IRELAND – TAX RELIEFS FOR THE WISE AND TAX TRAPS FOR THE UNWARY

Sandra Chambers[1]

The historical close ties between Ireland and the UK, together with the increasing amount of cross border investment, mean that practitioners in each jurisdiction need to keep abreast of tax law in the other.

The purpose of this article is to flag some points of interest in Irish tax law, that have potential application to Irish resident UK domiciled individuals, in the areas of income tax, capital gains tax and gift/inheritance tax.

1 Why locate in Ireland to start with?

In addition to the usual business or family reasons for living in Ireland and the availability of the remittance basis of tax, Ireland also offers very significant tax breaks for creative artists and stud fees.

In the case of Irish resident artists, the relief will be granted to a person who has written, composed or executed a work, either alone or jointly with another person. The work must be original and creative, and have either artistic or cultural merit. The effect of the relief is that income arising directly or indirectly from the work does not fall within the charge to income tax. It is important to note that there are certain conditions to be met, a formal claim for exemption must be made to the Irish Revenue Commissioners and the relief applies only to the original artist, not to anyone else who has purchased the rights.[2]

---

1 Sandra Chambers BCL LLM CTA. Sandra Chambers is the Technical Manager at the Irish Taxation Institute. The views expressed in the article however are her own and do not necessarily represent those of the ITI

2 S195 Taxes Consolidation Act 1997

On the topic of residence, the artist claiming the exemption must be either:

- Resident in the State for the purposes of income tax and not resident elsewhere, or

- Ordinarily resident and domiciled in the State and not resident elsewhere

In the case of bloodstock breeders, income arising to the owner or part owner of a stallion on the provision of services to mares within the State is exempt from income tax and corporation tax.[3]

2 What are the residence rules?

These rules are set out in S819 Taxes Consolidation Act 1997. An individual will be considered Irish resident if:

- He spends 183 days in the State in the tax year, or

- He spends 280 days in the State over two tax years

An individual will not be regarded as resident under the second test if he spends less than 30 days in Ireland in the second tax year.

In addition, there is an option for an individual who does not meet these tests to elect to be Irish resident, if he has the clear intention to be resident the following year.

The Irish Revenue recently confirmed that, in the case of artists, if a double taxation treaty determines that an individual is resident in Ireland under the tiebreaker clause, they are prepared to accept that the individual is resident in Ireland, and not resident elsewhere, for the purposes of the artist's exemption relief.[4]

An individual will be ordinarily resident in Ireland in a year once he has been resident for the three consecutive tax years preceding that year.[5]

---

3 S231 TCA 1997

4 Tax Briefing 58

5 S820 TCA 1997

3 How is a non-domiciled individual treated for income tax purposes?

S71 Taxes Consolidation Act 1997 provides that a person who is either:

- Resident and non-domiciled in the State, or
- Irish domiciled but not ordinarily resident

will be subject to Irish income tax only on the remittance basis. Irish source income is, of course, taxed on an arising basis, as is UK source income.

4 How is a non-domiciled individual treated for capital gains tax purposes?

S29 Taxes Consolidation Act 1997 provides that a non-domiciled individual will be subject to capital gains tax on gains remitted into Ireland. However, this rule does not apply to either gains arising in Ireland, or gains arising in the UK; such gains are taxed on the arising basis. The current rate of CGT is 20%.

The tax code also specifies that the losses arising on the disposal of foreign assets shall not be allowable losses for the purposes of capital gains tax.

When the proceeds of a disposal realising a gain are remitted, the Irish Revenue take the view that the gain element is remitted first. There is no statutory guidance on this, and this also differs from the UK position, whereby gains are deemed to be remitted to the UK in proportion to the amount of proceeds remitted.

4.1 Example

Sebastian has been living in Ireland for a number of years. He intends to return to the UK at some point and considers that he has retained his UK domicile. In May 2005, he sells an Old Master drawing that he had kept in London. The proceeds are paid into his London bank account. The gain is €120,000.

In June 2005, he disposes of his holiday house in Italy. The proceeds are €500,000 and the gain is €130,000. The proceeds are paid into his Isle of Man account. However in September 2005, Sebastian brings €85,000 into Ireland from the Isle of Man account. This is to cover an unexpected gambling debt.

Under S29(2) TCA 1997, the gain on the Old Master painting is subject to Irish capital gains tax.

Under Irish practice, Sebastian is deemed to have remitted the gain element on the Italian property in priority to the cost. This means that the €85,000 will be fully subject to capital gains tax.

In the Irish tax year ending 31st December 2005, Sebastian will have realised gains of €205,000, giving rise to a CGT liability of €41,000.

5 What about gift and inheritance tax?

This is where the position for non-domiciliaries gets less attractive.

The Irish equivalent of UK IHT is Capital Acquisitions Tax (CAT). This incorporates gift tax, inheritance tax and tax on trust dispositions. It is governed by the terms of the Capital Acquisitions Tax Consolidated Act 2003, and subsequent Finance Acts. CAT is levied at 20% on the value of a gift or inheritance, subject to the appropriate threshold, below which there is no tax charge. The appropriate threshold is determined by the blood relationship between the donor and donee.

The Finance Act 2000 introduced fundamental changes in the basis on which CAT is charged. It moved from a system where gift or inheritance tax was charged if the donor was domiciled in Ireland for tax purposes, to a system where gift or inheritance tax is charged if either the donor or the recipient is resident or ordinarily resident in Ireland. Irish situate assets remain within the charge.

These rules apply to gifts or inheritances taken on or after 1st December 1999. However, there was a transitional period for non-domiciled individuals to organise their affairs to minimise a potential charge to CAT. The legislation provided that a non-Irish domiciliary would not be regarded as being Irish resident or ordinarily resident unless:

- the date of the gift or inheritance is on or after 1st December 2004, and
- the person had been resident in Ireland for the five consecutive years of assessment immediately preceding the year of assessment in which the gift or inheritance was taken, and
- the person was either resident or ordinarily resident in the Ireland at the date of the gift or inheritance.

Therefore, with effect from 1st December 2004, the position of non-domiciliaries has changed. Now, a foreign domiciled individual will be within the CAT net if he or she is resident or ordinarily resident in Ireland and has been tax resident in Ireland for the five previous tax years.[6]

5.1 Example

*Siegfried is a UK domiciliary. He commutes to Ireland regularly, and his family have stayed in the UK. His daughter wishes to purchase a house in the UK and he wants to give her **€**100,000 to do so.*

If the gift of €100,000 was made before 1st December 2004, there are no issues as the recipient (the daughter) is not resident or ordinarily resident in Ireland, and the donor (Siegfried) is non-Irish domiciled.

With effect from 1st December 2004, the gift of €100,000 is potentially taxable in the Republic of Ireland as Siegfried has been resident in Ireland for the past five years.

There was some speculation before the Irish Budget on 1st December 2004 that these rules would be relaxed somewhat, given the concerns arising at the short length of time it takes for non-domiciliaries to fall within the Irish CAT net. However, the Minister of Finance did not announce any change to the regime in the Budget, and it remains to be seen if change will be signalled through a subsequent Finance Act.

5.2 How does the UK/Ireland Capital Taxes Treaty operate in this changed system?

Article 8(1) of the Capital Taxes Treaty provides that where both countries impose tax, one country will give credit for tax paid in the other country on the property situated in that country. For example, a UK domiciled individual leaves an Irish property on his death. There will be a charge to CAT on the basis that the property is situate in Ireland. There will also be a charge to UK inheritance tax on the basis of the deceased's domicile. The UK will give credit for the CAT paid in Ireland.

Where the property is not located in either Ireland or the UK, and both countries impose a tax charge, then credit is given by the state that has the subsidiary taxing rights.

The rules for determining the state that has the subsidiary taxing rights are contained in Article 5(2). This provides that this is the country where the

6 S6 and S11 CATCA 2003

deceased was not fiscally domiciled under Article 4(2). However, Article 4(2) determines fiscal domicile in circumstances where a person is domiciled in both Ireland and the UK.

As CAT is now imposed by reference to residence and not domicile, there is an anomaly in the rules for determining the State with subsidiary taxing rights in relation to property situate in a third territory. It may be that the treaty should be renegotiated to take this point into account.

5.3 Are there any measures that could be taken to reduce exposure to CAT and UK inheritance tax for UK domiciliaries?

The main concern is that an Irish resident, UK domiciled individual will be subject to both UK IHT and Irish CAT on death. Despite the ease with which one does fall within the charge to CAT, it is only levied at 20% and therefore is a more benign charge than UK IHT which is levied at 40% above the nil rate band.

Therefore, as in inheritance tax mitigation strategy, it may be preferable to pay CAT only, rather than fall within the charge to both.

Some considerations to be taken into account in achieving this situation are as follows:

- The UK domiciliary could renounce his UK domicile in favour of an Irish domicile of choice, and cease to hold any UK assets above the nil rate band. However, it would also be necessary to consider the impact of such a plan on the individual’s income tax and capital gains tax position, especially if the individual had used the remittance basis extensively. The Irish anti-avoidance provisions on trusts would also become applicable if the individual became Irish domiciled.

- Moreover, because of the deemed domicile provision in S267 IHTA 1984, where a UK domiciled individual abandons his domicile, he must wait another three years before his worldwide estate is outside the IHT charge.

- The individual could seek to transfer gifts to his spouse of assets held outside the UK and Ireland. Assuming the spouse is non-UK domiciled, the assets would fall out of the UK domiciliary’s estate, and would form part of the spouse’s estate. The individual would need to bear in mind the £55,000 limit contained in S18(2) IHTA 1984.

- If the assets gifted amounted to cash, then under the principle in *Carter v Sharon* [1936] 20 TC, a transfer of the monies into the State by the spouse should not constitute remittance by the non-domiciled individual.

6 Conclusion

The Irish tax system offers some very attractive tax breaks to certain individuals, such as artists and stud farmers. Moreover, the remittance basis is available for non-domiciliaries in the areas of income tax and capital gains tax.

Such individuals, however, need to be aware that they may fall within the Irish CAT net fairly soon after taking up residence. If there is a potential charge to CAT and UK IHT, it may be worthwhile to review ways in which this could be mitigated.