Chartered Institute of Taxation
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THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2015

PAPER 2.06 – IRELAND OPTION

ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

Suggested solutions

Question 1

Caroline and Peter O'Donnell
Apartment 27
2 Main Street
Terenure
Dublin 6

10 June 2015

Dear Caroline and Peter,

Thank you for meeting with me last week and for providing me with background information on your forthcoming migration to France. In this letter, I will summarise the issues that arise and I suggest that we meet in the next week or so to go through these in some detail and to ensure that I have understood your plans correctly.

Your residence and ordinary residence position for 2015 and thereafter

Your residence for Irish tax purposes is determined individually but since you are planning on moving on the same day, the following provisions will apply to each of you.

There are two aspects to the determination of residence and ordinary residence – the Irish domestic law provisions and the provisions of the tax treaty between Ireland and France. Where there is a conflict, the latter take precedence. Because you will not be French resident until 2016, we need only consider the domestic provisions to determine your residence for 2015.

For domestic law, residence is initially determined for a year of assessment (calendar year) based on either:

- Being in Ireland during 183 days or more (at any point in a day) in the year; or
- Between the year under consideration and the prior year, being in Ireland during 280 days or more.

Visits of up to 30 days in any year are disregarded. Given a likely departure day of 1 September next, you will therefore, on an initial analysis, be resident here for 2015.

However, where you are leaving Ireland with the intention of not being resident for the subsequent year (2016 in your case), you are entitled to what is known as "split year residence" and are treated for tax purposes as being resident only up to the date of your departure for France – ie from 1 January to 1 September.

This conclusion assumes that you do not have an intention to be resident for 2016. Since you are planning to work full time in France, this could only be the case if the "280 day rule" described above applies for 2016. Based on being in Ireland from 1 January to 1 September in 2015, this would give you 273 days to count for 2016 and as long as you are here for less than 30 days in 2016, you should be non-resident for 2016. Even if the 280 day rule brings you back into residence for 2016, the tax treaty with France should apply as you anticipate being resident there for tax purposes from 1 January 2016. If you are dual resident under the domestic law of both countries, the tiebreaker clause in the treaty will treat you as resident in the country where you have a permanent home available to you. Because by that stage you will have purchased a house in France and Caroline's apartment will be rented out and not available to you, you should in all circumstances be French resident for 2016 and subsequent years, as long as you are based in France. This confirms your eligibility for split year basis in 2015.

You have each been long enough in Ireland (three consecutive years or more) to be also ordinarily resident here. This characterisation – being ordinarily resident – lasts for three years of assessment after a residence change, subject to treaty provisions. Thus you are ordinarily resident for 2015 and normal Irish rules would say that you will remain ordinarily resident for 2016, 2017 and 2018. The "split year" basis described above does not apply for ordinary residence, so you will remain ordinarily resident for the whole of 2015 and normal Irish rules would make you continue ordinarily resident until 31 December 2018. The consequences of being ordinarily resident are that foreign investment income in excess of €3,810 remains taxable in Ireland. Investment income in this context includes rents from non-Irish property but not employment income exercised outside Ireland.

However, we need to take account of the impact of the French treaty on these normal rules. From 2016 (as described above) the French treaty will ensure that you are treated as resident only in France. The treaty tiebreaker test applies in Ireland also for the purposes of ordinary residence and takes precedence over the domestic rules. You will therefore be ordinarily resident in France for 2016 and subsequent years, for as long as you are resident there and have your permanent home there.

In summary, you will be Irish resident up to 1 September 2015, ordinary resident up to 31 December 2015 and for Irish purposes will be resident and ordinarily resident in France for 2016 and subsequent years.

<u>Income Tax liabilities for 2015</u>

The following is a summary of your sources of income and the extent to which each is subject to Income Tax for 2015:

Income source	*Taxation in Ireland*	*Comments*
Peter		
University salary from Dublin	Taxable	PAYE will apply to this
Rent from house in Belfast up to 1 September 2015	Taxable up to the extent remitted to Ireland. Credit is available for any UK tax on the rental income.	Peter is non-domiciled and the remittance basis applies
Rent from house in Belfast 1 September to 31 December 2015	Taxable up to the extent remitted to Ireland if total investment income exceeds €3,810. Credit is available for any UK tax on the rental income.	Peter is non-resident from 1 September but remains ordinarily resident.
Belfast bank deposit interest up to 1 September 2015	Taxable (at the DIRT rate of 41%) to the extent remitted to Ireland	
Belfast bank deposit interest 1 September to 31 December 2015	Taxable up to the extent remitted to Ireland if total investment income exceeds €3,810.	Peter is non-resident from 1 September but remains ordinarily resident.
Dividends from Russ Trading plc	Taxable up to 1 September 2015 to the extent remitted to Ireland. Dividends after 1 September are taxable up to the extent remitted to Ireland if total investment income exceeds €3,810.	Peter is non-resident from 1 September but remains ordinarily resident.
Salary in France (after 1 September)	Not taxable in Ireland	Not counted as investment income for tax liability when ordinarily resident

Caroline		
Practice income from Ireland up to 1 September 2015	Taxable	Because Caroline will be leaving the partnership, her 2015 Income Tax will be based on her share of the partnership profits from 1 January to the date of cessation. Her prior year computation may be revised because of the cessation.
Rental income from Dublin apartment from 1 September to 31 December	Taxable	Irish rents taxable in Ireland. Only 75% of mortgage interest deductible
Dublin bank deposit interest	Taxable (at the DIRT rate of 41%) up to 1 September 2015. Interest arising after 1 September should be tax free.	DIRT tax will apply up to 1 September. After 1 September Caroline will need to complete a non-residence declaration with the bank once she becomes non-resident.
Dividends from Genome Research Ltd up to 1 September 2015.	Taxable	
Dividends from Genome Research Ltd 1 September to 31 December 2015.	Taxable (no lower limit on taxation as not foreign investment income)	Caroline is ordinarily resident and not treaty resident for the balance of 2015 and the section 153 TCA exemption therefore does not apply.

<u>Income tax liabilities after 2015</u>

For years from 2016, Caroline and Peter are French resident and are neither resident nor ordinarily resident in Ireland. Their liability to Irish Income Tax is therefore confined to the rental income from Caroline's apartment in Dublin. Normal Case V deductions are available, but the relief for mortgage interest is confined to 75% of interest paid. The tenant has an obligation to deduct tax on payment of the rent at a 20% rate. Since this will exceed Caroline's liability on the net rents, it would be advisable to appoint a local agent that can receive the rent on her behalf and file the relevant Income Tax returns.

<u>Capital gains tax on sale of shareholdings</u>

Peter's shares in Russ Trading plc

If Peter disposes of his UK shares in July 2015, this disposal will be subject to Irish Capital Gains Tax based on the difference between the sale proceeds and the base cost, taxed at 33%. However, as Peter is non-domiciled, he is taxable on capital gains only to the extent that the proceeds are remitted to Ireland. Tax liability can therefore be avoided if Peter sells the shares and does not remit the proceeds to Ireland.

By early 2016, Peter will be resident in France for treaty purposes and the disposal of the shares will therefore be outside the scope of Irish Capital Gains Tax (regardless of whether the proceeds are remitted).

Caroline's shares in Genome Research Ltd

If Caroline disposes of her Irish shares in July 2015, she will be liable to Irish Capital Gains Tax by reference to the difference between the sale proceeds and the base cost of the shares, taxable at 33%.

By early 2016, Caroline will be resident in France for treaty purposes. Based on the Model Convention, if the shares do not derive the greater part of their value from immovable property in Ireland, they are taxable only in France.

This conclusion would normally be subject to a caveat about the impact of section 29A TCA 1997 in the event that Caroline resumes Irish residence within 5 years. However the section has no application in view of Caroline's non-domiciled status.

Gifts between Caroline and Jennifer

A gift from Caroline to Jennifer in August 2015 would be liable to gift tax in view of the fact that Caroline is resident and ordinarily resident in Ireland. By August 2016, neither Caroline nor Jennifer will be resident or ordinarily resident in Ireland and thus a gift from Caroline to Jennifer would only be liable to gift tax if the property comprising the gift was Irish property. If gifts from August 2016 are made from a non-Irish bank account, Irish gift tax should not arise. The group threshold for CAT is €30,150 and thus as long as there are no prior gifts from Caroline (or another person in the same class as Caroline) to Jennifer (while either was resident or ordinarily resident in Ireland) no tax should be payable on a taxable gift up to this amount. The threshold applies cumulatively.

Yours sincerely

Brian Kent

Question 2

This question is not conducive to a precise model answer. The examiner expects to see an awareness of the EU freedoms and the prohibition on discrimination on grounds of nationality, a discussion of the basis on which cases in the CJEU that sought to demonstrate contravention of treaty provisions have been decided, argued and defended and an ability to apply these decisions, arguments and defences to provisions of Irish tax law.

Candidates have a variety of legislative provisions to choose from. These might include:

Relating to Article 18 TFEU (nationality)

Paragraph 3, Schedule 24 TCA 1997
Section 195 TCA 1997

Relating to Article 49 TFEU (freedom of establishment)

Section 232 TCA 1997
Section 666 TCA 1997

Relating to Article 63 TFEU (free movement of capital)

Section 590 TCA 1997
Section 244 TCA 1997

Question 3

Memo to: Fred Quaver
From: Jane Egan

Subject: Digital Solutions Inc

Fred,

Congratulations on your great achievement in winning this significant new client. I confirm that we will be very happy to provide any assistance you need in becoming familiar with the Irish tax issues relating to the client's Irish structure and operations.

As an initial matter, you should note that the structure adopted by Digital Solutions Inc for its Irish operations is a variation of what has become known in the media as a "double Irish with a Dutch Sandwich". Recent Irish tax legislation has significantly impacted on the tax effectiveness of this structure but the good news is that, for companies already operating in Ireland, the changes will not take effect until 1 January 2021.

Current residence of Digital Solutions (International) Holdings Ltd

Although Digital Solutions (International) Holdings Ltd is incorporated in Ireland, its board of director meetings have invariably been held in the Cayman Islands. For a company such as this, Ireland currently determines corporate residence by reference to the location of central management and control and a long line of case law has held that the location of the board of director meetings is the most important determinant of the location of central management and control. To qualify for this residence treatment, two conditions must be met:

- The company, or its parent, must be quoted (and substantially and regularly traded) on a stock exchange in a country with which Ireland has a tax treaty. The NASDAQ quote of Digital Solutions, Inc. ensures that this condition is met.
- The company, or a related company, must carry on a trade in Ireland. The Irish operations of Digital Solutions (Ireland) Ltd ensure that this condition is also met.

For Irish tax purposes, we regard Digital Solutions (International) Holdings Ltd as not resident in Ireland, notwithstanding its incorporation here. It is therefore for tax purposes a hybrid entity, regarded as foreign for Irish purposes and as Irish for US purposes.

Changes enacted in Finance Act 2014

As a result of legislation enacted last December, the residence of Digital Solutions (International) Holdings Ltd will change on 1 January 2021. The new legislation has simplified the definition of corporate residence in Ireland and the change has come about in part as a response to the OECD BEPS process. For companies incorporated before 1 January 2015 corporate residence will be determined from 1 January 2021 on the same basis for all companies, regardless of their ownership and regardless of their operations in Ireland. The new rules will make all companies incorporated in Ireland resident here unless the tiebreaker clause in a tax treaty treats them as being resident in the treaty partner country. As Ireland does not have a tax treaty with Cayman, this means that, even if the board meetings continue to be held in Cayman, Digital Solutions (International) Holdings Ltd will become Irish resident on 1 January 2021.

Current residence position of Digital Solutions (Ireland) Ltd

Digital Solutions (Ireland) Ltd is currently resident in Ireland on the basis that its board of directors meets here and its central management and control is therefore located in Ireland. There will be no change to this residence position on 1 January 2021. From that date, Digital Solutions (Ireland) Ltd will be Irish resident both on the grounds of its incorporation in Ireland and on the ground of the location of central management and control in Ireland.

Irish tax exposure of Digital Solutions (International) Holdings Ltd – currently

As a non-resident company, Digital Solutions (International) Holdings Ltd is subject to Irish tax only on Irish source income (or income of an Irish branch). Since its income comprises royalty income from Digital Solutions (Luxembourg) SARL and interest income on its financial portfolio, neither of which arise in Ireland, it has no liability to Irish tax, and is under no obligation to file Irish tax returns.

Irish tax liability of Digital Solutions (International) Holdings Ltd – from 1 January 2021

When the new residence rules take effect on 1 January 2021, Digital Solutions (International) Holdings Ltd will become liable for Irish Corporation Tax on worldwide income. Although Ireland has a tax rate of 12.5%, this rate applies only to income arising from a trade (broadly an active business operation) undertaken in Ireland. Passive income is taxable in Ireland at 25%. This rate would apply to the interest on the certificates of deposit. It is very unlikely that the royalty income from Digital Solutions (Luxembourg) SARL would be regarded as a trade in Ireland and this income is also therefore likely to be taxable at 25%.

Ireland has an effective tax rate on capital gains of 33%, and this rate would apply to any gains on the certificates of deposit portfolio. These gains would be computed by reference to euro amounts, and thus an Irish tax liability could arise based on appreciation of the dollar over the ownership period, as well as by reference to gains in the value of the certificates themselves. Any disposition of the rights under the cost sharing agreement could similarly give rise to Irish Capital Gains Tax at an effective 33% rate.

The cost sharing payments themselves would not be tax deductible in Ireland. Although Ireland has a system of tax deductions for expenditure on acquired intellectual property and on scientific research, deductions are only available for trading companies, and it is unlikely that Digital Solutions (International) Holdings Ltd is trading.

Irish tax liability of Digital Solutions (Ireland) Ltd

As a resident and trading company, Digital Solutions (Ireland) Ltd will be liable for tax on worldwide income throughout the period. Because the company trades in Ireland, its income will be taxable – as currently - at 12.5% and there will be no change in this position from 1 January 2021.

Summary – Impact of the structure – current and from 1 January 2021

From the above analysis, the current impact of the structure is to render Digital Solutions (Ireland) Ltd taxable in Ireland (at 12.5%) on the operations of the group undertaken in Ireland. The (substantial) profits attributable to the intellectual property of the group are paid to Luxembourg by way of arm's length royalty on the intellectual property. Luxembourg is included in the structure to avoid consideration of Irish withholding tax on the patent element of the intellectual property. Arm's length royalties are in turn paid from Luxembourg to Digital Solutions (International) Holdings Ltd and this company is not currently subject to Irish tax.

All this will change on 1 January 2021 when Digital Solutions (International) Holdings Ltd becomes Irish resident and fully subject to Irish tax. If no action is taken, the combination of a 25% tax rate on income and limited deductions for expenses will produce a very high effective tax rate.

Possible reorganisation of the Group

Clearly Digital Solutions Inc will need to carefully consider a reorganisation of the group in order to reduce the adverse impact of the new provisions. One possibility, given the fact that the whole purpose of the new legislation is to eliminate the tax advantages of the "Double Irish" is to eliminate the hybrid structure before 1 January 2021. This could take place in the following manner.

- Step 1 – One month prior to a year end of the company, Digital Solutions (International) Holdings Ltd gives 30 days' notice of the cancellation of the licence of the software products of the group to Digital Solutions (Luxembourg) SARL and Digital Solutions (Luxembourg)

SARL gives 30 days' notice of the cancellation of its licence to Digital Solutions (Ireland) Ltd. This step should have no Irish consequences.

- Step 2 – On the year end of the company, Digital Solutions (International) Holdings Ltd holds a board meeting in Cayman and resolves to transfer the residence of the company to Ireland. From the date of the next board meeting, Digital Solutions (International) Holdings Ltd will become Irish resident.
- Step 3 – On the following day (the first day of new the accounting period), the board of Digital Solutions (International) Holdings Ltd meets in Ireland and resolves to acquire the business and assets of Digital Solutions (Ireland) Ltd. On the same day, the board of Digital Solutions (Ireland) Ltd meets and resolves to sell its business and assets to Digital Solutions (International) Holdings Ltd. Since both companies are Irish tax resident at this point, they form an Irish tax group and the assets of Digital Solutions (Ireland) Ltd transfer to Digital Solutions (International) Holdings Ltd tax free with a transfer of base cost for Irish Capital Gains Tax purposes. The transfer is also free of Irish Stamp Duty because of group relief. The entire business is thereafter carried on by Digital Solutions (International) Holdings Ltd, now an Irish resident company. Business profits reported in Ireland will be much higher, in the absence of the royalty payments to Luxembourg, but there are two significant advantages from a tax perspective – (1) the trading profits will be taxable in Ireland at 12.5% and (2) cost sharing payments incurred after the date of transfer of the business will be deductible either as incurred on the basis that they represent expenditure on scientific research or over a five year period (to the extent that they are capital) on the basis that they are expenditure on intangible assets. Although the interest on the certificates of deposit portfolio will be taxable in Ireland at 25%, this may not represent a significant additional cost if the interest is in any event taxable in the US under Subpart F.
- Step 3 – To tidy up the corporate structure, Digital Solutions Luxembourg SARL could be dissolved. Since it has distributed its profits on an annual basis, a gain is unlikely to arise for Irish tax purposes.
- The latest date for this reorganisation would be 31 December 2020 if the adverse impacts of the new legislation are to be avoided.

Question 4

Part 1: Repatriation of surplus cash from foreign subsidiaries

Dividends

Cash can be repatriated by the payment of dividends.

The main foreign issues that arise in this context are:

- Availability of reserves in the foreign jurisdiction;
- Any exchange control permissions or restrictions;
- Foreign withholding tax applicable and treaty or EU Directive relief available; and
- The impact of the dividend on any thin capitalisation provisions in the foreign country – the dividend will reduce the foreign equity.

The relevant Irish issues are:

- Tax rate applicable to the dividends in Ireland (25% or 12.5% or exempt);
- Availability of foreign tax credit for foreign direct and underlying tax; and
- Whether the foreign tax credit is:
    - Fully utilisable against Irish Corporation Tax liability in the same year (including via the pooling provisions)
    - Available for carry forward under the pooling provisions
    - An expense in the profit and loss account (and the corresponding impact on the effective tax rate for the year)

Loans

Cash can be repatriated by making a loan from the foreign company to its Irish parent.

The main foreign issues are arise are:

- Any exchange control permissions or restrictions;
- The requirement to charge interest on the loan and the taxation of the interest in the foreign jurisdiction (the interest rate required by any transfer pricing provisions, the tax rate and the impact of any Irish withholding required, the latter being unlikely); and
- Any foreign tax issues in the event that the loan is denominated in euro rather than in the foreign currency.

The relevant Irish issues are:

- The loan will not generate distributable income for accounting purposes;
- The deductibility of any interest payable on the loan in Ireland (unlikely) and, if deductible, the tax rate at which the deduction is available (trading v charges on income);
- Any withholding tax on the interest from Ireland (unlikely); and
- Any mismatch between the Irish and foreign treatment of exchange gains or losses on repayment of the loan.

Redemption of shares

Cash can be repatriated by redemption of shares by the foreign subsidiary.

The main foreign implications are:

- Any exchange control permissions or restrictions;
- The foreign tax treatment of the redemption – as a distribution (with dividend withholding tax) or a disposal of shares (with possible foreign Capital Gains Tax on the Irish parent); and

- The impact of the dividend on any thin capitalisation provisions in the foreign country – the redemption will reduce the foreign equity.

The relevant Irish implications concern the Irish tax treatment of the redemption – as dividend (see above for implications) or capital gain. If capital gain, whether relief is available under section 626B TCA 1997. If the disposal is subject to Capital Gains Tax, the level of Capital Gains Tax payable, the availability of any credit for foreign Capital Gains Tax and the impact on the tax charge for the year.

<u>Part 2: Corporation tax computation for the year to 31 December 2015 for BRA Overseas Holdings Ltd</u>

Computation of credit on dividend from BRA Spain Holdings SA	*Spain Operations*	*Mexico Operations*
	€m	*€m*
Effective tax rate	25%	35%
Pre-tax reserves (Gross up at effective tax rate)	13.33	23.08
Tax (effective rate)	3.33	8.08
Distributable	10.00	15.00
Dividend before WHT	7.00	8.00
WHT Mexico to Spain 5%		0.40
Net dividend to Spain Holdings	7.00	7.60
Additional credit on Spain Operations dividend (para. 9I Sch 24 TCA 1997):		
No additional credit is due because the Spanish effective rate exceeds the lower of the Spanish and Irish statutory rates (ie 12.5%)		
The credits feed into BRA Spain Holdings SA as follows:	*Spain Holdings*	
Net dividend from Spain	7.00	
Net dividend from Mexico	7.60	
WHT from Mexico	0.40	
Pre-tax profit in Spain Holdings	15.00	
Tax (WHT) - tax charge in Spain Holdings	0.40	
Distributable by Spain Holdings	14.60	
Dividend	14.60	
WHT (Parent/Subsidiary Directive applies)	-	
Dividend to Ireland Holdings	14.60	
Foreign tax for credit in respect of the Spain Holdings dividend:		
Spain Operations underlying tax (7/10ths of total)	2.33	
Mexico Operations underlying tax (8/15ths of total)	4.31	
WHT from Mexico	0.40	
Total foreign tax for credit on dividend from BRA Spain Holdings SA	7.04	

Computation of credit on the dividend from BRA Belgium SARL	*Belgium*
	€m
Effective tax rate	5%
Pre-tax reserves (Gross up at effective tax rate)	5.26
Tax (effective rate)	0.26
Distributable	5.00
Dividend before WHT	5.00
WHT (Parent/Subsidiary Directive Relief)	-
Net dividend	5.00
Foreign tax qualifying for credit in respect of Belgium dividend	
Belgium underlying tax	0.26
Additional credit on EU dividends (para. 9I Sch 24 TCA 1997)	
Formula for additional credit:	
E=(D*B/(1-B))-C	
Where E is the additional credit	
B is the lower of the Irish and foreign statutory rate payable on the dividend	
D is the net dividend	
C is the foreign tax credit available before computation of the additional credit	
Compute additional credit on EU dividends (para. 9I Sch24 TCA 1997):	
B - Tax rate on Belgium dividend (assume treasury operations are a trade)	12.5%
D	5.00
C - Foreign tax as computed above based on underlying tax computation	0.26
Additional credit on EU dividends E=(D*B/(1-B))-C	0.45
Total credit on Belgium dividend	
Underlying credit relief	0.26
Additional EU credit	0.45
Total foreign tax for credit on dividend from BRA Belgium SARL	0.71

Computation of the credit on the dividend from BRA Cayman, Inc.	*Cayman*			
	€m			
Effective tax rate	0%			
Pre-tax reserves	30.00			
Tax	-			
Distributable	30.00			
Dividend (no credit available)	30.00			
Computation of foreign tax credit limit on dividends in BRA Overseas Holdings Ltd	*Cayman*	*Belgium*	*Spain Holdings*	*Total*
	€m	*€m*	*€m*	*€m*
Foreign tax qualifying for credit	-	0.71	7.04	
Net dividend received in Ireland	30.00	5.00	14.60	
Total (Gross Irish income)	30.00	5.71	21.64	
Foreign effective rate (Foreign tax/Gross Irish income)	0.0%	12.5%	32.5%	
Irish rate (Note Cayman is trading and BRA plc is listed so eligible for 12.5%)	12.5%	12.5%	12.5%	
Net dividend received in Ireland (net foreign income)	30.00	5.00	14.60	
Gross up net foreign income at lower of Irish and foreign effective rate (0 for Cayman and 12.5% for Belgium and Spain)	30.00	5.71	16.69	
Qualifying for credit (Grossed up amount at lower of Irish and foreign effective rate)	0.00	0.71	2.09	
Qualifying for deduction (balance of foreign tax)	0.00	-	4.96	
Corporation tax computation - BRA Overseas Holdings Ltd - year to 31 December 2015				
Income taxable in Ireland	30.00	5.71	21.64	57.36
Deduct: foreign tax			4.96	4.96
Income after foreign tax deduction	30.00	5.71	16.69	16.69
Irish tax at 12.5%	3.75	0.71	2.09	6.55
Foreign tax credit		0.71	2.09	2.80
Irish tax payable	3.75	-	-	3.75
Available for pooling (87.5% of deductible foreign tax)			4.34	
Pooling credit	3.75		-3.75	
Pooling credit for carry forward			0.59	
Net tax payable	-			-

Question 5

This is an open-ended question that enables the student to demonstrate their awareness of the Irish tax system and its advantages and challenges in an international context.

There is no "right" or "wrong" answer to this question and students that describe how particular aspects of the Irish tax system are attractive in particular circumstances and to particular types of foreign direct investors will gain marks. Obvious aspects of the Irish tax system that could be discussed in this context include the Corporation Tax rate, R&D incentives, SARP and the taxation provisions to encourage investment in intellectual property. Alternative approaches could include a discussion of the ease of tax compliance in Ireland (by reference to the World Bank/PwC survey "Paying Taxes 2015") or consideration of non-corporate tax issues such as the VAT administrative provisions or the remittance basis for foreign domiciled individuals.

The threats to competitive advantage could be discussed by reference to either external threats or threats arising from the (internal) need to maintain fiscal discipline and broaden the tax base. Threats could include the impact of the Common Consolidated Corporate Tax Base proposed by the EU Commission, an EU Commission's challenge by reference to the State Aid provisions, the OECD BEPS process, anti-deferral legislation in the United States and domestic political pressure to reduce personal taxes or charges which would have to be compensated for by elimination of tax expenditures or increases in taxes on business.

Policy responses or other issues to counter the threats to competitive advantage could include a discussion on the protracted process required to secure progress in tax policy at an EU level, the analogous processes in the United States in enacting tax reform provisions there and ensuring that tax incentives are designed so as not to contravene OECD and EU rules on harmful tax competition. This section could also include a discussion on the application of cost-benefit analysis to the evaluation of tax expenditures, in order to justify retention or extension.

Question 6

Introduction

This report considers the Irish direct tax issues that arise on the acquisition, holding and disposal by Property Holdings BV of a portfolio of commercial and industrial properties in Ireland.

Taxation framework that will apply to your Irish project

Although Ireland has a Corporation Tax rate of 12.5%, this rate applies only to income from a trade (an active business undertaken in Ireland). Holding property assets for the long term would not qualify as a trade and a different taxation regime therefore applies.

Property held by a non-resident company

Where the property investment is held by a non-resident company, the applicable tax is Income Tax rather than Corporation Tax. Income Tax applies to net rental income (after specified allowable deductions) at a 20% rate. Net rental income or loss is computed separately for each property and then these amounts are aggregated to compute the overall tax liability. If there is an overall rental loss, this amount can be carried forward against net rental income of future years.

A unique feature of property holding by a non-resident company is that the person paying the rent must deduct Income Tax at 20% on the gross rent payable and remit this to the tax authorities. The tax deducted is available as a credit against the Income Tax liability of the landlord and any excess is repayable after the tax return has been submitted. The adverse cash flow consequences of the withholding arrangement can be avoided by appointing a resident agent (such as an estate agent or a solicitor) to receive the rent on behalf of the landlord. This agent then takes over the liability to make the tax returns of rental income and to ensure that tax payments are made on behalf of the landlord. It is of course possible to arrange with the agent that any funds collected in excess of the requirements for the property are remitted to the property owner. The agent will usually require appropriate indemnities in relation to the payment of the tax on behalf of the non-resident owner. This method of tax return and rent collection is very common for non-resident investors in Irish property.

Property held by a resident company

Where the property investment is held by an Irish resident company, the applicable tax is Corporation Tax which applies to net rental income at 25%. In addition, where the company is “close” (controlled by five or fewer persons, counting relatives as a single person), there is an additional Corporation Tax burden, known as a surcharge. The surcharge applies to the taxable income less tax payable that remains undistributed (by way of dividend) 18 months after the company’s year-end and is payable at 20%. In effect, the surcharge increases the effective tax rate from 25% to 45% (25% + 20% of 75%) if rental profits after tax are not distributed.

Deductions in computing rental income – resident or non-resident owner

Deductions include interest on funds used to acquire, improve or repair the property, rates (local property taxes), maintenance, insurance and management fees. However, no deduction is available for guarantee payments, so if property can be funded without a parent guarantee, this will improve the effective tax rate. Other than these specified deductions, there is no general entitlement to deduct expenses in a rental computation and in general no deduction is available in Ireland for building depreciation. There are exceptions to this rule on depreciation, and for example new industrial buildings are eligible for a 4% annual depreciation allowance (on the building element of the acquisition cost – this element is computed by reference to a formula and depends on the site cost and construction expenditure), usually referred to as a capital allowance. Capital allowances may be available on second-hand industrial buildings and on other buildings in particular locations. The level and duration of available allowances is generally included in the selling agent’s documentation for the property. Capital allowances are recaptured for tax purposes when the building is sold for an amount in excess of its tax written down value, and the recapture is taxed at the same rate as the rental income (20% or 25%).

Capital gains on Irish property

Gains on the sale of Irish property are liable to Capital Gains Tax at an effective 33% rate. Tax is computed based on the difference between the sale proceeds and the tax base in the property (typically acquisition cost, acquisition expenses and any enhancement expenses reflected in the value of the property). Rental losses, either in the current year or carried forward from prior years, cannot reduce capital gains. Although the effective rate is 33%, the mechanics of the computation for gains by a resident company are such that the company is taxed on an amount that, when taxed at 12.5%, will produce a 33% liability.

Capital gains tax applies whether the property is sold by a resident or a non-resident company, and also applies where shares (Irish or foreign) deriving the greater part of their value from property are sold. Shares not deriving their value from Irish property (for example a company whose property investment has been sold and which holds cash) do not give rise to Capital Gains Tax in the hands of a non-resident.

Capital gains tax on disposals by non-residents is normally collected through a withholding regime, where the purchaser (Irish or foreign) applies a withholding tax of 15% of the purchase consideration where the total consideration exceeds €500,000.

Other withholding taxes

Apart from the withholding taxes described above on rents and on capital gains, Ireland does not generally apply withholding taxes to repatriation of income to foreign investors. Thus an Irish rent collection agent may transfer funds to the foreign property owner without withholding tax and dividends from an Irish company to a Netherlands parent are exempt from dividend withholding tax (based on domestic law and on the Parent-subsidiary Directive). There is no withholding tax on interest paid to lenders (third party or related party) in treaty countries where the treaty follows the OECD Model. Interest paid to Irish banks may be paid without withholding tax.

Group relief

There is no group relief regime for Income Tax, and nor does group relief apply between Corporation Tax and Income Tax. There is a group relief regime for Corporation Tax but insofar as property holdings are concerned, it only applies to “excess” capital allowances (capital allowances in excess of net rental income) and not to normal rental losses. Any relief available in one company (ie any excess capital allowances) may be offset against the taxable income of another company in the group. For a Corporation Tax group to exist, the surrendering and claimant companies must be under at least 75% common EU control.

Structuring the investment by Property Holdings BV

Considering the above considerations in the context of structuring the investment by Property Holdings BV, the following issues will be important:

- There is a 5% tax rate advantage available on net rental income by undertaking the investment in a company that is not Irish resident.
- Retaining net rental income in an Irish company for more than 18 months after year end will give rise to an effective tax rate on income of 45%.
- Capital gains on the properties will always suffer Irish Capital Gains Tax at 33%.
- Financing can be sourced either in Ireland or in the Netherlands without a tax distinction in terms of the treatment of the interest expense.
- Rental losses not arising from capital allowance will give rise to cash flow tax costs unless rental profits arise in the same entity.
- The costs of the parent company guarantee will be non-deductible in Ireland.

Taking these issues into account, the suggested structure would be to hold all the properties directly in Property Holdings BV and borrow for the properties that are to be debt financed in whichever of Ireland or the Netherlands produces the better loan offer. In practice, adopting this structure would necessitate the appointment of an Irish agent to collect the rents, so as to avoid a 20% withholding on the gross rents.

Compliance obligations summary

Liability to Income Tax would be reported and computed based on calendar year transactions, with the tax return due on 31 October following the calendar year. A preliminary Income Tax payment is due on 31 October during the calendar year. Interest is avoided if this payment is 100% of the liability for the preceding year or 90% of the liability for the current year. Any balance of tax must be paid by 31 October of the subsequent year.

Question 7

Ms Florence Maguire
Cookstown Vintage
Cookstown
Co Tyrone
Northern Ireland

22 April 2015

Dear Florence

Thank you for consulting me in relation to the tax implications of your Irish operations. In this letter, I will provide my view on how the Cookstown Vintage business interacts with the Irish tax system, and offer some advice on your Irish tax compliance obligations.

Residence

As an initial matter, it is probably best to make the assumption that neither you nor Richard are likely to be Irish resident for tax purposes. Based on the information you provided, Richard is in Ireland on about 100 days a year as part of the business operations and you are here on 23 days a year, but of course each of you could separately be here for other reasons. Ireland determines residence based on a count of days during any part of which an individual is present here. However, this determination is subject to the tax treaty provisions. You and Richard are UK resident based on your time spent there and on your home base being there. In these circumstances – and regardless of the number of days that you are in Ireland – the UK-Ireland treaty deems you to be a resident of the country where you have a permanent home and for both you and Richard this is in the UK.

The Cookstown Vintage business – Income Tax and Universal Social Charge

You operate the Cookstown Vintage business as a sole trader. Ireland taxes business operations under Case I of Schedule D, making these business operations liable to Income Tax (and a similar tax called Universal Social Charge). Once a business operation is carried on in Ireland, the operator is liable to Income Tax, regardless of the country of residence. This provision is, of course, subject to the provisions of the tax treaty. Like most of our treaties, the UK-Ireland treaty (Article 8) provides that a UK business is liable to Irish tax only if the business is carried on in Ireland through a permanent establishment situated in Ireland. The treaty defines a "permanent establishment" as a fixed place of business in which the business of the enterprise is wholly or partly carried on. There are a number of specific inclusions in (eg a factory or a branch) and exclusions from (eg a warehouse) the term "permanent establishment" but they do not provide any guidance for your particular circumstances.

The three characteristics of a permanent establishment given by the OECD are:

- The existence of a place of business such as premises or equipment;
- The place must be "fixed" at a distinct place with a degree of permanence; and
- The business must be undertaken there, usually via personnel employed by the business.

Because of the recurring nature of your operations, the fact that the stalls operate at the same place each week and the fact that you and your employee make sales from the stalls on an organised basis, you operate through a permanent establishment in Ireland. Strictly speaking, you probably have a permanent establishment at each location (Monaghan, Sligo and Donegal) but as a practical matter you can consider the overall results of your stalls in markets (including the Christmas market) that are located in Ireland.

Operating through a permanent establishment makes you liable for Income Tax, Universal Social Charge and potentially PRSI (the latter as a self-employed contributor).

To compute your income for Irish tax purposes, the treaty requires that we consider the profits that would accrue in the Irish operations if they were a distinct enterprise. This is most conveniently established by preparing accounts for your Irish "branch" – recording the sales income from the Irish markets and the costs incurred in earning these sales. Where appropriate, these costs can include costs incurred in Northern Ireland (such as the cost of production), in addition to Irish expenses such as the rental of the pitch for the stalls. Any equipment that you use (such as the stall itself or the van) may be eligible for capital allowances, which here are normally based on 12.5% per year on a straight line basis.

Your income – the tax-adjusted profits of the Irish operations – will be taxable at 20%, the standard rate, and, if the standard rate band of €33,800 is exceeded, at 40%. Your entitlement to personal tax credits must also be considered. Although non-residents are not normally eligible for personal tax credits, as an EU national you can get a proportion of these credits (and other tax deductions and allowances), based on the proportion of your Irish income to your aggregate "worldwide" income.

Universal Social Charge will also be payable on your income. This is computed on the same basis as Income tax and USC is payable at graduated rates that range from 1.5% to 8%.

<u>Richard's Income Tax and Universal Social Charge position</u>

Richard's tax position is relevant in that, if he is liable to Income Tax in Ireland, you, as his employer, will have an obligation to operate Irish PAYE (which covers both Income Tax and Universal Social Charge). Richard is exercising his employment in Ireland for about 100 days each year. His tax exposure is determined by Article 16 of the Ireland-UK treaty. This provides that to the extent that the employment is exercised in Ireland it may be taxed here. There is an exclusion from this provision, but it requires three conditions, only two of which are met in present circumstances:

- He must be present in Ireland for a period not exceeding 183 days (this condition is met);
- His salary must be paid by a non-resident employer (this condition is met); and
- The salary must not be borne by a permanent establishment in Ireland. This condition is not met because the proportion of Richard's total salary that is attributable to his work in Ireland is deductible from (and therefore "borne by") the Irish branch of your business.

The income which is liable to Irish Income Tax is the part of Richard's income that is attributable to his work here. As a practical matter, this could be computed on a time basis. For example, in the summer months, Richard is in Ireland on three half days and thus 30% of his salary should be subject to Irish PAYE. For December, he is in Donegal for the full month, and thus Irish PAYE should be operated on his entire salary. I appreciate that you are also operating UK PAYE on Richard's income but in circumstances where there is a liability for Income Tax based on exercise of an employment in Ireland, it is for the country of residence (ie the UK) to give credit relief for double taxation. Like you, Richard should be eligible for proportionate tax credits and deductions based on the ratio of his Irish to his worldwide income.

<u>Social security (PRSI)</u>

We also need to consider social security taxes – known here as PRSI – for both you and Richard. Fortunately, the position is less complex here since there is provision for EU nationals to pay social security only in one jurisdiction. Thus you and Richard should be liable to social security only in the UK, and Irish PRSI should not arise.

<u>VAT</u>

Sales made by the Cookstown Vintage business are within the charge to Irish VAT, given that your annual turnover exceeds the threshold, which for sales of goods is €75,000. The VAT rate on both cheese and jams/preserves is zero percent, and thus you will not be actually paying over VAT on the sales of the business. To the extent that you incur any business expenses that carry deductible VAT, you can claim refund of VAT in your VAT returns.

<u>Capital taxes – Capital Gains Tax and Capital Acquisitions Tax</u>

These are unlikely to be immediately relevant and are mentioned for completeness. If you ever sell the business, the goodwill attributable to the Irish operations will be subject to Capital Gains Tax in

Ireland (the rate is currently 33%). Gains on assets used for the purposes of a trade carried on through an Irish branch are subject to Capital Gains Tax regardless of the residence of the trader. Article 14 of the Ireland-UK treaty reserves capital gains on movable property, which forms part of an Irish permanent establishment, to Ireland.

Any disposition of the Irish trade by way of gift or inheritance could be subject to Irish gift or inheritance tax. Any tax payable should be creditable against a UK liability on the same property.

Summary of Irish compliance obligations

You should be registered for Irish Income Tax. You should make annual Income Tax returns for the Irish business (using branch accounts as described above) and claim the appropriate portion of Irish tax credits and deductions. You should make an annual preliminary Income Tax payment on 1 November each year, with the balance of tax for the prior year due on the same day. Income Tax in Ireland is on a calendar year basis.

You should also be registered for PAYE in respect of the part of Richard's salary that is taxable in Ireland. This will involve monthly PAYE and USC payments to the Collector General.

For VAT, from a compliance perspective, you should register for Irish VAT and make bi-monthly VAT returns. This will summarise your sales at the various VAT rates (all zero in your case), your intra-community acquisitions (the cheese and jams/preserves for sale, also zero rated) and any business costs on which you have borne Irish VAT. You are likely to be in a net refund position, so VAT compliance is largely a matter of making returns of sales and intra-Community acquisitions.

PAYE, VAT and Income Tax returns can be made via the Revenue's online system, which is known as ROS.

Yours sincerely

Jane Murphy