

Revenue

# Tax Briefing No 70

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## Capital Allowances for Energy-Efficient Equipment

### Introduction

*Section 46 Finance Act, 2008 (now Section 285A TCA, 1997)* introduced a new incentive for the provision of certain energy-efficient equipment for use in a company's trade. The equipment must be approved and listed by the Minister for Communications, Energy and Natural Resources. Accelerated capital allowances of 100% of the capital expenditure incurred can be claimed for the year in which the equipment is provided and used. The new scheme will run for a trial period of 3 years.

### Capital Allowances

Capital allowances in the form of wear and tear allowances will be available where the provisions of *Section 284 TCA, 1997* are met as follows:

- A person carrying on a trade must incur capital expenditure on the provision of machinery or plant for the purposes of that trade;
- The machinery or plant must belong to that person;
- The machinery or plant must be in use at the end of the chargeable period for which the allowances are claimed;
- While the machinery or plant is used for the purposes of the trade, it must be wholly and exclusively so used.

Because of the possibility that the approved energy-efficient equipment might not be regarded as machinery or plant in its own right for the purposes of wear and tear allowances, any products that have been approved and listed are deemed to be machinery or plant.

Wear and tear allowances for machinery or plant are generally given over an 8-year period at an annual rate of 12½% of the capital expenditure incurred. In the case of approved energy-efficient equipment, this rate is accelerated and the entire allowance can be claimed in the first year in which the equipment is provided and used for the company's trade. Energy-efficient equipment that is machinery or plant but that has not been approved and listed can, of course, avail of the normal wear and tear allowances.

The normal rules regarding balancing allowances/charges in *Section 288 TCA, 1997* apply. Where certain 'balancing' events occur, for example, the sale of the equipment or its ceasing to be used for the purposes of the trade, additional wear and tear allowances may be due, or there may be a clawback of the allowances already granted. This will depend on the proceeds or value of the equipment (or deemed proceeds/value) at the time of the event.

### Who can qualify for the incentive?

The normal wear and tear allowances can be claimed by both individuals and companies. However, the new accelerated allowance is only available to **companies** who incur expenditure on approved energy-efficient equipment for use in their trade. The equipment must be owned by the company. Equipment that is leased, let or hired will not qualify for the allowance.

### Qualifying period

The scheme will run for a trial period of three years from the date on which the Minister for Communications, Energy and Natural Resources made the first Order to establish the list of approved energy-efficient equipment. This Order (S.I. 399/2008) was made on 9 October 2008.

However, expenditure that is incurred on equipment on or after 31 January 2008 will qualify for the incentive if that equipment is subsequently on the approved list.

The scheme itself also came into operation on 9 October 2008 when the Minister for Finance made the required Commencement Order.

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The energy-efficient equipment must be new. It must meet specified energy-efficient criteria and must fall within three specified classes of technology. These criteria and classes of technology have been determined by the Minister for Communications, Energy and Natural Resources. The Minister will approve items of equipment within each class that will be eligible under the scheme and will publish these on a list. The Minister can, by Order, amend the list of approved items after the initial list has been published. The list of approved items will be maintained by Sustainable Energy Ireland and will be available at **www.sei.ie**. A company is required to incur a minimum amount of expenditure on providing the equipment and this varies with the particular class of technology to which the equipment belongs. The classes of technology and their corresponding energy-efficient criteria and minimum expenditure limits are set out in the table below.

Class of technology	Energy-efficient criteria	Minimum expenditure
Motors and Drives	<p>Motors: An asynchronous electric motor with a power rating of 1.1kW or greater, either standalone or as part of other equipment, meeting a specified efficiency standard.</p> <p>Variable speed drive: A drive that is specifically designed to drive an AC induction motor in a</p>	€1,000

Class of technology	Energy-efficient criteria	Minimum expenditure
	manner that rotates the motor's drive shaft at a variable speed dictated by an external signal.	
Lighting	Lighting units, comprising fittings, lamps, and associated control gear, that meet specified efficiency criteria, or lighting control systems designed to improve the efficiency of lighting units. Includes occupancy sensors and high efficiency signs.	€3,000
Building Energy Management Systems	Computer-based systems, designed primarily to monitor and control building energy use with the aim of optimizing energy efficiency and meeting specified efficiency standards.	€5,000

The Finance (No. 2) Bill 2008, as initiated, contains a provision in section 33 to extend from 3 to 7 the categories of energy-efficient equipment to be included in the scheme.

The **proposed** new categories are:

- Information and Communications Technology
- Heating and Electricity Provision
- Process and Heating, Ventilation and Air-conditioning (HVAC) Control Systems
- Electric and Alternative Fuel Vehicles

These proposed new categories will not become effective until the Finance (No. 2) Bill 2008 is passed into law and the Minister for Finance makes the required Commencement Order. In addition, the Minister for Communications, Energy and Natural Resources will have to make a new Order listing the approved items within the new categories. The Finance (No. 2) Bill 2008, as initiated, does not extend the initial trial period of 3 years.

### How relief is claimed

There is no requirement to obtain approval for expenditure on the energy-efficient equipment. The normal self-assessment provisions apply. Once a company meets all of the required conditions, it can claim the allowance for the accounting period in which the equipment was first provided and used for its trade provided that the equipment is included on the published list at some stage during that accounting period. The allowance should be claimed on the company's return of income (form CT1) and should be included along with any other wear and tear allowances for machinery and plant. The current form CT1 does not contain a dedicated entry for the new allowance but may do so in the future.

## VAT Treatment of Factoring and Invoice Discounting

### Introduction

#### 1.1 For the purposes of this article,

'Factoring' involves the assignment of a debt to a financier by the originator of the debt (the 'client'), the giving of notice of such assignment to the debtor and collection of the debt by the financier. Examples of generic factoring product names used in Ireland include 'full service', 'main line', 'traditional', 'maturity'.

'Invoice discounting' involves the assignment of a debt to a financier by the client and the collection of the debt by the client as the appointed agent of the financier. Such assignment and the corresponding agency appointment may be disclosed to the debtor or may be kept confidential. Examples of generic invoice discounting product names used in Ireland include 'bulk factoring', 'agency discounting', 'disclosed invoice discounting', 'confidential invoice discounting', 'confidential factoring', 'undisclosed factoring' and 'commercial finance'.

1.2 Factoring and invoice discounting are provided as a service, either with or without recourse in the event of default by a debtor in payment (see paragraphs 3.2 and 3.3 below).

1.3 In this article the financier is called a 'Factor' irrespective of whether the financier provides factoring or invoice discounting services. Unless specific mention is made to the contrary 'factoring' also includes invoice discounting.

### Background

2.1 The purpose of this article is to clarify Revenue's position on the VAT treatment of factoring and invoice discounting following the High Court judgment in the judicial review proceedings in the case of *Hagemeyer Ireland plc and the Revenue Commissioners*<sup>[1]</sup>.

2.2 Issue 59 of **Tax Briefing** contained an article on such treatment in the light of the European Court of Justice ('ECJ') ruling in the *MKG-Kraftfahrzeuge-Factory GmbH* case (case C-305/01) ('MKG'). Following the High Court Decision in the *Hagemeyer* case, Revenue has undertaken a general review of the processes and the legal form of the factoring and invoice discounting arrangements operated in the Irish market. Following consultation with industry groups, Revenue now confirms that certain aspects of the earlier **Tax Briefing** article require to be revised.

[1] Unreported High Court Decision of 9 February 2007

### MKG case and the Hagemeyer case

3.1 Revenue has always accepted that pure debt collection services and also debt collection or administration provided in accordance with a debt-factoring contract are taxable activities, with the right to deduction. Conversely, before the ECJ decision in the *MKG* case, Revenue had regarded true factoring as being, essentially, the granting of credit by the factor and, as such, exempt from VAT without the right to deduction. True factoring in the *MKG* case was considered to be 'the purchase of debts with the full assumption of the risk of default' [2] [by the debtor]. This was compared with 'quasi-factoring' which was described in the ECJ judgment as 'where the client assigns to the factor debts owed to him arising from the supply of goods or services but remains fully liable in regard to the debtor's ability to pay.' [3]

3.2 In Ireland, 'true factoring' is usually called 'non-recourse factoring' where the Factor collects the debts and assumes the risk of debtor default and is called 'non-recourse invoice discounting' where the Factor assumes the risk of debtor default and appoints the client to collect the debts as the agent of the Factor.

3.3 In Ireland, 'quasi-factoring' is usually called 'recourse factoring' where the Factor collects the debts but the client remains responsible for debtor default and is called 'recourse invoice discounting' where the risk of debtor default remains with the client who collects the debts as the appointed agent of the Factor.

3.4 Under both true factoring and quasi-factoring the Factor is rewarded for his collection and/or administration activities by a 'factoring fee', also sometimes referred to by practitioners and the industry as a 'service fee', 'administration fee', 'facility fee' or 'ledger management fee'.

3.5 The facts of the **MKG** case concerned true factoring which the ECJ held to be a taxable economic activity with the right to deduction. In reaching this decision the ECJ examined the *Sixth VAT Directive* where *Article 13B(d)(3) (now Article 135(1)(d) of Council Directive 2006/112/EC - the VAT Directive 2006)* specifies that 'debt collection' cannot be treated as VAT exempt activity.[4] In arriving at its conclusion, the ECJ commented[5] '...the term debt collection must be interpreted as encompassing all forms of factoring' and '...factoring must be regarded as constituting merely a variant of the more general concept of debt collection, whatever the manner in which it is carried out'.

3.6 Having concluded that factoring is a form of debt collecting, the ECJ then dealt with the two principal forms of factoring, namely 'true factoring' and 'quasi-factoring', as explained in paragraphs 3.2 and 3.3 of this article. The ECJ held that 'there is no valid justification for treating true factoring and quasi-factoring differently from the point of view of VAT, given that in both cases the factor makes supplies to the client for consideration and accordingly pursues an economic activity.'[6]

3.7 In implementing the ECJ judgment in the *MKG* case, Revenue took the view that since the basis of that decision was that factoring was a form of debt collection, the case would not have any application where debts were purchased but the collection



of those debts remained with the originator (i.e. the creator and seller of the debts), even if the originator acted as agent for the Factor in the collection of the debts.

3.8 However, the High Court has now ruled to the contrary in the *Hagemeyer* case. The High Court has held that in such circumstances the transaction involved (being the purchase of the debts without recourse) goes beyond the mere provision of an exempt financial service since the purchaser has in return for consideration in the form of a factoring fee assumed the risk of debtors' default and relieved the seller (originator) of the debts of the relevant trade credit waiting time before payment. Such a transaction was held to be a taxable economic activity for VAT purposes, the consideration being the relevant factoring fee charged.

3.9 The purchase of the debts under a factoring agreement gives the Factor complete discretion as to who (if anyone) to appoint as its agent to collect the debts. This can be the seller or any other undertaking. Such appointment does not change the essence of the transaction from one of factoring. In short, therefore, the High Court has held that 'factoring' and 'debt collection' are separate; i.e. the purchase of the debts, with or without the assumption of the risk of default, constitutes factoring and collection of those debts involves the process of debt collection, and both services are taxable activities.

[2] See paragraph 13 of ECJ judgment

[3] See paragraph 13 of ECJ judgment

[4] Only the English and Swedish versions of the Sixth Directive specifically stated that 'debt collection and factoring' cannot be an exempt activity whereas the German and other language texts only mentioned the equivalent term of 'debt collection'. ECJ referred to this in support of its finding in the MKG judgment - see paragraph 53 of the judgment.

[5] See paragraph 77 of ECJ judgment

[6] See paragraph 54 of ECJ judgment

## **VAT Treatment**

4.1 Revenue has accepted the High Court decision in the *Hagemeyer* case and is implementing the judgment. Through the forum of an Indirect Taxes TALC Sub-Group and the assistance of the Asset Based Finance Association, examples of practical scenarios involving debt factoring were submitted to Revenue for its views on the VAT treatment to be applied in the scenarios in question. The Revenue position on those scenarios is now outlined in *Appendix 1* to this article.

4.2 Revenue accepts that the taxable consideration for the factoring supply is the relevant fee charged, which is liable to VAT at the time the fee is charged by the Factor. This is usually either upon notification by the seller of the debt to the Factor



or a fixed periodical amount. Revenue also recognises that it is common practice within the Irish factoring industry to purchase debts at face value with a right to set off relevant fees and charges against the purchase price of debts. The terms of the Factoring Agreement normally provide that the purchase price for a factored debt is only payable well after a debt is assigned to the Factor. Under a recourse Factoring Agreement this currently coincides with the actual collection of the debt from a third party debtor. Under a nonrecourse agreement<sup>[7]</sup> the purchase price is payable at the expiry of an agreed period from the debt's 'due date'<sup>[8]</sup>, if the debtor has not by then discharged the debt. The agreed period is typically (but not essentially) 90 to 180 days after such due date. If the debtor pays earlier, then payment of the purchase price is due / paid at the same time. Once the purchase price has been paid, no further supply takes place for VAT purposes.

4.3 It has now been brought to Revenue's attention that many Irish factoring companies, which operate such delayed payment terms under their factoring agreements, also offer and provide advance funding as an additional service. This option permits the clients to request a draw down of advance funding up to an agreed facility limit. This will normally be set as a percentage of the value of uncollected approved factored debts but often subject to an overall maximum financial limit on all such advances.

4.4 It is entirely at the discretion of the client whether to utilise this facility for advances. Upon utilisation the Factor will normally charge an additional advancement fee or charge equivalent to a margin over an agreed base rate for the funds advanced. This is variously called an 'advance fee', 'discount', 'discounting charge' or 'discount fee'. Revenue accepts that this facility for advances, when availed of, constitutes a separate supply for VAT purposes to the main factoring supply and that the nature of the advancement fee is that of a VAT exempt charge for the provision of credit.

4.5 Where a taxable person engages in both taxable factoring activities and VAT exempt activities, entitlement to recover VAT incurred on general overhead and dual use inputs will arise on an apportionment basis as outlined in issue 46 of **Tax Briefing**, Guide to Apportionment of Input Credit.

4.6 In addition, it is confirmed that where an assignment of the debt is made in return for a factoring service, Revenue will disregard the assignment or its reassignment for VAT purposes. All VAT incurred in relation to the putting in place of a factoring agreement and the collection of receivables is understood to directly relate to the taxable factoring activity. VAT incurred directly relating to the VAT exempt advance draw down facility will not qualify for recovery other than as noted at footnote 10 in relation to qualifying activities - see *Appendix 1* to this article.

4.7 However, where a debt is simply assigned for its face, or other, value to a third party, without a factoring or similar arrangement, then such assignment will continue to be regarded as a VAT exempt transfer of or dealing in a debt.

4.8 Finally, while what is common to factoring agreements is generally a 'factoring fee' (also called a 'service fee', 'administration fee' or 'ledger management fee') which is chargeable to VAT, and an 'advance fee' (also called a 'discount', 'discounting charge' or 'discount fee') which is exempt from VAT, factoring agreements may also contain other specific fees and charges for certain services. *Appendix 2* to this article lists some of these other fees and charges, and outlines the VAT treatment of the fees and charges in question.

[7] This is the same as 'true factoring' referred to in the ECJ Judgment

[8] The due date for payment as agreed between the client and the debtor, i.e. the expiry of the credit terms.

## **Appendix 1**

### **VAT treatment of debt factoring - practical scenarios.**

#### **Scenario 1: Non-recourse factoring - i.e. 'true factoring'**

An Irish-established Company A ('Factor') purchases debts from an Irish Company B ('client') for a purchase price of €100,000, being the book value of the debts. Under the factoring agreement, the risk of debtor default passes to the Factor, which assumes responsibility for collecting the debts with no recourse to the client.

The Factor will charge a service fee of say 2.5% of the value of the debts. The actual services provided in return for such fee can vary but will usually include some of the following, relief from bad debts, sales ledger administration, provision of credit advice and statistics and a debt collection service from initial contact with debtors through to legal enforcement.

The Factoring Agreement provides that:

1. the service fee is payable upon notification of each debt by the client to the Factor;
2. the purchase price of each debt is payable at 90 days past the due date of each debt or its earlier collection;
3. the client can draw down advances from the Factor before such purchase prices are payable;
4. for such advances the client must pay an advancement fee to cover the period from the draw down date until the time of payment of the purchase price specified in point 2 immediately above.

#### **Revenue response:**

1. This scenario closely mirrors the facts in the *MKG* judgment. The Factor is purchasing debts and assuming the risk of the debtor's default. The factoring

consideration is receivable in respect of an economic activity, not falling within the exemption<sup>[9]</sup>, and is therefore taxable with the right of deductibility.

2. The service fee charged by the Factor to its client for providing its factoring services is liable to VAT at the standard rate of 21 per cent, (21.5 per cent from 1 December 2008).
3. The separate advancement fee payable by the client to the Factor will continue to be recognised as an exempt supply for VAT purposes, being paid in return for the provision of funds outside the agreed payments terms of the purchases price under the factoring agreement.
4. If the Factor were not established in Ireland, the VAT treatment for the Irish established client (company B) would be that it has received factoring services or Fourth Schedule services, which would be taxable in the hands of such recipient.
5. Should the Factor be Irish-established and the client not, there would be no VAT liability in Ireland.<sup>[10]</sup>
6. The equitable or legal assignment of title to debts in favour of a Factor pursuant to a Factoring Agreement is disregarded for VAT purposes.
7. The Factor will be entitled to recover all VAT incurred in putting in place the Factoring Agreement and the operation of the agreement, including debt recovery. VAT incurred directly relating to the VAT exempt advance draw down facility will in general not be available for recovery other than as noted at footnote 10 in relation to 'qualifying activities'.

[9] Under Article 13 B(d) of the EU Sixth VAT Directive exempting from VAT the granting, negotiation and management of credit; now article 135 of Council Directive 2006/112/EC.

[10] If the client (Company B) is outside EU both the factoring supply and the advance draw down supply will be effectively zero rated as a 'Qualifying Activity' such that both the factoring fee and the advance draw down fee will permit full VAT recovery.

## **Scenario 2: Factoring with recourse, i.e. 'quasi-factoring'**

An Irish-established Company A ('Factor') purchases debts from an Irish established Company B ('client') for a purchase price of €100,000, being the book value of the debts, payable only upon receipt from the debtor. The Factor does not assume the risk of debtor default. If the debtor defaults then the relevant debts are then reassigned by the Factor back to the client.

The Factor will charge a service fee of say 2% of the value of the debts. The actual service provided in return for this fee can vary but will usually include some of the following: sales ledger administration, provision of credit advice, statistics and a debt collection service from initial contact with debtors through to legal enforcement. NB there is no relief from bad debts.

The Factoring Agreement provides that:

1. the service fee is payable upon notification of each debt by the client to the Factor;
2. the purchase price of each debt is payable only if and when the debt is collected;
3. the client can draw down an advance from the Factor before the purchase price is payable in point 2 immediately above;
4. such advance has to be repaid if the debt is uncollected;
5. for each advance the client must pay an advancement fee to cover the period from the draw down date until either payment of the purchase price in accordance with point 2 above or the advance is repaid.

**Revenue response:**

1. Even though the Factor does not accept the risk of debtor default, the VAT treatment is the same as in Scenario 1.
2. Points 2 to 7 inclusive of the response to Scenario 1 also apply.

**Scenario 3: Invoice Discounting without recourse - i.e. 'true-factoring'**

An Irish-established Company A ('Factor') purchases debts from an Irish Company B ('client') for a purchase price of €100,000, being the book value of the debts. Under the factoring agreement the risk of debtor default passes to the Factor. The client is appointed as the agent of the Factor to collect the debts. The Factor has no recourse to the client for debtors' default.

The Factor will charge a service fee of say 1.5% of the value of the debts. The actual services provided in return for such fee can vary but will usually include some of the following: the relief from bad debts, provision of credit advice, review and advise on ledgers and systems and statistics.

The Factoring Agreement provides that:

1. the service fee is payable upon notification of each debt to the Factor;
2. the purchase price of each debt is payable at 90 days past the due date of the debt or its earlier collection;
3. the client can draw down advances from the Factor before such purchase prices are payable;
4. for such advances the client must pay an advancement fee to cover the period from the draw down date until payment of the purchase price specified in point 2 immediately above.

**Revenue response:**

1. Apart from the fact that the originator, as the appointed agent of the Factor, continues to collect the debt, this scenario mirrors that of Scenario 1 above. In keeping with the Hagemeyer decision, Revenue accepts that the Factor by

relieving the vendor of the risk of default is carrying on a taxable economic activity.

2. Points 2 to 7 of the response to Scenario 1 also apply.

#### **Scenario 4: Invoice discounting with recourse i.e. 'quasi factoring'**

An Irish-established Company A ('Factor') purchases debts from an Irish established Company B ('client') for a purchase price of €100,000, being the book value of the debts, payable only upon receipt from the debtor. The client is appointed the agent of the Factor to collect the debts. The Factor does not assume the risk of debtor default. If the debtor defaults then the relevant debts are reassigned by the Factor back to the client.

The Factor will charge a service fee of say 1% of the value of the debts. The actual services provided can vary but will usually include some of the following: provision of credit advice, review and advise on ledgers and systems and statistics. There is no relief from bad debts.

The Factoring Agreement provides that:

1. the service fee is payable upon notification of each debt by the client to the Factor;
2. the purchase price of each debt is payable only if and when the debt is collected;
3. the client can draw down an advance from the Factor before such purchase price is payable in accordance with point 2 immediately above;
4. such advance has to be repaid if the debt is uncollected;
5. for each advance the client must pay an advancement fee to cover the period from the draw down date until payment of the purchase price in accordance with point 2 immediately above or the advance is repaid.

#### **Revenue response:**

1. 1. Apart from the fact that the originator - as the appointed agent of the Factor - collects the debt, this scenario mirrors that of Scenario 2 above.
2. 2. Points 2 to 7 inclusive of the response to Scenario 1 also apply.

#### **Scenario 5: Simple Transfer of Debt**

An Irish-established Company A (the purchaser) purchases debts with a book value of €100,000 from an Irish-established Company B (the vendor). At this time the market value of the debts is agreed to be €97,000 and the debts are purchased for such market value. Neither party raises an invoice for commission or other services.

**Revenue response:**

1. The sale of the debts by Company B is VAT exempt.
2. In keeping with the decision in the *Hagemeyer* and *MKG* cases, the activities of Company A do not fall to be regarded as taxable factoring services for VAT purposes as the arrangement is not governed by a factoring agreement and there is no consideration or fee received or payable to Company A. Accordingly, this will be regarded for VAT purposes as a simple debts transfer agreement.

**Note:** While Revenue has attempted to respond to the scenarios posed, it should be borne in mind that these are necessarily general in nature and that each case has to be decided on by reference to its own particular facts and circumstances.

**Appendix 2****VAT treatment of debt factoring - treatment of certain fees and charges**

Generally, factoring companies have standard agreements that they use with their clients. Generally, too, the only variations to such agreements that are permitted relate to the financial terms negotiated with each client such as the level of charges and any pre-conditions to funding. These do not affect the framework of the agreements, including the services and funding, or the consequent VAT treatment.

All factoring facilities operate on the basis that the purchase of debts involves an assignment by the client of the purchased debts.

As already explained in this article, what is common to factoring agreements is generally a 'factoring fee' (also called a 'service fee', 'administration fee' or 'ledger management fee') which is chargeable to VAT, and an 'advance fee' (also called a 'discount', 'discounting charge' or 'discount fee') which is exempt from VAT. Factoring agreements, however, may also contain other specific fees and charges for certain services. Below is a description of some of the more common of these other fees and charges; where possible an outline of the VAT treatment to be applied to these fees and charges is also set out. It should be borne in mind that this outline of the VAT treatment is necessarily general in nature. Each case has to be decided on by reference to its own particular facts and circumstances.

**Take-on Fee** (of a fixed amount)

Factoring agreements often do not specify what this covers but, in general, it is intended to cover the work load involved by the Factor in testing and verifying the client's sales ledger and other records before the commencement of the relationship, obtaining the sales ledger and setting up the control account and all necessary reconciliation. If this is the case, then the take-on fee relates to debt collection and ledger management. Accordingly, the fee is chargeable to VAT.



**Arrangement Fee**

Again, there may be no definition or explanation of this fee in a factoring agreement. In general, this fee is agreed before negotiations for the facility start and is payable upon commencement of the facility. The VAT liability very much depends on the activity and the specific circumstances, e.g. if the arrangement only relates to the negotiation of the terms for the advancement of credit then this would be an exempt supply for the negotiation of credit.

**Computerised Services**

Factors often agree to provide licensed software and a user manual to enable the Client to send EDI messages, download details of debts, request payments and view accounts. VAT is chargeable on any fee for this service. Such service is often provided free of charge, in which case the agreed services covered by the normal taxable service charge will also include the computerised services.

**Collect-out Fee**

If the client's parallel agency to collect is cancelled by the Factor, this fee becomes payable. This usually happens upon breach of the agreement by the Client or its insolvency. This fee is often described as being for '*our additional work in collecting or procuring the collection of debts*' as a result of such breach or insolvency. This fee is chargeable to VAT.

**General Indemnities**

There are often indemnities in favour of the Factor for various out of pocket expenses incurred before and during the relationship. As the indemnities are in very general terms and often akin to claims for damages, it is beyond the scope of this article to express a view on their VAT treatment.

**Facility Fee** (payable on each anniversary)

Among factoring companies, a facility fee is normally charged in relation to the provision of financial facilities and if this is the case then it would be exempt from VAT. If it is not for a financial facility, then it is liable to VAT.

**Arrangement fee** (for variations to the agreement or services outside its scope)

This should be liable to VAT if the variations or services relate to taxable supplies. If the fee relates to exempt supplies such as the negotiation of credit, it is exempt from VAT.

**Costs of outside visits**

This is an ancillary charge to the factor's debt collection and factoring services and, as such, is liable to VAT.

**Legal fees incurred**

These would relate to perfection of security, debt collections or enforcement of rights, and would be ancillary to the factor's debt collection and factoring services and, as such, liable to VAT.



**Debt enforcement costs**

These are clearly ancillary to factoring services and are liable to VAT.

**Credit status reports**

Factors often agree to provide credit status reports on any of the client's customers or proposed customers. This is ancillary to the factoring service and is liable to VAT.

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into a Tax and Duty Manual  
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## Finance (no.2) Bill 2008 - Notes on Some Aspects

- [Air Travel Tax](#)
- [Research and Development](#)
- [Stamp Duty - Late Stamping of Instruments](#)
- [Tax and Duty Civil Penalties](#)
- [Parking Levy in Urban Areas - Guidance Document](#)

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## Salary Sacrifice

### 1. Introduction

*Section 118B Taxes Consolidation Act 1997* deals with the issue of salary sacrifice. The section came into effect on 31 January 2008.

This section;

- copper-fastens on a legislative basis Revenue's administrative practices for Benefit-in-kind exempt 'Travel Passes' and the treatment that applies in relation to employee contributions to approved profit share arrangements that have been in place for a number of years and
- ensures that any other salary sacrifice arrangements are subject to PAYE and PRSI.

### 2. Revenue's position

An article on the administrative practice for bus and train passes was originally published in **Tax Briefing** Issue 41 in 2000. This article supersedes that article.

Revenue's position is that salary sacrifice arrangements do not reduce an employee's taxable income. If an employee forgoes any remuneration by way of any arrangement, either by changing the existing terms or contract of employment or creating new terms or contract of employment, or indeed if there are no recorded terms and conditions in relation to the employment, the employee will remain taxable on their 'gross' income.

Remuneration sacrificed is to be considered as an application of the income earned by an employee rather than an expense incurred by that individual's employer. The only exceptions are the two schemes provided for in *Section 21 Finance Act 2008*.

### 3. What is new

3.1. This section provides a clear legislative basis for the Revenue approved administrative practices in respect of the two existing salary sacrifice arrangements, namely:

1. Benefit-in-kind exempt 'Travel Passes' - as provided for in *Section 118(5A)* of the TCA - provided by employers to employees where there is a corresponding reduction in the employees' remuneration. Under the scheme, an employee is not charged to either tax or PRSI on the remuneration sacrificed, and the employer saves on employer PRSI contributions in respect of the employee. (See <http://www.taxesaver.ie/>)

2. Similarly, the section confirms the treatment that applies in relation to employee contributions to approved profit share arrangements set up by employers under *Section 510* of the TCA. Under the scheme employees may forgo up to 7.5 percent of basic salary towards the purchase of shares. Shares appropriated to an employee under such a scheme are exempt from a charge to tax by virtue of *Section 510(4) TCA*.

Hereafter these two schemes are referred to as 'exempt employee benefits'.

3.2. To qualify the remuneration sacrificed must be from the same year of assessment as the year in which the exempt employee benefits are provided.

3.3. In all other circumstances where any salary sacrifice arrangement is in place, the salary sacrificed is treated as remuneration of the employee and is taxable as such. The employer must operate PAYE/PRSI on the amount of remuneration foregone.

3.4. There is also provision in the new section to prevent any attempts that might be made to circumvent the intent of the section either by employers providing benefits to connected persons or by reimbursing employees for remuneration forgone.

3.5. Remuneration is not restricted solely to cash remuneration but includes all forms of remuneration arising from the holding of an office or employment. This includes bonus payments and any form of discretionary payment.

#### 4. Anti-abuse

The legislation provides for a number of anti-abuse provisions to ensure that the provision is only applied in the manner in which it was intended. These are:-

1. Where the exempt employee benefit is provided to a spouse or connected person, rather than an employee, it will not be treated as an exempt employee benefit, but the value of the benefit will be treated as salary sacrificed by the employee and taxed accordingly.
2. Where an employee, as part of an arrangement, is provided with both an exempt employee benefit and a compensating payment in return for the salary sacrificed, then the exemption status conferred by *Section 118B* will not apply and the income sacrificed will be taxed in full.
3. It should also be noted that the legislation provides that any exempt employee benefit provided for a year before the year of claim will not be effective. Specifically, where income is not paid during the year (e.g. a bonus, commission or other income which only arises after the end of the year) such income cannot be taken into account for the purposes of an exempt employee benefit scheme.

#### 5. Tax treatment of salary sacrifice arrangements

Where an employee forgoes any remuneration in return for any benefit, then the legislation in relation to salary sacrifice applies (i.e. *Section 118B of the TCA*) and the remuneration sacrificed is taxable in full under Schedule E, unless the benefit provided is an exempt employee benefit.

## 6. Tax treatment of benefit-in-kind and salary sacrifice arrangements

6.1. Where an employer provides a benefit, directly or indirectly, at a cost to that employer, then the resulting benefit is taxed as a benefit-in-kind in the hands of the employee in accordance with *Section 118* of the TCA.

### 6.2. There are a number of rules for benefit in kind set out in tax legislation on;

- the exemption of specific items from the benefit in kind charge.
- the calculation and valuation of benefit in kind in specific instances.
- the reimbursement of the cost of the benefit by an employee out of net salary.

6.3. In circumstances where the costs of the provision of a benefit are partly borne by the employer, with the balance borne by the employee under a salary sacrifice arrangement, there will be a charge to tax because of *Section 118B* (salary sacrifice). However, the only double charge that could arise would be to a benefit-in-kind charge under *Section 118*. That charge applies 'to so much of the expense as is not made good to the body corporate by the director or employee...' - so the 'double charge' would be reduced as the employee has given salary to his/her employer for the benefit received under the salary sacrifice arrangement.

It should also be noted that all remuneration provided by an employer is taxable unless specifically exempted by a provision of tax legislation.

## 7. Examples

A number of examples are given below showing how the salary sacrifice legislation works. It should be noted that this list is not exhaustive and any specific circumstance will be examined in the light of the individual taxpayer's conditions.

Examples of arrangements subject to tax.

- Attempts to circumvent the limits imposed on personal contributions to pension schemes by forgoing salary and transferring the contribution from the hands of the employee to the employer.
- Employees forgoing salary to enable their employer make partial or full contribution to the costs of childcare.
- Reimbursing an employer by sacrificing salary in return for the provision of benefits, like motor cars.
- Provision of life cover.
- Provision of golf club or gym membership.

The legislation confirms Revenue's view that such arrangements have always given rise to a tax charge.

Examples of arrangements not affected by the introduction of this legislation.

The reason these schemes are not affected is because earned income is not being sacrificed in return for a benefit.

- Unpaid leave / leave in lieu arrangements.
- Employee Assistance programmes.
- Course and exam fees.
- Benefit in kind charge in respect of medical insurance premiums paid by employer

Set out below are a number of worked examples of how it is intended that the new legislation would apply :-

#### Example 1 (salary forgone equals value of benefit)

Without Salary forgone	With Salary forgone (€20k)
Salary €100,000	Salary € 80,000
	Taxable BIK € 20,000
	PAYE/PRSI on salary €100,000
PAYE/PRSI on €100,000	PAYE/PRSI on BIK € 20,000
	less amount made good € 20,000 €0
	€100,000

#### Example 2 (salary forgone is less than value of benefit)

Without Salary forgone	With Salary forgone (€20k)
Salary €100,000	Salary € 80,000
	Taxable BIK € 30,000
	PAYE/PRSI on salary €100,000
PAYE/PRSI on €100,000	PAYE/PRSI on BIK € 30,000
	less amount made good € 20,000 € 10,000
	€110,000

#### Example 3 (salary forgone is greater than value of benefit)

Without Salary forgone	With Salary forgone (€20k)
Salary €100,000	Salary € 80,000
	Taxable BIK € 10,000

Without Salary forgone	With Salary forgone (€20k)
PAYE/PRSI on €100,000	PAYE/PRSI on salary €100,000 PAYE/PRSI on BIK € 10,000 less amount made good € 20,000 €0 €100,000

**Example 4 (salary forgone equals value of an exempt benefit other than those mentioned in S118B(2)(a))**

Without Salary forgone	With Salary forgone (€20k)
Salary €100,000	Salary € 80,000 Taxable BIK € 20,000 PAYE/PRSI on salary €100,000 PAYE/PRSI on BIK € 0 less amount made good € 20,000 €0 €100,000
PAYE/PRSI on €100,000	

## 8. New or renegotiated contracts.

The legislation covers any arrangement made between an employer and an employee. Therefore, an employee who enters into any arrangement with their employer to forego remuneration and receive any part of the remuneration due under the terms or contract of employment as a benefit, either by way of new or renegotiated terms or contract, is subject to the legislation.

## 9. Pension contributions

Where an employee foregoes remuneration in return for an increased pension contribution by the employer, such an arrangement will be subject to the provisions of *Section 118B*.

## 10. Clarifying if a scheme is in operation in a workplace

Salary sacrifice schemes may also be known as Flexible Benefits Packages or Flexi-Plans. In general, the scheme will require an employee to agree to revised terms in relation to their terms or contract of employment whereby a benefit is provided in return for a reduction in take-home pay. Such schemes may be subject to the salary sacrifice legislation and should be examined in relation to the legislation.



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