Response to Department of Finance consultation on
“Funds Sector 2030: A Framework for Open, Resilient & Developing Markets”

November 2023

Introduction

The Society of Actuaries in Ireland ("Society") is the professional body representing the actuarial profession in Ireland. The Society welcomes the opportunity to engage with the Department of Finance in relation to their consultation on "Funds Sector 2030: A Framework for Open, Resilient & Developing Markets". We have focussed our comments in particular on the subject of life assurance exit tax (LAET), including differences between the LAET regime and the taxation regime applicable to other investment vehicles. The response has been prepared by a cross-section of members of the Society and does not purport to reflect the views of the insurance industry.

Overview

The Society of Actuaries in Ireland welcomes the opportunity to take part in this consultation. We recognise the importance of a well-regulated sector in maintaining Ireland's reputation and ensuring the continued substantial economic contribution of this sector. Our focus has been on Questions 24-32, which cover topics where we can offer most expertise and experience. We have also responded to Question 48.

It is crucial to recognise that any alterations to taxation can potentially lead to unintended consequences. As policy decisions become more refined, it is advisable to engage in further consultations and conduct impact assessments. This approach can help mitigate unforeseen consequences for both the funds industry and cross-border companies.

Executive Summary of Responses to Questions 24 to 32

The key principle that underlies the response from the Society of Actuaries in Ireland is one of equality, simplicity and incentivising better investing behaviour:

1. The Society believes that different forms of investment and savings income and gains should be subject to an equal level of taxation at a harmonised rate.

2. The Society believes that Life Assurance policyholder investments and savings should be on a Final Liability taxation basis.

3. The Society seeks a level playing field as between: (i) direct investment in securities and deposits; and (ii) investment in securities via a collective investment fund ("CIV") such as a unit-linked life fund or a UCITS-type CIV. This should be achieved by applying the harmonised tax rate from point 1 to CIVs. The rate should be linked to the DIRT tax rate. This would help reduce some of the advantages very wealthy individuals have under the current system.

4. The rationale for investments made in single premium life assurance policies being subject to a 1% levy on the investment is not clear. Lump sum investments in IUTs do not incur such a levy. The Society proposes the levy is reviewed.

<u>Equality and Simplicity:</u>

The taxation rates should be harmonised to achieve equality of treatment of different forms of investment returns (i.e. dividends, coupons, interest or gains). This would simplify much of the complexity in taxation of different forms of securities that give the same investment outcomes but may be subject to different taxation treatments. Encouraging initiatives that streamline and simplify tax compliance for taxpayers is a positive step.

For administrative simplicity for both Revenue and taxpayers, taxes ought to be deducted at source and represent a final liability tax with no requirement to make a return. This is the case proposed by the Society of Actuaries in Ireland in relation to investments in Irish domiciled and certain EU domiciled unit-linked life funds and UCITS-type CIVs. The principle of equality should be applied to

the classification of investment products to avoid unnecessary taxation differences.
From both a Revenue and taxpayer administration perspective, a final liability tax with no requirement to make a return greatly simplifies the administration of taxation. Annual tax returns in general are a disincentive to investing and there would also be a higher risk of tax evasion. Collecting tax at source reduces that risk and simplifies the administration for Revenue. Further studies may be required to get the appropriate rate if one tax rate was adopted. It is noted that Revenue may be able to target where they want to apply reliefs (for example, sustainable funds) if the tax regimes were simplified and harmonised.

Currently life insurance policyholders do not get relief for capital losses. It should be noted that even if tax rates are harmonised, there is an inequity in this treatment. It is noted that annual Capital Gains Tax relief is available for direct investors to remove the burden of tax returns for immaterial gains/losses. However, there is no simple solution to grant this relief to life insurance policyholders without introducing complexity and individual tax returns. When the taxation of investing directly in a portfolio of securities is on par with investing in the same portfolio through a unit-linked life fund or a UCITS-type CIV, the relevance of cross-product aggregation of gains and losses for regular investors is expected to decrease. This is due to the fact that: 1) they are unlikely to maintain multiple investments simultaneously, and 2) investing in a diversified portfolio eliminates the necessity for multiple individual investments.

The Society also recommends that for life products, the "old basis" taxation regime remains unchanged. The main reason is that this is a ring-fenced group of policyholders where any change could potentially increase their tax. It is noted that the relative immateriality of this business and that the cost and effort required for any change may not be worthwhile.

Further studies would be needed to determine an appropriate harmonised rate that is neutral for the Exchequer.

Diversification:

The diversification required by the average retail investor can, from a practical perspective, be quickly, easily, and at minimum cost achieved by investing in a CIV such as a UCITS, a unit-linked life fund, or an exchange traded fund ("ETF"). However, the differential taxation treatment as between holding the securities directly or holding the securities via a CIV remains the central barrier to the average retail investors achieving a diversified portfolio with the same tax treatment as wealthier individuals.

Greater equality between different economic groupings

In the case of individuals, the differential treatment as between: (i) direct investment in securities and deposits; and (ii) investment in the same securities via a collective investment vehicle is discriminatory. Differential treatment tends to give an advantage to wealthier individuals who can invest directly in a wide range of securities, while placing a significant disadvantage on regular retail investors with limited funds seeking to invest their modest savings in a diverse portfolio of securities to support themselves and their dependants.

Incentivising Better Investing Behaviour:

When investing in what are relatively risky assets such as shares in companies, corporate bonds, or certain government bonds most retail investors are professionally advised to diversify their portfolio across a wide range of geographical locations and industrial sectors in order to manage the risk of their portfolio.

Investing in Unit-Linked Funds (ULFs) or UCITS (Undertakings for Collective Investment in Transferable Securities) can effectively allow individuals to invest in a diversified portfolio of assets. This approach typically leads to higher returns for a given level of risk. In contrast, investing in single assets, like an individual stock, by the average investor can essentially amount to speculative investing, often without them realizing the inherent risks involved. Many ordinary investors may not be familiar with the concept of diversification and may underestimate the level of risk associated with investing in a single asset.

Furthermore, at the moment, advisors have to spend a lot of time on tax which varies quite considerably across products. This complicates the investment decisions made and may lead to suboptimal decisions, as people seek simplicity.

One possible option considered by the Society:

If the tax rates for gains and income are not harmonised, the Society has considered in the timeframe available one alternate possible option to achieving the aim of equitable treatment between the taxation basis of:

(i) investing directly in securities; and

(ii) investing in securities via a unit-linked life fund or a UCITS-type CIV1, for persons domiciled and resident in Ireland.

We note that other approaches might achieve similar objectives and impact studies would be needed to understand the feasibility of this option outlined and other options on the industry as a whole.

The following amendments to the taxation basis of such CIVs could potentially achieve equality:

a. Unit-linked life funds and UCITS-type CIVs shall be required to notionally distribute all of their income (coupons/dividends/interest excluding realised or unrealised gains) at least annually.
b. The operator of the CIV shall be required to deduct tax at a rate consistent with the DIRT tax rate from all deemed distributions of income from such CIVs and remit it to Revenue. The tax deducted is a final liability tax with no requirement for the taxpayer to make a return. This greatly simplifies the administration for Revenue, significantly improves compliance, and provides a continuous annual flow of taxation income.
c. The rate of taxation on gains on disposal of shares in a unit-linked life fund or CIV is brought into line with the CGT rate applicable to direct holdings of securities, i.e. the [33%] CGT rate applies to gains on disposal of shares in a CIV.
d. The eight-year deemed disposal rule would cease reflecting the inability of investors in a CIV to offset gain and losses from other investment holdings.

e. All CIVs would have the same annual or semi-annual income distribution dates for tax purposes as an anti-avoidance measure.
f. Harmonising the tax rate on income and gains would give further options to simplify the treatment of CIVs (versus other investments) further.

Single Premium Life Assurance Policies versus Lump Sum Investments in IUTs:

Investments made in single premium life assurance policies are subject to a 1% levy on the investment, whereas lump sum investments in IUTs do not incur such a levy. Additionally, there seems to be no clear and justifiable rationale behind the nuanced variations in how the Life Assurance Exit Tax (LAET) and the right to declare under an IUT operate. It would be beneficial to gain clarity on the underlying reasons for these differences.

Concluding Comments:

- Any taxation changes could have unintended consequences and unforeseen complexity. The Society recommends that a comprehensive impact assessment of any potential changes needs to be completed to prevent unforeseen consequences on the industry as a whole. For example, the funds industry and cross-border companies need to be considered in this discussion.
- The benefits of simplification and equal treatment would have potential positive behavioural consequences, less time and money would be spent on complex tax advice and could lead to more optimal investment decisions.
- As policy decisions become more defined, the Society would be happy to participate in further consultations on any options being considered and to give feedback in that regard. Any such consultation would require a dedicated working group to be set up and sufficient time would be needed to carefully work through each option.

[1] This category includes Irish funds and EU/EEA/OECD equivalent funds that agree to distribute substantially all of their income at least once a year.

Responses to specific questions

Question 24

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

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

Taking account of the different nature of the investment products, is this an appropriate way to class investments for the purposes of taxing the returns on those investments?

- No. In the case of individuals, the differential treatment as between: (i) direct investment in securities and deposits; and (ii) investment in the same securities and deposits via a collective investment vehicle is discriminatory. Differential treatment tends to give an advantage to wealthier individuals who can invest directly in a wide range of securities, while placing a significant disadvantage on regular retail investors with limited funds seeking to invest more modest savings in a diverse portfolio of securities to support themselves and their dependants.

Does the differing tax treatment of different investments drive investor behaviour, and if so how?

- When investing in what are relatively risky assets such as shares in companies, corporate bonds, or certain government bonds most retail investors are professionally advised to diversify their portfolio across a wide range of geographical locations and industrial sectors in order to manage the risk of their portfolio.

  Investing in Unit-Linked Funds (ULFs) or UCITS (Undertakings for Collective Investment in Transferable Securities) can effectively encourage individuals to invest in a diversified portfolio of assets. This approach typically leads to higher returns for a given level of risk. In contrast, investing in single assets, like an individual stock, by the average investor can essentially amount to speculative investing, often without them realizing the inherent risks involved. Many ordinary investors may not be familiar with the concept of diversification and may underestimate the level of risk associated with investing in a single asset.

To cover the wide range of geographic locations and industrial sectors requires diversification across the major developed market and major emerging market countries of the world. Such an investment portfolio would need to span something of the order of 3,000 individual holdings.

For the average retail investor with say EUR10,000 to invest, this means allocating something of the order of EUR3.33 into each holding.

Aside from the above cost hurdles, the average retail investor would not have access to professional advice to identify the securities and execute the transactions required in terms of purchasing the securities and arranging the foreign exchange transactions. Additionally, it is worth noting the challenge of portfolio rebalancing, which can be impractical for the average investor.

By contrast, for a wealthier individual with say €1,000,000 or more to invest, all securities are accessible, stockbrokers will charge a small percentage commission rather than apply minimum monetary commission for the purchase of each holding and will arrange the foreign exchange transactions at competitive rates.

A gross roll up, in relation to gains, on their portfolio of securities throughout their lifetime, is available to such individuals. By contrast, the average retail investor is subject to the eight-year deemed disposal rule taking 41% of the gain over each eight-year period and is therefore discriminated against relative to opportunities available to wealthier individuals.

Do you propose an alternative method / methods of classifying investment products?

- Yes. The diversification required by the average retail investor can, from a practical perspective, be quickly, easily, and at minimum cost achieved by investing in a CIV such as a UCITS, a unit-linked life fund, or an exchange traded fund ("ETF"). However, the differential taxation treatment as between holding the securities directly or holding the securities via a CIV remains the central barrier to the average retail investors achieving a diversified portfolio with the same tax treatment as wealthier individuals.

  Prior to 1 January 2022, Revenue guidance confirmed[2] that investments in ETFs domiciled in the USA, the EEA or in an OECD member state with which Ireland has a double taxation treaty followed the treatment that would apply to share investments generally.

  The Society of Actuaries in Ireland proposes that the rate of tax for income and gains is harmonised. This would allow similar treatment to the existing treatment (gross roll-up and 8 year deemed disposal) at this new harmonised rate for CIVs.

[2] Source: Tax and Duty Manual, Part 27-01A-03, Exchange Traded Funds.

If the rates are not harmonised, the Society proposes that where an individual taxpayer who is domiciled and resident in Ireland invests in securities via a unit-linked life fund or other CIV domiciled in Ireland, the following amendments to the taxation basis of such CIVs should be made:

a. Unit-linked life funds and UCITS-type CIVs shall be required to notionally distribute all of their income at least annually.
b. The operator of the CIV shall be required to deduct tax at a rate consistent with the DIRT tax rate from all notional distributions of income from such CIVs and remit it to Revenue. The tax deducted is a final liability tax with no requirement for the taxpayer to make a return. This greatly simplifies the administration for Revenue, significantly improves compliance, and provides a continuous annual flow of taxation income.
c. The rate of taxation on gains on disposal of shares in a CIV is brought into line with the CGT rate applicable to direct holdings of securities, i.e. the [33%] CGT rate applies to profits on disposal of shares in a CIV.
d. The eight-year deemed disposal rule would cease reflecting the inability of investors in a CIV to offset gain and losses with gains and losses from other investment holdings outside of the particular CIV.
e. All CIVs would have the same annual or semi-annual dividend distribution dates for tax purposes as an anti-avoidance measure.

Where the unit-linked life fund or CIV is domiciled in the EU, provided conditions a., b., and e. above are met, they can be granted the same tax treatment as Irish domiciled unit-linked life funds and CIVs.

Question 25

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

a) Is it desirable that, where possible, taxes are:
   i. deducted at source; and
   ii. final liability taxes?

- For administrative simplicity for both Revenue and taxpayers, taxes ought to be deducted at source and represent a final liability tax with no requirement to make a return. This is the case proposed by the Society of Actuaries in Ireland in relation to investments in Irish domiciled and certain EU domiciled unit-linked life funds and UCITS-type CIVs. The principle of equality should be applied to the classification of investment products to avoid unnecessary taxation differences.

Or

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

- For the average individual taxpayer who cannot afford professional tax advice, self-assessment, the application of tax reliefs and credits, and grasping the concept of marginal tax rates can be burdensome, potentially deterring them from complying with tax regulations. Self-assessment can also be challenging to oversee from a revenue perspective, and some ordinary taxpayers may not even be aware of the requirement to file tax returns.

  From both a Revenue and taxpayer administration perspective, a final liability tax with no requirement to make a return greatly simplifies the administration of taxation.

  The Society recommends that the "old basis" taxation regime remains unchanged. The main reason is that this is a ring-fenced group of policyholders where any change could potentially increase their tax. It is noted that the relative immateriality of this business and that the cost and effort required for any change may not be worthwhile.

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

- Yes. The Society of Actuaries in Ireland proposes no change to "old basis" Irish life products, foreign life products, EU/EEA/OECD non-equivalent funds, other distributing funds unless they distribute substantially all of their income at least annually, other non-distributing funds, and personal portfolio investment products. It is noted that the relative immateriality of this business and that the cost and effort required for any change may not be worthwhile.

Question 26

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

- In relation to a link between the rate of DIRT and the rate of tax applied to other investment products, taxpayers might be offered a similar regime, i.e. to apply a final liability tax at the same rate as for unit-linked life funds and UCTIS-type CIVs with no requirement to file a return or elect for self-assessment with reliefs and credits and marginal rate of taxation.

Question 27

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

- Yes. As outlined earlier in the reply to question 24, there ought to be no differential treatment between the taxation of direct investment in a portfolio of securities and investment in a portfolio of securities via a unit-linked life fund or a UCITS-type CIV.

  Note that, as per our response to question 25, we do not propose any changes for Irish life products "old basis" taxation.

Question 28

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

- Encouraging initiatives that streamline tax compliance for taxpayers is a positive step. Moreover, the data analytics associated with this pre-population process could have utility in Revenue audits by enabling a complete allocation of reported figures in accordance with international reporting standards. Any substantial variance between: (i) the aggregate reported under international reporting standards; and (ii) the aggregate allocated under the pre-population proposal would trigger a sequence of Revenue audits.

Question 29

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

- Currently life insurance policyholders do not get relief for capital losses. It is noted that annual Capital Gains Tax relief is available for direct investors to remove the burden of tax returns for immaterial gains/losses. However, there is no simple solution to grant this relief to life insurance policyholders without introducing complexity and individual tax returns. Further studies may be required to get the appropriate rate if one tax rate was adopted.

  The Society of Actuaries in Ireland's main proposal is in the nature of a final liability tax deducted at source and so it is not proposing any change to the current tax regime in relation to cross product aggregation of gains and losses for tax purposes. However, it recognises that technology improvements may make it possible to have alternate systems that could further equalise the opportunities to offset losses and gains for example. While they may not be currently available for a final liability tax, we are open to further research on these.

  When the taxation of investing directly in a portfolio of securities is on par with investing in the same portfolio through a unit-linked life fund or a UCITS-type CIV, the relevance of cross-product aggregation of gains and losses for regular investors is expected to decrease. This is due to the fact that: 1) they are unlikely to maintain multiple investments simultaneously, and 2) investing in a diversified portfolio eliminates the necessity for multiple individual investments.

Question 30

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

- Single premium life assurance investments are subject to a 1% levy on investment whereas lump sum investments in IUTs are not. Further, there appears to be no rational reason for the somewhat subtle differences in the operation of LAET and the right to make a declaration under IUT. The ability of companies to seek a refund of IUT tax in certain circumstances seems anomalous in relation to investment via life assurance funds.

Question 31

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

- For individuals, as opposed to CIVs, derivative products which mirror the performance of regulated product ought to be taxed in the same way as the regulated investment product. For example, a total return swap on an equity or bond index should be taxed in the same way as a direct investment in the index underlying the derivative.

  Further opportunities for simplification and clarity could be generated by equalising taxation of income and gains from investments at the same rate.

Question 32

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

- All unit-linked life funds and UCITS-type CIVs should have the same income distribution dates for anti-avoidance purposes. Failure to do so allows investors to have income taxed at CGT rates, if the rates were not equalised.

Question 48

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

1) The harmonisation of tax treatment between:
   (i) direct investment in a portfolio of securities; and
   (ii) investment in that same portfolio of securities via a unit-linked life fund or UCITS-type CIV.

2) Single rate of taxation for all investment returns whether dividends, coupons, interest or gains. This would enable a simpler taxation approach for securities and avoid taxation distortions via structuring of investments that give the same economic returns but different taxation treatment.

3) Restructuring the tax system to incorporate a final liability tax framework for the annual income generated from unit-linked life funds or UCITS-type Collective Investment Vehicles (CIVs), with a harmonised rate aligned with Capital Gains Tax (CGT), can simplify administrative processes for both taxpayers and Revenue. It would eliminate the need for taxpayers to file separate tax returns for this income source, thereby ensuring a more predictable and auditable flow of taxation revenue to the Revenue authorities.

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