The Irish Tax System – A General Guide

Overview

Ireland has for many years used tax incentives to attract inward investment and has traditionally directed its tax incentives towards active business income – notably, the standard 12.5% rate of corporation tax applicable to most trading income.

However the Irish tax regime is favourable not only to those multinationals wishing to establish an operation in Ireland for the purposes of availing of the headline 12.5% corporation tax rate. Recently there has been a marked increase in the number of companies looking at Ireland as a holding company jurisdiction. This has been evidenced in particular by the reorganisations implemented by a number of listed international groups which had the effect of moving domicile (for corporate and tax purposes) of the ultimate holding company of the group to Ireland.

Corporation tax

Rates of corporation tax

Although the 12.5% rate of corporation tax attracts most headlines, it is worth noting that there are in fact two separate rates. As mentioned above, the rate of tax applicable to most trading profits (other than profits derived from trading activities in mining, petroleum activities and dealing in land) is 12.5%. In the case of profits generated from these excluded trades and all other non trading income, the applicable corporation tax rate is 25%.

Companies within the charge to Irish corporation tax

All income of an Irish resident company, wherever it arises, will normally be liable to Irish corporation tax. In addition, and subject to applicable double taxation treaty provisions, a non-resident company carrying on a business in Ireland through an agency or branch will be liable to corporation tax on all income arising through that branch or agency.

The general rule is that a company is tax resident in Ireland if it is incorporated in Ireland. This is subject to two exceptions, which are as follows:

(i) If the company is under the ultimate control of a person or persons resident in an EU Member State or in a country with which Ireland has a double tax treaty, or which itself is, or is related to, a company whose principal class of shares is substantially and regularly traded on a stock exchange in an EU country or treaty country; and

(ii) the company carries on a trade in Ireland or is related to a company that carries on a trade in Ireland.

In addition, an Irish incorporated company will not be regarded as resident in Ireland if under the terms of a tax treaty between Ireland and another country, the company is to be regarded as resident in the treaty country.

Where either of the exceptions apply, a company will only be resident if its central management and control is exercised in Ireland. Generally speaking, central management and control is taken to denote control at the highest strategic level of a company's business rather than at the level of the day to day business activities. There are a number of factors that need to be looked at when considering where a company is to be regarded as having its place of central management and control. However, the most important factors generally are the place where the directors of the relevant company are themselves resident and the place where board meetings of the company are held.

A trade for the purposes of availing of the 12.5% rate

There is no specific statutory definition in Irish tax law as to what constitutes a "trade". The starting point generally therefore is what are known as the "badges of trade", which is a list of factors published by the UK Royal Commission on the Taxation of Profits in 1955 and are indicative of trading activity. These factors include the length of period of ownership of the relevant subject matter and the frequency of transactions which the relevant company enters into. The way in which industry has progressed in the intervening period means that applying these principles and the other principles established by the older cases in this area can leave some gaps.

However the matter has been aided by the fact that the Irish Revenue authorities have published guidance setting out the issues which they consider when determining whether an activity constitutes a trade for these purposes. The Revenue authorities have also published general details of the matters where their opinion has been sought as to whether a particular activity constitutes a trade for these purposes. Although the confirmations given would have depended on the relevant circumstances and in particular, the fact pattern submitted by the applicant to the authorities (which largely remains confidential), included within that list are:

- activities relating to the development and exploitation of intellectual property rights
- corporate treasury functions
- investment management activities
- distribution activities
- activities relating to the carrying out of research and development

Transfer Pricing

During 2010, Ireland implemented a transfer pricing (TP) regime which applies to trading transactions between associated persons where, as a result of entering into the relevant arrangement, the receipts of the Irish resident company are understated or its expenses are overstated. The TP rules are not applicable to small and medium sized enterprises. The introduction of TP rules in Ireland aligns the Irish tax code with best international practice by adopting OECD Transfer Pricing Guidelines. Under grandfathering arrangements, related party arrangements entered into before 1 July 2010 fall outside the scope of the TP regime. From a practical perspective, the Irish TP rules require that there is documentation prepared and available that substantiates the arm's length nature of the arrangement.

Incentives for the development of and investment in intangibles

In addition to the favourable rate of tax applicable to trading income, Ireland has also a number of tax incentives aimed specifically at the IP sector. The main incentives are as follows:

Amortisation of intellectual property rights

A regime allowing for the amortisation of intellectual property rights was introduced in 2009. Intellectual property acquired by a company after 7 May 2009 may be amortised for tax purposes in line with its treatment in the accounts of the company or, alternatively, the expense may be written off over a 15 year period (at the rate of 7% per annum and 2% in year 15). Subject to leaving a specified minimum amount of the income in charge, the deduction may be set off against taxable income generated from the management, development or exploitation of the relevant intellectual property or from the sale of goods or services that derive the greater part of their value from that intellectual property.

Research and development expenditure

Irish tax legislation provides for a tax credit of 25% of incremental expenditure by a company, or a group of companies incurred wholly and exclusively on research and development (R&D). The R&D tax credit is comprised of 25% of the incremental spend by a company on its qualifying R&D expenditure in the current year over qualifying expenditure in the base year. The base year for these purposes is taken to be 2003. Recent measures introduced by Finance Act 2013 have enhanced this R&D tax credit regime further by providing that the first €200,000 of R&D spend will benefit from the tax credit on a volume basis. The R&D tax credit will continue to apply to R&D expenditure in excess of €200,000 on the incremental basis described above. In addition, the regime allows for the carry back of unused tax credits so that they may be set off against corporation tax paid in the previous accounting period and, to the extent there is an excess, the unused tax credit can be carried forward and in certain circumstances, a cash payment in the form of a refund of tax previously paid can be claimed from the Irish tax authorities.

Key employee reward

Recent Finance Acts have introduced a reward mechanism for key employees involved in the R&D activities of a company and this was substantially enhanced even further by Finance Act 2013. While certain limitations apply, the mechanism effectively enables a company in receipt of R&D tax credits to surrender a portion or all of such credits
to key employees for offset against their employment income.

A key employee for this purpose is one whose employment duties comprise of at least 50% R&D activity. In general, it allows a key employee to seek a tax refund from the Irish tax authorities based on the R&D tax credit surrendered to him by the company, provided certain conditions are met.

Expenditure on scientific research

A deduction is granted to a person carrying on a trade and who incurs non-capital expenditure relating to scientific research even if the scientific expenditure incurred is not related to the particular trade carried on by the company.

A further relief applies where the expenditure is of a capital nature and is incurred in relation to scientific research. The effect of this provision is to grant to a person who incurs capital expenditure on scientific research capital allowances equal to 100% of that expenditure. This relief also applies even if the expenditure on scientific research is not related to the particular trade carried out by the company.

Principal features of Ireland's holding company regime

Over the last number of years, the Irish government has introduced a number of measures designed to increase the attractiveness of Ireland as a location for the establishment of holding companies of multinational groups. There are now a wide number of benefits in locating a holding company in Ireland and the benefits can be increased by establishing trading operations falling within the 12.5% tax regime in Ireland in tandem with having an Irish holding company. The principal benefits of the holding company regime are as follows:

- Exemption from the charge to Irish capital gains tax in respect of the disposal of qualifying shareholdings in subsidiaries.
- Beneficial regime for the taxation of foreign dividends. By way of background, foreign dividends paid out of the trading profits of (i) subsidiaries resident in the EU, (ii) subsidiaries resident in a tax treaty country or in a country which has ratified the Convention on Mutual Administrative Assistance in Tax Matters, or (iii) subsidiaries, regardless of its location, where that subsidiary is itself, or is related to, a company quoted on a recognised stock exchange in either Europe or in a jurisdiction that has entered into a double tax treaty with Ireland, can be taxed at 12.5%, with other foreign dividends being taxed at 25%. In both cases, it is generally possible to claim a foreign tax credit in respect of withholding taxes and underlying corporation tax paid by the

relevant subsidiary, so that generally no further charge to Irish tax should arise on receipt.

- Limited thin capitalisation legislation and no controlled foreign corporation rules for foreign income.
- Wide domestic exemptions from withholding tax on dividend and interest payments made by an Irish holding company. Although Ireland imposes a dividend withholding tax and withholding on interest payments (both at a rate of 20%), domestic law provides for wide exemptions from these obligations, in particular with respect to dividend payments.

Wide tax treaty network. Ireland currently has signed 69 tax treaties with other countries, 64 of which are in effect, and several more are in the pipeline.

Principal features of Ireland's structured finance regime

Ireland has increasingly become the jurisdiction of choice for establishing vehicles to be used in a wide range of structured finance transactions. Ireland has specific tax legislation setting out the tax treatment of these vehicles. For those companies falling within the regime, it is generally possible to structure matters so that little or no profit for Irish tax purposes is recognised by the vehicle. In addition, there are also generous exemptions available from Irish withholding tax on payments of interest by such entities. These include a quoted Eurobond exemption for listed, bearer or registered instruments and, subject to very limited exceptions in the case of payments to certain "treaty recipients", an exemption for payments of interest to persons resident in EU countries (other than Ireland) or countries with which Ireland has a double tax treaty.

Principal features of Ireland's funds regime

Ireland has established a globally recognised reputation as one of the leading jurisdictions in which to established and administer regulated funds. This has been driven in particular by the Irish Financial Regulator's balanced and dynamic approach to regulating Irish funds which in turn has enabled a wide range of fund products to be developed and offered out of Ireland.

The regulatory regime has been complimented by the specific tax regime that applies to regulated funds. Such funds are not subject to tax on their income or gains but instead operate an exit tax regime. Under this regime, a tax liability is only triggered in respect of certain chargeable events, for example a payment to an investor. However the exit tax charge is only imposed in respect of chargeable events for Irish resident investors. Therefore, non-resident investors are not subject to any charge to Irish tax in respect of their investment in an Irish regulated fund.

While many funds established in Ireland are geared towards the retail sector, it may also be possible to use an Irish fund in the context of more bespoke investments by establishing what is known as a "Qualifying Investor Fund" or QIF. Such funds are aimed at more "sophisticated" investors who meet minimum net worth and minimum subscription tests.

The benefit of using this category of fund is that the authorisation process for regulatory approval is "fast-tracked" and the fund is subject to a lighter degree of on-going regulatory requirements with the fund still benefiting from the favourable tax regime. Finance Act 2013 amended the tax rules applicable to Investment Limited Partnerships (ILPs) and these entities are now treated as 'transparent' for Irish tax purposes, an amendment which brings the treatment of Irish ILPs into line with how equivalent entities are treated internationally.

Relevant tax issues for individuals

Rates of income tax

Income tax in Ireland is charged at two rates. A rate of 20% applies in respect of a single individual's first €32,800 of income. The threshold is higher when the taxpayer is married. Income above these limits is taxed at the rate of 41%. Social insurance contributions (known as Pay Related Social Insurance or PRSI) are generally levied at the rate of 4%. A universal social charge (USC) has been recently introduced which applies at the rate of 2% on income up to €10,036, 4% on income between €10,036 and €16,016 and 7% on any balance. For self-employed individuals, there is an additional 10% rate applied to income in excess of €100,000. The levy is generally charged on gross income and therefore before deduction of pension contributions for example.

Territoriality

A charge to Irish income tax arises where a person is resident or ordinarily resident and domiciled in Ireland. Residence is determined by the number of days an individual spends in Ireland, and includes presence at any time of the day (not just at midnight). To be resident an individual must spend either (i) a total of 183 days in any tax year or (ii) a combined total of 280 days over two years, with a minimum of 31 days in each tax year.

A person will be ordinarily resident in Ireland where he or she is resident for three consecutive years. An individual is domiciled in the country of his or her permanent home. Each person is deemed to have a domicile of origin (generally the country where their father is domiciled when they are born) and will be regarded as domiciled in that country until a domicile of choice is acquired. A consultation process on the tax residence rules took place in 2012, so it may be that the criteria noted above will be altered in the future.

Tax implications of domicile and residence

Individuals who are both domiciled and tax resident in Ireland are liable to income tax on their worldwide income wherever arising. Individuals resident and non-domiciled in Ireland who exercise their employment or office in the State are liable to pay income tax on all income attributable to the performance of that office or employment in the State, but are only liable to income tax in respect of income from non Irish sources (excluding employment income) to the extent that it is brought into Ireland.

In relation to non-Irish source employment income, legislation was introduced in 2008 to provide a relief for non Irish domiciled individuals who were employed by a company incorporated and tax resident outside of the EEA (and in a treaty jurisdiction) and were seconded to work in Ireland. The result of this relief was to subject a specified maximum amount of the employee's income to Irish income tax, and to the extent an employee had paid tax (via the PAYE system) on a sum in excess of that amount, a refund is available at the end of the tax year.

Finance Act 2012 introduced a new relief for employees seconded to Ireland from 1 January 2012. The new relief applies to employees of companies incorporated and tax resident in a double tax treaty country, a country with which Ireland has concluded a tax information exchange agreement and in some instances to Irish resident companies. The relief is subject to certain conditions and restrictions and will only apply to employees arriving in Ireland in any of the tax years 2012, 2013 or 2014.

The relief introduced in 2008 which is outlined above will continue to apply to employees who arrived in Ireland before 1 January 2012 who qualified for the regime in 2009, 2010 and 2011 and such employees can continue to benefit from that relief until the earlier of either (i) the employee's fifth year of qualifying for the relief or (ii) 31 December 2015.

Individuals who are not resident in Ireland are generally only liable to Irish income tax on income arising in Ireland (subject to the terms of any applicable double tax treaty). Such individuals are also generally only liable to Irish capital gains tax on gains arising on the disposal of certain specified assets (although there are provisions in relation to temporary non-residents). Individuals who are resident in Ireland are liable to capital gains tax arising on the disposal of worldwide assets. Where such individuals are not domiciled in Ireland however, they can avail of a remittance basis – this would effectively mean that they would be liable to capital gains tax on a disposal of non-Irish situate assets only to the extent that the relevant proceeds are brought into Ireland.

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