BY
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Tax Implications of the Personal Insolvency Act

Tara Cheevers CPA, ACO Financial & Business Solutions, explains the tax implications of the Personal Insolvency Act.

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Background

The Personal Insolvency Act was signed into law on the 29th December 2012, officially launching on the 9th of September 2013 with the first Protective Certificates issued in the last quarter of 2013.

The Personal Insolvency Act introduced 3 formal debt solutions reforming the Bankruptcy Act 1988. The 3 debt solution mechanisms are the Debt Relief Note (DRN), the Debt Settlement Arrangement (DSA) & the Personal Insolvency Arrangement (PIA).

In conjunction with the Personal Insolvency Act 2012 Revenue established a dedicated Personal Insolvency unit, to ensure the efficient communication between Revenue Caseworkers Approved Intermediaries (AIs) in the case of DRNs and Personal Insolvency Practitioners (PIPs) in the case of DSAs & PIAs.

Guidelines for Approved Intermediaries (AIs) and Personal Insolvency Practitioners (PIPs)

At the outset, Revenue issued guidelines to practitioners to streamline the engagement between Revenue and the key stakeholders operating within the Personal Insolvency environment. The dedicated Personal Insolvency unit acts as the first point of contact for all Personal Insolvency queries and related matters. The key is early engagement with Revenue and opening a clear channel of communication for practitioners acting on behalf of their clients.

Revenue Opt In

Revenue debt is an excludable debt within the Personal Insolvency Acts 2012-2015. In the case of a DRN 'Opt In' means consenting to the issue of a DRN in respect of Revenue debt. In the case of a DSA or PIA 'Opt In' means consenting to the inclusion of the Revenue debt in any proposed arrangement.

Revenue Debt Write off

Revenue already have well developed procedures for dealing with taxpayers who are in default and unable to meet their tax obligations. Revenue will assign a caseworker to work with the taxpayer to recover their debt and this recovery process where necessary may be via court enforcement. Revenue may also assist the defaulting taxpayer through a phased payment plan with interest accruing on late payment. In extreme situations where there is no ability to make any payments Revenue will write the debt out. Where a debt is written out it is not written off, it is only temporarily written out to be collected in the future when the taxpayers' financial circumstances improve. An 'Opt In' and subsequent approval of an arrangement by revenue is the only mechanism where debt write off will be granted.

Preferential Debt

Revenue will confirm the preferential element of their debt at the proof of debt stage of the Personal Insolvency process, within an arrangement the preferential element will be paid in priority to all other unsecured debt with the balance of revenue debt ranking and abating equally with other unsecured creditors entitled to a dividend payment over the term of the arrangement.

Current Taxes

Section 100 (3) of the Finance Act 2013 amends S65 (2)(e) and S99 (2) (f) of the Personal Insolvency Act 2012 provides for the inclusion of a mandatory provision in a DSA or PIA for the payment of all current tax liabilities incurred by the debtor as they fall due over the course of the arrangement. Failure by the debtors to comply with this provision will result in Revenue withdrawing their agreement to accept any compromise of historic tax debt entered into under the DSA or the PIA.

State Pension

Revenue work in conjunction with Social Welfare and debtors who have defaulted and have outstanding tax liabilities will not be entitled to receive the state pension. An extremely high percentage of debtors presenting to practitioners are aged between the ages of 55 – 65 and are unaware that their state pension is affected by their unpaid tax liabilities.

Deferral of Local Property Tax

An 'Opt In' from Revenue will not include any outstanding liabilities relating to LPT. LPT is a debt secured against the property, any unpaid LPT plus interest must be paid prior to the sale of any property. Where a debtor has entered a DSA or a PIA they may apply for a deferral of the LPT that is due during the period for which the insolvency arrangement is in effect. The deferred LPT plus interest will become due when the DSA or PIA ceases to have effect.

Tax Treatment of various events that may arise in relation to a DRN, DSA or PIA.

Rental Income arising from foreign property S100(1)(a) Finance Act 2013 – while foreign property is held in trust under the terms of a DSA or PIA the debtor is the person chargeable to tax in respect of foreign rental income arising from the property.

Rental Income arising from property in the state S100(1)(b) Finance Act 2013 – while property situated in the state is held in trust under the terms of a DSA or PIA the debtor is the person chargeable to tax in respect of rental income arising from the property.

Transfer of a Property held in trust for the benefit of creditors S100(1)(c) Finance Act 2013 – The transfer of an industrial building or structure (within the meaning of section 268 of the TCA 1997) under the terms of a DSA or a PIA by a debtor to a trustee for the benefit of creditors will not be treated as an exchange of that property, thereby ensuring that the transfer will not trigger a balancing event. The subsequent disposal of the property by the trustee is treated as having been made by the debtor and may give rise to a balancing charge/allowance for the debtor at that stage.

Transfer of "Section 23 property" S100(1)(d) Finance Act 2013 – a transfer of a Section 23 property into a trust under the terms of a DSA or PIA does not give rise to a Clawback of Section 23 relief. A subsequent disposal of the property by the trustee is treated as a disposal by the debtor and may give rise to a clawback. In practice where a Section 23 property forms part of the assets of a DSA or PIA the proposal will generally provide for the retention of the property until the 10 year clawback period has ceased.

Capital Gains Tax Treatment S100(1)(e) Finance Act 2013 – a transfer by the debtor of assets to be held in trust by the PIP for the benefit of creditors under the terms of a DSA or a PIA, will not be treated as a disposal for capital gains tax purposes. The subsequent disposal by the PIP may give rise to a chargeable gain. The PIP must account for any Capital Gains tax that may be due on the disposal.

Capital Acquisitions Tax Treatment S100(2) Finance Act 2013 – any benefit arising where a debt is relieved or reduced under a DRN, DSA or PIA will not be a gift or inheritance for the purpose of the Act.

New Court Review Process – Rejected Personal Insolvency Arrangements.

The Personal Insolvency (Amendment) Act 2015 was signed into law on the 28th July 2015 granting the Irish Court the ability to overturn a secured creditor's decision to reject a proposal for a Personal Insolvency Arrangement.

Conclusion

Practitioners need to engage with Revenue at the outset to ensure the inclusion of Revenue debt in an arrangement. In many cases the PIP will have to seek the assistance of the debtor's accountant in order to ensure all past and current tax returns have been filed. In order for tax liabilities to be included the liability must be on record. Revenue will not consider an 'Opt In' unless all tax returns have been correctly filed. A DRN, DSA & PIA is a once in a lifetime opportunity for a debtor to resolve their debt problems. Revenue debt will only be written off within the Personal Insolvency regime therefore it is imperative that practitioners ensure that the revenue debt is included in any DSA/PIA arrangement being put forward for approval for their clients.