Tax treatment of stocklending/sale and repurchase (repo) transactions

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Revenue
Cáin agus Custaim na hÉireann
Irish Tax and Customs

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Table of Contents

Background 3
1.1 Transfer of Title 3
1.2 Income receipts/payments 3
2. Tax Treatment 4
2.1 Substance 4
2.2 Receipt of manufactured payments 4
2.3 Fees 4
2.4 Payment of manufactured dividends 5
2.5 Rebates 5
2.6 DWT 5
3. Conditions and Restrictions 5
3.1 Qualifying Institutions 5
3.2 Qualifying Securities 6
3.3 Non-Qualifying Securities 6
3.4 Accounting Treatment 6
3.5 Records 6
3.6 Duration of lending arrangement 7
3.7 Implementation 7
4. Tax Avoidance 7

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Background

The purpose of this manual is to set out a tax treatment, which may be followed for the purposes of corporation tax, in the case of stocklending and repo transactions[1]. To avail of this treatment, a company must follow the treatment in relation to all of its stocklending and repo transactions.

Stocklending and repo transactions are a common feature of financial centres. These transactions involve the temporary transfer of stock or securities from one party to another with a simultaneous commitment to reverse the transaction at some point in the future. The difference between a stock loan and a repo transaction is that in a repo contract there is an agreed return date whereas in a stock loan contract there is no pre-agreed return date. There are two important aspects to stocklending and repo transactions for tax purposes:

1.1 Transfer of Title

A key feature of the transactions is that a transfer of legal title occurs which is subsequently reversed on completion. Taxation of these transactions based on the strict legal form would result in a charge to Capital Gains Tax or Income/Corporation tax. Notwithstanding this legal form, the substance is essentially one of lending.

1.2 Income receipts/payments

Where stock is the subject of the loan / repo, the borrower is normally entitled to any dividend/interest payments made because a transfer of legal title occurs so that the stock is held in the borrower's name. However, the borrower will normally be required to reimburse the lender for any such dividend/interest payments. This compensating payment is termed a "manufactured payment".

The effect of this reimbursement transaction is that:

- the lender is effectively placed in the same position as if it had not loaned the stock and had received the real dividend, and
- the borrower, as if it had not borrowed the stock and so received no dividend.

In stocklending and repo transactions the profit earned by the lender will either be reflected in a small margin between the "selling" and "repurchase" price or in the form of a fee paid by the borrower, depending on the particular circumstances.

[1] Stamp Duty does not apply to stocklending or repo transactions where the transactions comply with the conditions set out in sections 87 and 87A of the Stamp Duties Consolidation Act 1999.

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2. Tax Treatment

The Revenue Commissioners will recognise the substance of these transactions and, in accordance with paragraphs 2.1 - 2.6, tax only the accounting profit earned (being the fee or margin to the lender) where the conditions and restrictions set out at paragraph 3 are satisfied.

The tax treatments which must be applied where taxpayers intend to rely on this Statement of Practice are as follows:

2.1 Substance

A stock loan or a repo will not be regarded as a disposal/acquisition for tax purposes. Similarly, the subsequent return of the stock by the borrower will not be regarded as an acquisition/disposal. Profits or gains on subsequent disposals of the stock by the lender will be calculated with reference to the original acquisition date and cost. If the loan and return take place at different prices then any profit earned will be treated as a fee received by the lender and taxable in full.

2.2 Receipt of manufactured payments

Manufactured payments will normally be taxable in the hands of the recipient. However, they will be treated as exempt from tax when received by a lender for whom the corresponding real dividend would have been an exempt receipt (examples 1 and 2 below) or would not have given rise to Irish tax by virtue of foreign tax credits in respect of the dividend if it had been received by the lender (example 3). Examples of this treatment include:

1. the receipt of manufactured payments by tax-exempt funds such as charities, pension funds or the pension fund business of a life assurance company;
2. the receipt of manufactured payments in respect of Irish equities by an Irish resident company for whom the real dividends would have ranked as franked investment income and,
3. the receipt of manufactured payments in respect of overseas securities by Irish taxable lenders for whom the real dividends on such securities would have attracted a nil Irish tax liability by virtue of an entitlement to a credit against Irish tax for foreign tax. This situation will apply only where the combined rate of foreign underlying tax and withholding tax would have exceeded the Irish tax rate if the lender had received the real dividend.

If the manufactured payment on dividends exceeds the real dividend received (net of foreign withholding tax, but before Irish encashment tax) then the excess will not be treated as exempt by virtue of this paragraph.

2.3 Fees

Stocklending fees and margins are taxable in full, subject to any statutory exemption from tax of income of the recipient.

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2.4 Payment of manufactured dividends

Where these arrangements apply, the amount of the manufactured payment must be deducted directly from the related real dividends or interest and should not be deducted from any other income in the tax computation. However, the manufactured payment should not be deducted from the real dividend or interest, or any other income, where that real dividend or interest:

- is exempt from tax either because the income is franked investment income or because the borrower is exempt from tax - i.e. the borrower is a charity, pension fund or the pension fund business of a life assurance company, or
- does not give rise to Irish tax in the hands of the borrower, for example by virtue of an entitlement to credit relief for foreign tax.

2.5 Rebates

Rebates of interest on cash collateral, being a full or partial compensation to the counterparty, cannot be deducted for tax purposes otherwise than directly from the interest arising on such cash collateral.

2.6 DWT

In the case of a loan / repo arrangement where DWT has been deducted from a dividend paid to the borrower, a refund of that DWT may be claimed from the Revenue Commissioners by the lender where the lender would be entitled to a refund of the DWT if the dividend had been paid to it and it can provide:

1. the appropriate exemption declaration form,
2. a statement from the borrower disclaiming entitlement to the refund
3. confirmation that the lender is beneficially entitled to the dividend in accordance with the stocklending arrangement and
4. the original dividend voucher.

3. Conditions and Restrictions

The tax treatments outlined above may only be applied where the following conditions and restrictions are satisfied:

3.1 Qualifying Institutions

The arrangements apply to lending and borrowing institutions whether trading or non-trading which are within the scope of Irish tax and which are companies, building societies, pension funds, charities or collective investment funds. The arrangements will not apply to individuals or partnerships. There is no requirement that both parties to the stocklending or repo transaction be within the scope of Irish tax.

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3.2 Qualifying Securities

Subject to the two exceptions outlined in paragraph 3.3 below, the arrangements will apply to:

- all interest-bearing, discounted or premium-bearing securities
- equities quoted on recognised stock exchanges.

The stocks/securities may be denominated in any currency.

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3.3 Non-Qualifying Securities

The arrangements will not apply to:

- **Irish Equities loaned across dividend payment dates**
  Stocklending/sale and repurchase transactions involving Irish equities that are lent across dividend payment dates will not qualify except where the lender would have been entitled to a refund of the tax withheld under domestic law or the terms of a Tax Treaty.

  Where DWT is deducted from the dividend paid to the borrower, a lender who is eligible to have the DWT refunded under domestic law or the terms of a Tax Treaty may apply for a refund of the DWT deducted from the payment to the borrower - see paragraph 2.6 above.

- **Irish Corporate Bonds lent across coupon dates**
  Stocklending/sale and repurchase transactions involving Irish corporate bonds which are lent across coupon dates will not qualify except in either of the following circumstances:
  - where the lender of the bonds would have been entitled to a refund of the tax withheld under domestic law or the terms of a Tax Treaty or,
  - where both parties to the transaction are subject to the interest withholding tax provisions.

3.4 Accounting Treatment

Statutory audited accounts of the relevant institutions, insofar as these transactions are concerned, must recognise the substance rather than the form of the activities. In this regard the accounts must be unqualified.

3.5 Records

Any party to a stocklending/sale and repurchase transaction who avails of these arrangements is required to keep a record of any such transactions. Such records must be maintained for a minimum of six years.

3.6 Duration of lending arrangement

The tax treatment outlined above is limited to transactions where the transfer is for periods of not more than 12 months. The arrangements will not apply where the lending transaction is renewed without a return of equivalent stock to the lender on or before the date of expiry of the agreement. Where the borrower and lender enter into a further arrangement in relation to equivalent stock, whether on or before, or subsequent to, the expiry of the previous agreement, the arrangements will not apply unless the transaction is bona fide and not for the purpose of the avoidance of tax. For this purpose the term “equivalent stock” has the same meaning as in section 87 of the Stamp Duties Consolidation Act 1999 (SDCA), in the case of a stocklending transaction, and as in section 87A of the SDCA in the case of a repo transaction.

3.7 Implementation

These arrangements will be effective for stocklending/sale and repurchase transactions which take place on or after 1 June 2012. Revenue will consider, on a case-by-case basis, any unusual situations not addressed in this Statement of Practice.

4. Tax Avoidance

The tax treatments set out above do not apply in the event of their being used for:

1. tax avoidance purposes or otherwise to gain a tax advantage or
2. transactions the sole or main purpose of which is to provide that a deduction is available for tax purposes in the State or another jurisdiction and the corresponding receipt is not subject to tax in the State or another jurisdiction.

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