Inside the Kerry Co-op shares project

Exposed: Revenue's Kerry

Documents obtained under the Freedom of Information Act reveal a far-reaching campaign by the Revenue Commissioners to generate additional tax streams from Kerry Co-op shareholders. **Thomas Hubert** with **Pat O'Toole** sifted through the papers to get an idea of the scale of the investigation

The Revenue Commissoners tax demand for co-op patronage shares sent a shockwave through Kerry suppliers last November.

Two things quickly became obvious – firstly that huge sums of money were involved, and secondly that this must have implications for the broader co-op movement.

Two months on, numerous questions have remained unanswered. Why did patronage shares issued by Kerry Co-op for many years and regularly declared by farmers as capital assets suddenly get turned into taxable trading income in the eyes of the Revenue Commissioners? Who sanctioned this new approach? How are tax officials backing up their case to prepare for upcoming appeals? What is coming next?

Through a freedom of information request, the *Irish Farmers Journal* has pieced together the paper trail of the past year. While some questions remain, internal Revenue communications shed light on what tax officials have named the "Kerry Co-op project".

Timeline

15 OCTOBER 2015: Revenue first mentions it is investigating Kerry Co-op patronage shares at a meeting of the Tax Institute. Only the disposal of shares is under scrutiny at this point.

EARLY 2016: Revenue meets with Kerry Group seeking detailed information on patronage shares traded since 2012.

SUMMER 2016: Revenue obtains records from Kerry Co-op and Anne Dullea seeks internal approval to re-assess patronage shares as trading income.

18 OCTOBER: Dullea circulates a memo updating colleagues on Kerry Co-op shares project progress and launching income tax operation for patronage shares received in 2012 and 2013.

27 OCTOBER: Revenue's business management executive gives the national-level green light to the project.

1 NOVEMBER: Revenue adds patronage shares received in 2011 to the project.

18 NOVEMBER: Initial "aspect query" letters go out to 400 Kerry Co-op shareholders identified as having received more than 100 patronage shares in 2011, asking them to reply within 21 days and seeking "appropriate payment" for the new income tax liability, with many farmers reporting estimated tax bills of around €20,000.

23 NOVEMBER: Revenue updates the section of its internal staff manual dealing with patronage shares.

7 DECEMBER: Joint Oireachtas Committee on Finance hears Revenue officials and obtains a commitment to offer Kerry Co-op shareholders more flexibility in dealing with the issue, but officials maintain position on the tax liability.

14 DECEMBER: The 400 recipients of aspect query letters receive a second letter extending the deadline to engage with Revenue until 28 February 2017 and accepting that a test case will determine the final outcome.

31 DECEMBER: Revenue sends formal income tax assessments to the 400 farmers for the patronage shares they received in 2011.

30 JANUARY: Deadline to appeal the tax assessments, which will open a test case before the Tax Appeals Commission.

The key players

People at centre of project

Anne Dullea, the Revenue Commissioners' manager of Kerry Tax District who signed the initial letters sent to 400 farmers in November, appears as the driving force and central contact point at every juncture in the ever-growing Kerry Co-op shares project.

In successive internal memos, she updated other Revenue officials about progress by the unit she set up to recoup additional tax from the co-op's shareholders.

Since an investigation into the transfers of Kerry Co-op shares started in 2015, it has developed into a dedicated team "with staff now allocated fully to working the project", according to a memo Dullea circulated on 18 October.

In the same document, she claimed responsibility for the interpretation that shareholders should pay income tax on the resale value of patronage shares during the year they receive them. "I raised a query with RLS [revenue legislation service] last summer and only today received a response agreeing with my view," she wrote.

On 27 October, she was invited to present a paper to the Revenue's business management executive, the group of top civil servants making decisions on programmes and projects at the national level.

The executive "endorsed" her approach, according to minutes of the meeting.

As letters went out to Kerry Co-op shareholders on 18 November, Revenue officials also circulated their template internally, including in Co Clare and Co Limerick, advising staff who might receive queries on the issue to refer them directly to Dullea rather than the usual regional support offices. On the same day, she was meeting with Kerry Co-op secretary Brian Durran to inform him that the letters were going out.

Dullea was one of the four Revenue officials summoned by the Joint Oireachtas Committee on Finance on 7 December, but she did not speak. Instead, Charlie Phelan, the Revenue Commissioners' assistant secretary for the southwest region, did most of the talking, with assistance from principal officer Paul Walsh of the income and capital taxes division in Dublin Castle.

While Dullea has initiated, defended and carried out the project, her actions have been sanctioned at the highest level. Phelan gave the final order to send out letters in November.

Commissioner Gerry Harrahill, one of the Revenue's top three officials, was informed of every step in the process and chairs the business management executive that gave the overall green light in October.

Anne Dullea.
\ Mallow Star

Charlie Phelan.

Co-op project

The tax take

More than €400,000 in tax already recouped

BACKSTORY
For more coverage, see ifj.ie/kerryproject

CGT/CAT interventions on Kerry Co-op shares in 2016

194	37	1
appraisals	aspect queries	audit

€418,000

paid \Source: Revenue Commissioners

The process that led the Revenue Commissioners to issue income tax claims over patronage shares in November had previously focused on capital gains tax (CGT) and capital acquisitions tax (CAT). An internal memo circulated on 18 October provides an update on the "Kerry Co-op share disposal project", indicating that Revenue officials were until then investigating the tax implications of onward share transfers – and those efforts had already paid.

Between 1 January and 18 October 2016, the Revenue generated a "total yield" of €418,202 from "intervening in cases where we believed co-op shares were sold/transferred without CGT/CAT paid on them". Case workers checked the records of 194 taxpayers and contacted 37 of them to raise tax queries about their shares. One audit alone resulted in a payment of €39,248.

CGT is due by the person disposing of the shares on their rise in value since they acquired them. CAT is due by the person receiving shares through gift or inheritance.

Share transfers

Revenue identified those taxpayers by comparing lists of those who had declared share transfers and records of interests (dividends) paid by Kerry Co-op to its shareholders. If a shareholder was found to have stopped receiving interest without having declared the disposal of the shares, the Revenue queried their situation.

Kerry tax district manager Anne Dullea described the process so far as a "success". All similar cases in the south-west region were referred to her office as a result.

The Revenue's recent move to submit patronage shares received between 2011 and 2013 to income tax instead of CGT and CAT does not mean that it is dropping efforts to recoup missing payments under these taxes. On the contrary, internal documents indicate that "work will continue on this" in 2017. Regular shares (not patronage ones) and patronage shares issued in earlier years remain liable to CGT and CAT when transferred.

Escalation

The full team now in place to target Kerry Co-op shareholders is in fact about to ramp up efforts on this front. During the course of 2016, the Revenue compelled Kerry Co-op to provide "copies of all transfer documentation" related to its shares, and processed the data to enable automated searches. Using taxpayers' PPS numbers, Revenue staff can now pinpoint suspected undeclared share disposals faster.

"We have not yet commenced work on this," the 18 October memo read.

Kerry's precautionary move on VAT credit

Kerry Agribusiness has told milk suppliers that if the patronage shares allocated to them are eventually deemed to be an additional payment on milk, as is claimed by Revenue, then they will be entitled to the flat-rate addition on the value of the shares, the same as they receive on their milk sales.

In a letter to suppliers, financial controller Tom O'Brien wrote that Kerry has taken action to protect the potential VAT credit arising for the year 2011 for suppliers. It did so ahead of a statutory time limitation which the *Irish Farmers Journal* understands was 31 December 2016.

O'Brien wrote: "In the event that the Revenue's position stands, each milk supplier will be entitled to a VAT credit of 5.2% (2011 rate) on the Revenue's value of the patronage shares less the amount paid on the allocation of such shares."

Suppliers who agree with Kerry's move to secure the payment need not take further action, he wrote.

- PAUL MOONEY

Inside the Kerry Co-op shares project

Revenue was aware suppliers were 'broke'

Revenue officials were informed that Kerry Co-op shareholders would not be able to pay unexpected large tax bills as they wrote to them in November

Revenue does recognise the difficulty farmers will face in paying the income tax now demanded on purchased patronage shares.

On 18 November, the day the initial letters were posted to Kerry farmers, internal emails between officials including Kerry tax district manager Anne Dullea, assistant secretary for the southwest Charlie Phelan and national commissioner Gerry Harrahill discussed this.

Dullea reported she had a meeting with Kerry Co-op secretary Brian Durran that morning and received a phone call from an unidentified man understood to be involved in Kerry Co-op's tax affairs. "Brian advised him that a lot of the shareholders are broke," Dullea wrote.

"I advised that such taxpayers would also have difficulties paying other taxes as well and would be dealt with through Revenue's normal suite of options for taxpayers in such situation including inability to pay in extreme cases," she added.

Despite this, Dullea wrote that some letters had already gone and all 400 would be in the post that day.

She brought up the farmers' expected difficulties to pay as an afterthought in a second email, apologising that she "forgot to mention" that aspect in her first message.

The effect on Revenue

Kerry case leads to revision of Revenue staff manual

According to instructions circulated to Revenue personnel on 22 and 23 November, the internal manual used as reference by staff conducting tax audits was "updated" to reflect the stance adopted on Kerry patronage shares.

The section dedicated to share issues by co-ops includes a new section indicating that all co-op shares issued "where the amount of shares issued is dependent on the level of business between the member or the co-operative, and where the shares are issued at less than market value, then Revenue will regard the difference between the subscription amount and the market value of the shares (known as "patronage shares") at the date of issue as a profit of the business of the member".

This is presented as an exception to the general rules governing co-op spin-outs, which until then advised share swaps "will not be treated as a distribution" and referred to capital gains tax only.

The grey market

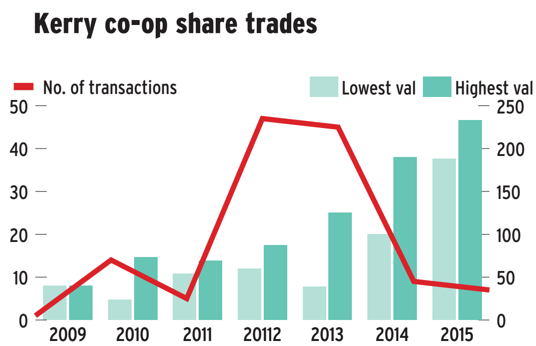
Only 128 share sales over seven years

Revenue is basing its valuation of the co-op shares purchased through the patronage scheme on a tiny volume of traded shares.

Every transaction on the internal "grey" co-op trading market is listed in the information circulated within Revenue in recent months.

In 2011, only five of the 13,000 Kerry Co-op shareholders traded shares according to Revenue records. On the basis of this handful of trades, Revenue placed a value of €65 on each co-op share, and wants any co-op shareholder who bought shares through the patronage scheme in that year to pay tax on the shares purchased as if they were income. This would leave any milk producer in the higher tax bracket paying €30/share purchased.

A farmer buying 100 shares at €2 apiece would therefore have a tax liability of €3,000.



Trading did increase in 2012 and 2013, but the total number of trades in each year was less than 50 – still less than one half of 1% of the co-op's shareholder register. In other words, only one in 250 people who owned co-op shares traded some or all of their shares.

With the 3,400 milk producers only accounting for 25% of the co-op's 13,000 shareholders, it is reasonable to assume that the majority of shares traded were by non-participants in the patronage scheme.

Indeed, "dry" shareholders – non-active milk suppliers – have far less reason to hold on to shares and maintain membership and voting rights in their co-op than milk suppliers, so it is reasonable to assume that even less than one-quarter of the share trades involved patronage share participants.

Grey market

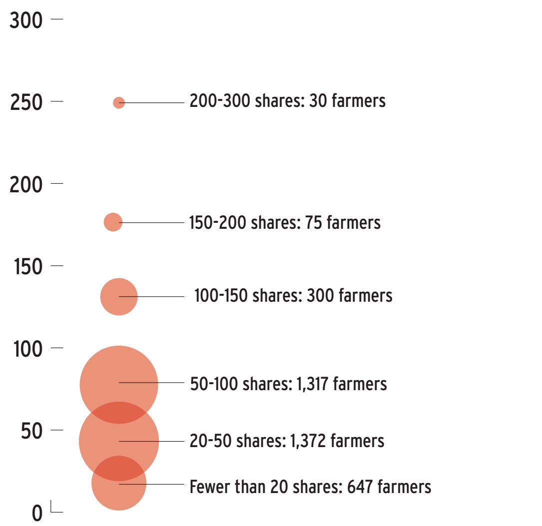
Trading of shares in Kerry Co-op is allowed, but only with the approval of the co-op board. The value of the shares traded is agreed in each case between vendor and purchaser, without the knowledge or involvement of the board.

The value of the shares is included for each transaction in the information circulated within Revenue, but not the volume of shares traded.

The next stage

3,500 suppliers to get tax bills this year

Patronage shares received at least once between 2012 and 2013



\ Source: Revenue Commissioners The Revenue withheld the number of farmers receiving more than 300 shares for confidentiality reasons.

Following its first letter to Kerry Co-op shareholders in November demanding payment for income tax on the estimated market value of patronage shares received in 2011, 2012 and 2013, the Revenue appeared to soften its stance in a second letter mid-December.

"Assessments for 2012 and 2013 are being deferred for the moment," Kerry tax district manager Anne Dullea wrote to the 400 farmers. This was in fact the plan all along.

Internal communications in October show that Revenue officials initially planned to target taxpayers who had received patronage shares in 2012 and 2013.

It was only when Anne Dullea presented her case to the Revenue's business management executive on 27 October that she introduced 2011 into the equation.

Four-year rule

The four-year rule prevents the Revenue from going further back in time. In this case, farmers filed their 2011 tax returns in 2012, leaving until the end of 2016 for the Revenue to query their self-assessment.

This left little time to tackle patronage shares issued in 2011, and papers from the 27 October meeting show the decision was made to target those farmers who received more than 100 such shares.

The rationale behind that number is not explained in the documents obtained through the *Irish Farmers Journal's* freedom of information request. When asked about it at an Oireachtas hearing in December, Charlie Phelan, Revenue Commissioners assistant secretary for the south-west region, said: "All our interventions are based on risk. We took the 400 people who received the largest amount of patronage shares."

> "Any exposures in 2012 and 2013 will be pursued in 2017

It appears that the Revenue just scrambled to fit as many taxpayers as it could by the end of the year, working from the top town.

Exposures

This does not mean, however, that other Kerry suppliers are off the hook. The minutes from the 27 October meeting already stated that "any exposures in 2012 and 2013 will be pursued in 2017".

This time, the Revenue will also review the tax returns of "those who received less than 100 shares in 2012 and 2013".

If the Revenue finds they have an income tax liability on their patronage shares, they will receive the same letters this year.

Internal documents show the Revenue has a full breakdown of patronage share recipients during those years and estimates their numbers at 3,500, ie the full number of active Kerry suppliers.

Revenue may target 2013 spin-out

In addition to its efforts to recoup additional CGT/CAT and income tax from Kerry suppliers over their co-op shares, the Revenue may open a third front this year – this time in relation to the spin-out decided in May 2013.

At the time, Kerry Co-op shareholders each swapped one-fifth of their co-op shares for a holding in Kerry Group plc. The six million plc shares transferred to co-op members in the deal were worth €275m at the time.

Internal documents show that the Revenue's large cases division (LCS) and legislation service (RLS), which is in charge of interpreting tax laws, have been reviewing the tax applicable to the spin-out since at least the first half of 2016.

The minutes of the Revenue's business management executive on 27 October state: "We are also interacting with LCD/RLS who are determining whether the 2013 redemption of co-op shares for plc shares

€275m

value of the 6m plc shares when spun out in 2013

qualified for relief, which could require intervention in over 13,000 taxpayers."

While the documents released under the Freedom of Information Act do not provide details on the nature of the current review, the Revenue may be looking for a way to apply to the spin-out its new interpretation of co-op share values based on their price on the grey market. Each co-op share was exchanged for around six plc shares at the time. With co-op shares sold in early 2013 for around €100, and plc shares trading at €46 at the time of the spin-out, Revenue officials may be looking to tax the €175 apparent windfall generated by each co-op share swapped in the transaction.

The 2013 spin-out was the most recent occasion when Kerry Co-op has reduced its shareholding in Kerry Group plc to 13%. In 2011, 10.1m plc shares were transferred to co-op shareholders, worth an estimated €290m.

The law

Revenue to use UK case law to defend Kerry tax approach

Asked to examine patronage share schemes, the Revenue Commissioners' large cases division has identified British case law to defend its tax claims against Kerry Co-op shareholders in upcoming appeals.

Internal documents refer to Pope v Beaumont, a 1941 UK case in which a cash bonus issued by a co-op in proportion to its trading activity with each member was found to be taxable trading income rather than a dividend.

Another case involving Staffordshire Egg Producers in 1963 centred on whether the issue of bonus shares should be taxed in the same way as a cash bonus. The Revenue notes that the court decision was to treat bonus shares in the same way as cash.

Test case

When the Tax Appeals Commission hears a test case on Kerry Co-op's patronage shares, Revenue lawyers are likely to use both UK cases to defend their interpretation that the value of those shares should have been declared as taxable income at the time they were received.

Meanwhile, taxpayers opposing the Revenue's interpretation are expected to argue that their patronage shares were worth no more than their par value of €1.25 until they sold or transferred them.

Argument

This was the argument won by Kerry and Avonmore plc when they took a court case over the rules governing their shareholding in the Irish Dairy Board in the late 1980s.

NEXT WEEK
We examine the fallout from the *Irish Farmers Journal* investigation into the Revenue and Kerry Co-op patronage shares issue