profits

Overview

Chapter 2 of **Part 28** is directed against a tax avoidance scheme involving a device commonly known as “dividend stripping” by which a profit is made out of tax —

- through the acquisition of shares in companies which have accumulated reserves, and
- the taking of a dividend on those shares.

The avoidance device involves the acquisition by company A of shares in company B. A dividend is declared and paid to company A. This is franked investment income in the hands of company A. The shares in company B are subsequently sold at a loss reflecting the fact that the accumulated reserves in company B have already been paid out. The loss to company A on this purchase and sale transaction would normally be used to claim a repayment of any tax credit attaching to the dividends paid by company B (**section 157**). Dealers in securities are in a specially favourable position to do this. The device can also be practised by exempt bodies to claim a repayment of the tax credits and can also be used, in the case of a non-financial trader with trading losses. These losses can be used to claim a repayment of the tax credit.

The provisions of this Chapter ensure that, in general terms, the price paid for the shares is to be reduced, in computing the body’s profit or loss by the extent of the dividends earned before the acquisition of the shares. As in **Chapter 1** of this Part the broad effect is that this artificial loss is not now created.

752 Purchases of shares by financial concerns and persons exempted from tax

Summary

This section is the main provision designed to prevent avoidance of tax by the dividend-stripping device. The section affects persons who deal in financial securities as well as persons who enjoy an exemption from tax and are entitled to claim repayment of tax (for example, charities, pension schemes, etc).

Details

“dividends” includes all distributions. (1)

“gross amount” or “gross dividend” is the dividend (distribution) including the tax credit.

“distribution” has the same meaning as in the Corporation Tax Acts.

“company” is an Irish resident body corporate. (2)(a)

“control” broadly means the power of a person to secure that the affairs of the company

are conducted in accordance with that person’s wishes.

“person” includes any body of persons as well as a trust.

“share” includes stock other than loan stock, etc.

“shares of a class to which this section applies” means, in general, the share capital of a company other than preference shares. Shares are of a different class if their rights, etc are distinguishable.

The above definitions apply also for the purposes of *Schedule 22*.

The subsection also contains provisions for determining when 2 trades are under the same control. (2)(b)

In general, where a body acquires 10 per cent or more of the issued share capital of a company which is of a class to which this section applies, and receives a dividend within 10 years from the date of acquisition, the net dividend, if and so far as it is paid out of pre-acquisition profits is to be treated as a trading receipt. In considering whether there is a 10 per cent shareholding regard is to be had to all shares of the class in question which were — (3)

- acquired within 10 years of the date of the dividend payment,
- held by dealing concerns under the same control, and
- acquired by dealing concerns acting in concert.

There are also provisions relating to persons exempt from tax on dividends corresponding to those relating to financial concerns in *subsection (3)*. The net effect is that where dividends are received in the circumstances of *subsection (3)* no relief by way of repayment of tax or otherwise is to be available in respect of such a dividend, to the extent that it is paid out of pre-acquisition profits. (4)

Account is to be taken in the application of *subsections (3) and (4)* of the acquisition of shares by persons acting in concert. (5)

A mechanism for identifying the order in which shares acquired at different times are sold is outlined and that is on a “first in, first out” (FIFO) basis. (6)

When a new trade commences any shares which form part of the stock-in-trade at that date are deemed to have been acquired at that date. The same applies to a change of ownership. (7)

The computation in *Schedule 22* determines the extent to which profits are accumulated before any particular date. (8)

753 Restriction on relief for losses by repayment of tax in cases of dividends paid out of accumulated profits

Dividend stripping by non-financial concerns with trading losses are prevented by this section.

Where in any year of assessment, or where appropriate, accounting period a person carries on a non-financial trade and receives a dividend of the kind referred to in *section 752*, then in determining any repayment of tax due as a result of set off of trading losses, the “stripped” dividend taken by such a concern is to be left out of account. Similarly any tax credit attaching to such dividends is disregarded (this aspect is no longer relevant as tax credits do not attach to distributions made on or after 6 April 1999).

