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# Irish Tax Law and the Foreign Investor

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# IRISH TAX LAW AND THE FOREIGN INVESTOR

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## I. THE IRISH ENVIRONMENT FOR FOREIGN INVESTMENT

Foreign industrialists considering investment abroad, particularly those looking for a manufacturing base within the European Economic Community (EEC), should seriously consider the incentives that Ireland offers to foreign investors. A number of factors combine to provide a unique and attractive investment opportunity for overseas companies to develop and expand international markets from Ireland, and to achieve a high rate of return on those investments:

(1) Close, convenient, and duty-free access to the EEC market consisting of approximately 300 million people;

(2) An educated and adaptable English-speaking labor force, supported by a well-developed and flexible industrial training system;

(3) A stable political and business environment, in which the poli-

cies of successive Irish Governments since the mid-1950s has been attractive to overseas investors;

(4) A competitive cost structure relative to other European locations; and

(5) Generous tax and grant incentives.

These factors provide foreign investors with low start-up costs, competitive operating costs, and the opportunity for high profitability. Independent studies conducted by the United States Department of Commerce on the profitability of United States companies overseas confirm that the rate of return in Ireland has been consistently higher than that in any other EEC country. In the five years prior to 1982, the average return on investment in Ireland was 30.7 percent, almost twice the European average and among the highest in the world.[1]

For over twenty-five years, successive Irish Governments have actively sought and encouraged foreign investment in Ireland. With the exception of the insurance industry, Irish statutes grant foreigners the same rights as citizens of Ireland to establish whatever type of business they desire.[2] A minimum native Irish interest in any business is required only for the issue or transfer of shares to, or the establishment of, a business branch operation by nonresidents. Although these transactions require Exchange Control approval, that approval is usually a formality for investments expected to bring an economic benefit to Ireland.[3]

The Industrial Development Authority (IDA), a state agency, is responsible for stimulating and expanding both the manufacturing and the service sectors of Irish industry. The IDA encourages the establishment of projects in Ireland by offering an attractive range of investment incentives to both Irish and foreign entrepreneurs. These incentives include cash grants to defray the cost of fixed assets for approved industrial undertakings.[4] The amount of the grants range up to sixty percent of a fixed asset's cost, depending upon the location and the type of industry.[5] In addition,

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1. U.S. DEP'T OF COMMERCE, ANNUAL BUSINESS SURVEY (1982).
2. Stat. Instr. [SI] No. 115 of 1976 (regulating insurance).
3. Central Bank of Ireland, Exchange Control Reg. 13 paras. 12-13 [hereinafter cited as Exchange Control Reg.].
4. Industrial Development Act, No. 32 of 1969, §§ 33-35 [hereinafter cited as IDA].
5. *Id.* § 6.

the IDA provides grants for the total salary expense of training employees and for approved research and development projects in amounts up to one-half of a project's cost.[6] The IDA also provides per capita employment grants[7] for service industries. In conjunction with these cash incentives, the IDA offers comprehensive assistance to industrialists who set up enterprises in Ireland. This assistance includes selecting and providing sites and factories, systems for worker training, and support services for newly established industrial enterprises.[8]

The single most important factor in attracting foreign industries to Ireland, however, has been its enlightened tax law, which is designed to reward both the producer and the entrepreneur for contributions to Ireland's industrialization and economic growth. This Article will concentrate on the tax aspects of foreign investment in Ireland. Although Ireland is not considered a "tax haven" in the traditional sense of the term, it is a country with favorable tax laws for productive investments that create jobs and assist in Ireland's economic growth.

## II. An Overview of Irish Tax Law

### A. Introduction

William Pitt, former Prime Minister of the United Kingdom,[9] bears the dubious distinction of having first introduced an income tax in Ireland. It was originally implemented as a temporary measure to fund the British war effort against the French in the Napoleonic Wars. The income tax proved to be such a successful method of collecting revenue that it has been retained ever since. Some of the principles set forth in the early acts of 1803 and 1805 remain part of Irish income tax law today.

Until it obtained its independence from the United Kingdom in 1922, Ireland was an integral part of the United Kingdom and was subject to the British tax code. Even after gaining its independence, Ireland adopted the tax law of the United Kingdom with minor modifications, up to and including the Finance Act of

6. *Id.* § 39-40.
7. *Id.* § 2.
8. *Id.* § 15.
9. William Pitt was Prime Minister of the United Kingdom from 1783 to 1801, and from 1804 to 1806.

1922.[10] The tax codes of the two nations have diverged somewhat with the enactment of various Finance Acts by the Irish legislature,[11] but Irish tax law has not strayed too far from basic United Kingdom tax legislation and the two systems remain very similar.

Irish tax law, like that of most other common law countries, is comprised of both legislation and case law. United Kingdom court decisions prior to 1922 form part of the Irish tax law. Although subsequent United Kingdom cases are not binding in Irish courts, where Irish law is similar to that of the United Kingdom, those cases serve as a source of interpretation. Irish tax law regulates both individual and corporate income tax, as well as tax on capital gains, gifts, and inheritances. In addition, Irish tax legislation includes statutes on the value added tax (VAT) and stamp and capital duties on certain transactions.

### B. Income Tax

Except as provided in various tax treaties, all income generated in Ireland is subject to either corporation tax[12] or individual income tax,[13] irrespective of the nationality, domicile, or residence of the income recipient. The only exception to this general rule is that income from Irish Government Stock is tax-free to nonresidents.[14] Foreign income earned by Irish residents normally is subject to Irish tax.[15] Any foreign tax paid on income that is subject to Irish tax law generally is deducted in the computation of Irish taxable income.[16] Where allowed by tax treaties, Irish taxpayers are given credit for any foreign taxes paid.[17]

The following "Schedules" set forth the type of Irish income that is taxed in each "case":

Schedule D:

Case I—income from a trade.[18]

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10. Adaptation of Enactments Act, 1922, No. 2 of 1922.

11. In accordance with the statutory requirement that an income tax be introduced annually, the Irish Legislature has enacted a Finance Act each year since 1923.

12. Corporation Tax Act, 1976, No.7 of 1976, § 8 [hereinafter cited as CTA].

13. Income Tax Act, 1976, No. 6 of 1976, § 52 [hereinafter cited as ITA].

14. *Id.* § 464.

15. *Id.* § 53(e)-(f).

16. *Id.* § 76(1)(b).

17. *Id.* § 361.

18. *Id.* § 53.

Case II—income from a profession.[19]

Case III—Irish-sourced interest income and all types of foreign-sourced income.[20]

Case IV—any Irish-sourced income that is not charged to income tax by any other schedule or any other Case of Schedule D.[21]

Case V—rental or other similar income from interest in real estate situated in Ireland.[22]

Schedule E:

All forms of employee compensation except any such income that is derived from a source outside Ireland.[23]

Schedule F:

Dividends and other distributions from Irish resident corporations.[24]

Each schedule and case has its own rules for determining the amount of income from the various sources that should be included in taxable income for the relevant tax year. For example, employment income[25] and distributions from companies[26] are always included in the total taxable income on the basis of the full amount earned during the tax year in question. Income from trades or professions, however, is normally included in the total taxable income of the year succeeding the tax year in which the income was earned,[27] but there are special rules for particular classes of income arising for the first time[28] or ceasing entirely.[29]

An individual's total taxable income is the aggregate of income earned from all sources, as computed separately under the rules of each relevant schedule or case.[30] Capital gains are not included in total taxable income, but rather are subject to a separate capi-

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19. *Id.*
20. *Id.* § 76.
21. *Id.* § 228; Finance Act, 1970, No.___ of 1970, § 20.
22. ITA, *supra* note 13, §§ 52-108.
23. *Id.* at 83.
24. CTA, *supra* note 12, § 109.
25. ITA, *supra* note 13, § 110.
26. CTA, *supra* note 12, § 83.
27. ITA, *supra* note 13, § 58.
28. *Id.* § 77.
29. *Id.* § 58(5).
30. *Id.* § 1.

tal gains tax which has its own computation rules and tax rates.[31] The individual income tax applies to income earned by individuals in a partnership and to income received from trusts.[32] Although individual shareholders are required to pay income tax on dividends received, a "tax credit" of 35/65ths of the net dividends received from Irish companies may be applied in calculating the individual's overall tax liability.[33]

### C. Corporation Tax

All corporate bodies resident in Ireland are subject to a corporation tax on their profits.[34] Foreign corporations that do not have a branch or agency in Ireland are still subject to income tax on certain types of income earned in Ireland, such as property rents. Irish tax law does not distinguish between limited and unlimited companies, or between private and public companies, but certain closely controlled companies may be subject to a higher corporate tax rate on specific types of undistributed income.[35] With certain exceptions,[36] the computation of taxable corporate income is made for each type of income under the same schedules and cases that apply to individual income taxes, and in accordance with the law applicable to those schedules and cases.[37] Unlike the situation with individuals, capital gains earned by corporations (except gains from the sale of development land) are subject to a corporate tax at capital gains tax rates.[38]

A corporation's tax liabilities are calculated at the end of the company's accounting period, as defined in the Corporation Tax Act.[39] For corporate tax purposes, a company's accounting period may never exceed twelve months. The corporate tax rate applica-

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31. *See* Capital Gains Tax Act, 1975, No. 20 of 1975; (amended 1978); Finance Act, 1982, No.14 of 1982, §§ 29-41.
32. ITA, *supra* note 13, §§ 438-448.
33. 29 CTA, *supra* note 12, § 83.
34. *Id.* § 6; Finance Act, 1982, *supra* note 31, § 26. The maximum corporate tax rate is 50%.
35. CTA, *supra* note 12, §§ 100-101; *see infra* notes 39-44 and accompanying text. [Unless otherwise noted, all future references to £ refers to Irish pounds].
36. The primary exception to the principles of the Income Tax Act is that distributions from other Irish resident companies are not included in income. Other exceptions are highly technical.
37. CTA, *supra* note 12, § 11.
38. *Id.* § 19.
39. *Id.* § 30.

ble to a company's accounting period is based upon the rates applicable during each calendar year. When the rate is changed during an accounting period, the annual rate is apportioned accordingly. The maximum corporate tax rate is fifty percent of a company's taxable income in excess of £35,000. The corporation tax is payable in two equal installments which are generally paid six months and nine months from the end of the accounting period.[40]

The corporate tax on operating profits is measured principally by reference to accounting principles and practice. A company's income accounts are adjusted to reflect certain tax rules: neither capital expenditures nor depreciation of fixed assets is allowed to be deducted from a company's gross revenue as an expense. Extensive tax capital allowances, however, exist for certain types of fixed assets.[41] Ireland imposes no withholding tax on dividends received by a shareholder company. As a general rule, a shareholder company is not taxed on dividends received from an Irish resident company,[42] nor are dividends paid deducted from the taxable income of the paying company.[43]

### 1. *Capital Allowances*

Irish companies may not deduct depreciation expenses in the computation of adjusted taxable income. Companies, however, are granted capital allowances for the purchase of a wide range of assets, such as equipment and machinery, industrial buildings, hotels, ships, scientific research, patents, technical knowledge and mining.[44] Although there are no capital allowances for the acquisition of commercial premises such as offices or retail shops, expenditures on equipment for those locations may qualify.

Allowances for the purchase of capital assets may be classified as "annual," "free," or "initial."[45] As a general rule, road vehicles, whether new or secondhand, and used machinery qualify only for annual allowances.[46] Annual allowances are typically calculated

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40. Finance Act, 1982, *supra* note 31, § 27.
41. ITA, *supra* note 13, § 61; CTA, *supra* note 12, § 11; *see infra* notes 44-51 and accompanying text.
42. CTA, *supra* note 12, § 2.
43. *Id.* § 11.
44. *Id.* sched. 1; Finance Act, 1978, No. 21 of 1978, § 25.
45. CTA, *supra* note 12, sched. 1.
46. *Id.*; Finance Act, 1976, No. 16 of 1976, §§ 31-32.

on the basis of an asset's cost less the annual allowances deducted for that asset in prior years.[47] The annual allowance is calculated in the same manner as the double-declining balance depreciation method under the United States tax code. Other types of new machinery and owner-occupied industrial buildings qualify for free capital allowances.[48] A free capital allowance gives the taxpayer the option of writing off as an annual allowance any portion of an asset's purchase price that is allowed under the particular annual allowance method, up to its full cost in any given tax year. The free capital allowance is available only to manufacturers. To qualify for a free capital allowance, a manufacturer's machinery must be operating or an owner-occupied building must be in use as a factory at the end of the accounting period.[49] If these conditions are not satisfied, a company may claim initial allowances, which are similar to capital allowances, for capital expenditures incurred during the accounting period. A capital expenditure is considered to have been incurred when it becomes due and payable, except in the case of a new business, when capital expenditures are deemed to have been incurred on the first day of the business' operation. Initial allowances on industrial buildings are granted for that portion of the total capital expenditure that remains after deducting the amount of any grants which was directly or indirectly provided by the Irish Government.[50] This restriction does not apply to capital expenditures for machinery or equipment, because initial allowances are granted for the actual cost of those assets. Initial allowances are recaptured at the time of the asset's disposal to the extent that the sale proceeds exceed the depreciated value of the machinery or equipment.[51]

### 2. *Stock Relief*

Irish resident companies engaged in manufacturing, construction, or the sale of machinery and equipment are granted certain tax reliefs for the increased cost of maintaining inventory due to

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47. For example, road vehicle allowances are calculated on a written down value basis of 20%.

48. CTA, *supra* note 12, sched. 1. Free capital allowances are also known as "free depreciation."

49. *Id.*

50. ITA, *supra* note 13, § 255(4)(b).

51. *Id.* § 303.

inflation.[52] These companies are allowed to deduct fifty percent of the appropriate inflationary price increase[53] of the opening inventory asset accounts from that period's taxable income.[54]

### 3. *Relief for Operating Losses*

A corporation's operating losses, which may include unused capital allowances, can be applied against (1) any other income earned or capital gains from the same accounting period in which the loss was incurred; (2) any income or capital gains from the same trade or business that were incurred in the preceding accounting year; (3) any income to be earned in future accounting periods (without time limits), but only against income that was earned in the particular trade or business in which the loss was incurred; and (4) in the case of a "terminal" loss,[55] any operating income from the same trade or business in the three years prior to cessation[56] of that trade or business.

### 4. *Group Relief*

Where one company is a seventy-five percent subsidiary of another, or two or more companies are seventy-five percent subsidiaries of a third company, and all the companies are residents of Ireland, the companies are treated as a "group" for tax purposes.[57] Operating losses incurred in any accounting period by one member of a group may be transferred in whole or in part to another group member. The latter is entitled to apply those losses against any operating income or capital gains earned in the corresponding accounting period.

Under certain circumstances, group relief may also be claimed by a "consortium." A consortium consists of five or fewer Irish resident companies owning all the ordinary shares of stock of another resident company.[58] Each member of a consortium is entitled to a pro rata share of the operating loss of the resident

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52. Finance Act, 1984, No. 9 of 1984, § 49.
53. The inflation rate is currently estimated at approximately 6%.
54. *Id.* § 46.
55. A loss incurred in an accounting period commencing within a period of twelve months of the cessation of the trade or business. CTA, *supra* note 12, § 16.
56. *Id.*
57. *Id.* § 107.
58. *Id.*

company.

### 5. *Branches*

A nonresident corporation trading in Ireland through a branch must pay Irish corporation tax[59] on any income attributable to that branch and any associated capital gains.[60] A foreign corporation is generally considered to be trading in Ireland if it conducts manufacturing operations or enters into contracts and makes deliveries and payments in Ireland.

The net income of a branch is subject to Irish corporation tax at the same rate as Irish resident companies. All expenses, including a reasonable proportion of management expenses incurred by a branch outside Ireland exclusively for purposes of branch trade within Ireland, may be deducted in the computation of a branch's net taxable income or loss. Operating losses of a branch may be deducted or carried forward in the same manner as Irish resident companies.[61] It is important to note that Irish residency is a precondition to the availability of particular tax relief, and that relief may not be available to branch operations.[62]

### 6. *Advance Corporation Tax*

Irish resident companies must pay an Advance Corporation Tax (ACT) whenever a dividend distribution is made.[63] A company's corporate tax liability, however, may be reduced by the amount of ACT paid.[64] Manufacturing companies receive little or no tax credit from the dividends they pay, due in large part to the various tax incentive reliefs discussed in the following chapter,[65] and are largely unaffected by ACT. Foreign investors are not greatly affected by ACT, as branches of overseas companies operating in Ireland are outside of the ACT legislation. Dividend distributions made by a seventy-five percent Irish subsidiary of a nonresident company, whose country has a tax treaty with Ire-

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59. *Id.* § 8.
60. Capital Gains Tax Act, 1975, *supra* note 31, § 4.
61. CTA, *supra* note 12, § 16.
62. For example, Irish residence is a prerequisite for "group relief." *See supra* notes 57-58 and accompanying text.
63. Finance Act, 1983, No. 15 of 1983, § 38.
64. *Id.* § 39.
65. *See infra* notes 80-101 and accompanying text.

land, are also exempt from ACT.[66]

### D. Capital Duty and Stamp Duty

Irish limited companies must pay a capital duty on the issue of capital shares at a rate of one percent of the total value of the consideration received for those shares.[67] A stamp duty of one percent of the value of the consideration given on all transfers of Irish stocks and marketable securities is assessed, while the stamp duty assessed on the transfer of non-Irish stocks or marketable securities is two percent.[68] A stamp duty of six percent of the consideration paid is applied to all transfers of houses, land, and other fixed property in Ireland whose value exceeds £50,000.[69] Lower rates apply for the transfer of property valued at £50,000 or less. A stamp duty is also assessed on leases for a percentage of the annual rent, with the rate determined by the length of the lease. Transfers of real property between companies within a "group"[70] are assessed a stamp duty of two percent of the consideration paid regardless of the property's value.[71] An *ad valorem* duty is also payable upon the execution of other instruments, such as contracts, mortgages, bonds, and annuities.[72]

### E. Value Added Tax

With the exception of insurance, banking, and transportation services,[73] a Value Added Tax (VAT) is assessed on all goods and services supplied in Ireland by a taxable person in the normal course of business.[74] A VAT is also levied on imported goods at their point of entry into Ireland.[75] The standard rate of taxation is thirty-five percent of the value of the goods or services, with a reduced rate of twenty-three percent available for certain goods.[76]

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66. Finance Act, 1983, *supra* note 63, § 47.
67. Finance Act, 1973, No. 19 of 1973, §§ 68-69.
68. Stamp Act, 1891, 54 & 55 Vict., ch. 39, sched. 1.
69. *Id.*
70. *See supra* text accompanying notes 57-58.
71. Finance Act, 1982, *supra* note 31, sched. 1.
72. Stamp Act, *supra* note 68, sched. 1.
73. Value Added Tax (Amendment) Act, No. 34 of 1978, § 24 [hereinafter cited as VAT (Amendment) Act].
74. Value Added Tax Act, No. 22 of 1972, § 2 [hereinafter cited as VAT Act].
75. Finance Act, 1982, *supra* note 31, § 80.
76. Finance Act, 1983, *supra* note 63, § 81.

A taxable purchaser is entitled to a tax credit for any VAT assessed on goods and services purchased. The net VAT due from or refundable to any taxable person must be reported to government authorities bimonthly.

Certain reliefs from VATs are available in the form of a zero rating[77] or an exemption.[78] The principal goods and services entitled to a zero rating include: exported goods; certain transportation activities connected with the export of goods and most food items; footwear and children's clothing sold in Ireland; and services rendered outside of Ireland.[79] An exporting company, therefore, is entitled to a refund of all VATs paid on goods purchased for export.

### F. Machinery of the Irish Tax System

The tax legislation passed pursuant to the Income Tax Act of 1967[80] grants the Irish Government the power to raise revenue, but not to determine the size of a taxpayer's assessment nor to collect those taxes. Irish Government interests are represented by the Inspector of Taxes while a taxpayer may bring disputed assessments before the Appeal Commissioners for arbitration. Under Irish law, a Circuit Court can rehear determinations of the Appeal Commissioners only by application of the taxpayer. If the Inspector of Taxes is dissatisfied with a decision of the Appeal Commissioners, he must appeal to the High Court. Either party may appeal final decisions of a Circuit Court regarding questions of law to the High Court, although Circuit Court decisions on questions of fact are final. A final appeal on questions of law can thereafter be made to the Supreme Court.

## III. Tax Incentives to the Foreign Investor

### A. Introduction

Over the past twenty-five years, Ireland has been highly successful in its efforts to attract foreign investment in the manufacturing industry. The Industrial Development Authority (IDA) has

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77. *See infra* note 79 and accompanying text.
78. *See supra* note 73 and accompanying text.
79. VAT Act, *supra* note 74, sched. 2; VAT (Amendment) Act, *supra* note 73, § 25.
80. For example, the CTA, *supra* note 12, and the annual Finance Acts since 1967 are part of the Income Tax Act.

provided foreign investors with attractive incentives such as government grants, investment expertise, and manufacturing facilities. The primary factor contributing to the rapid industrialization of Ireland, however, has been the provision of generous investment incentives to entrepreneurs through the Irish tax system. The most significant of these incentives has been the Export Sales Relief.[81] Introduced in 1957, the Export Sales Relief provided companies exporting products manufactured in Ireland with a total tax exemption for fifteen years, and a partial exemption for five years, on profits derived from that exporting activity.[82] These exemptions obviously benefited shareholders of those exporting companies whose dividends were paid out of such profits.[83]

Ireland's accession to the European Economic Community (EEC) on January 1, 1973, resulted in this incentive being scrutinized by the EEC Commission under the provision of articles 92 and 93 of the Treaty of Rome.[84] These articles provide that any type of governmental assistance which affords an advantage to exporters in one sovereign state over their counterparts in other sovereign states will not be approved by the Commission. As a result of constant pressure from the Commission to revise its export incentives, Ireland phased out the Export Sales Relief at the end of 1980. Companies that were already exporting goods under the Export Sales Relief, or which had received a commitment from the IDA concerning the availability of the Export Sales Relief, were allowed to continue to claim relief until 1990.[85] On January 1, 1981, a new export tax incentive more acceptable to other EEC member states was made available to Irish industrial companies.

### B. Corporation Tax Rate for Manufacturing

The Finance Act of 1980 guaranteed that the maximum corporation tax would remain at the rate of ten percent of a manufacturer's profits from the domestic or export wholesale marketing of

81. CTA, *supra* note 12, §§ 53-63.
82. *Id.* § 53.
83. *Id.* § 64.
84. Treaty Establishing the European Economic Community, March 25, 1957, arts. 92-93, 298 U.N.T.S. 11.
85. Finance Act, 1980, No. 14 of 1980, § 42.

goods manufactured in Ireland for a period of twenty years.[86] This low incentive rate applies to the period beginning January 1, 1981, and ending December 31, 2000.

### 1. *What Constitutes "Manufacture"?*

Irish tax legislation does not contain a definition of the word "manufacture." The broad test under existing case law is whether the product that emerged from the manufacturing process is distinct from the materials used in that process.[87] Thus, an assembly process, especially a process involving some type of skill, normally qualifies as manufacturing as long as the assembly process is significant in relation to the unit produced. A process designed to preserve goods in their original state, to package goods, or to break up bulk goods does not generally qualify as manufacturing.[88]

Companies engaged in mining or manufacturing processes that use minerals as raw materials are not considered manufacturers under the Finance Act of 1980.[89] The construction industry is also excluded from the benefits of the new reduced corporation tax rate because income earned from "construction operations" does not qualify for the manufacturing exemption.[90] The complex legislative definition of construction operations includes the erection or alteration of buildings and the creation of any structure that forms part of a building. It is important to note, however, that when a company subjects commodities or materials to the process of manufacturing, it is considered a manufacturer for tax purposes, even though it may not own the raw materials or the finished goods.[91]

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86. *Id.* §§ 38-41.

87. There are no Irish cases on the definition of "manufacturing" for purposes of the reduced corporate tax rate. For cases from Northern Ireland and the United Kingdom that have considered the definition of manufacturing for other purposes, see, e.g., McCausland Ltd. v. Ministry of Commerce, 1956 N. Ir. 36; Kilmarnock Equitable Co-op. Soc'y Ltd. v. IRC, 42 T.C. 675 (1966); Guildford Corp. v. Brown, [1915] 1 K.B. 256.

88. There are no objective tests for the term "manufacturing" such as the 20% Value Added Rule under subpart F of the United States Internal Revenue Code. I.R.C. §§ 951-964 (1982).

89. Finance Act, 1980, *supra* note 85, § 50(1)(a).

90. *Id.* § 50(1)(b).

91. *Id.* § 39(2).

### C. Shannon Airport Relief

Even if a company is unable to qualify as a manufacturer in Ireland, it may still obtain the reduced corporate tax rate of ten percent by locating a business operation near Limerick in the Shannon Free Airport Zone.[92] The Shannon zone, Ireland's first and largest industrial park, retains certain investment incentives for entrepreneurs that are not available in any other part of Ireland.

In order to commence business operations within the Shannon zone, a company must first obtain a license from the Department of Industry and Commerce.[93] Licenses are granted to export businesses that have the potential to significantly increase jobs, passengers, and freight at the Shannon airport. The Department of Industry and Commerce particularly seeks companies that plan to (1) repair and maintain aircraft within the Shannon zone; (2) contribute to the use or development of the Shannon airport; and (3) be ancillary or associated with (1) or (2).[94] Having obtained a license and commenced operations in the Shannon zone, a company may apply to the Revenue Commissioners for a taxation certificate that qualifies the business for a ten percent tax exemption on profits earned from that operation.[95] To avoid any conflict with the Treaty of Rome and its prohibition of any governmental aid that might distort competition, the Department of Industry and Commerce subjects any company with fifty or more full-time employees to certain restrictions on the maximum tax relief it may receive.[96]

### D. Design and Planning Services

Companies that provide design and planning services may also qualify for the ten percent corporation tax rate under the Finance Act of 1980 if those services are rendered in connection with chemical, civil, electrical, or mechanical engineering projects executed outside the province of the EEC to a nonmember of the EEC.[97] With the exception of any necessary on-site work, a com-

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92. Finance Act, 1981, No. 16 of 1981, § 17.
93. Customs Free Airport (Amendment) Act, No. 29 of 1958, § 2.
94. Finance Act, 1981, *supra* note 92, § 17(5).
95. *Id.* § 17(2).
96. *Id.* § 17(8)(a).
97. Finance Act, 1980, *supra* note 85, § 38.

pany must perform these services within Ireland to obtain the incentive tax rate.

### E. Exemption of Patent Royalties

Companies and individuals that are resident solely in Ireland are entitled to have all royalty income, and any other income earned from a qualifying patent, exempted from Irish corporation tax[98] or individual income tax.[99] Section 34 of the Finance Act of 1973 defines a qualifying patent as "[a] patent in relation to which the research, planning, processing, experimenting, testing, devising, designing, developing or similar activity leading to the invention which is the subject of the patent was carried on in the State."[100] Income earned from a qualifying patent is defined as "[a]ny royalty or other sum paid in respect of the user of the invention to which the qualifying patent relates and includes any sum paid for the grant of a license to exercise rights under such patent."[101] This exemption is not subject to the manufacturing incentive tax rate time limitation of December 30, 2000.

## IV. Tax Sheltered Financing

### A. Introduction

Ireland's established banking and financial system, and the continued expansion of the Irish economy have contributed to the substantial growth in the number and the type of financial institutions operating in the country. With the exception of brief periods of time during the past ten years, interest rates in Ireland have remained at a higher level than those of its industrial neighbors. The high cost of financing has the potential to inhibit Ireland from achieving its national goals of increased industrialization and prosperity. The Irish tax code, however, has been structured not only to offer special incentives and generous tax allowances, but also to significantly reduce institutional financing costs for the manufacturing and exporting industries. The relative availability of tax relief to Irish manufacturing companies has meant that commercial expense deductions have been of little benefit to those companies. This unique situation has facilitated

98. CTA, *supra* note 12, § 170.
99. Finance Act, 1973, *supra* note 67, § 34.
100. *Id.* § 34(1).
101. *Id.*

the structuring of relatively inexpensive institutional financing.

### B. Financial Leasing

Finance leases are generally used for funding the acquisition of large and expensive equipment and machinery. Under the terms of this type of financing, lease payments cover the cost of the equipment and provide a profit to the leasing company over the term of the lease (usually five years). Throughout the lease period, the lessee is responsible for maintenance and repair of the leased items.

Under Irish tax law, a taxpayer who acquires new equipment and machinery is permitted an allowance for the gross cost of that equipment in its first year of use, and is not required to reduce the allowance by the amount of any grant received from the Irish Government.[102] A taxpayer who pays little or no tax obviously cannot receive the full benefit of these tax allowances. Under the financial lease method of financing, however, any allowances or grants received by a lessor on the purchase of machinery or equipment typically is passed on to the lessee in the form of reduced financing costs. The net effective cost of lease financing to the lessor varies according to the amount of the grant *received*, the total capital allowance taken, and the subsequent effect of those tax incentives on the cash flow of the lessor. Recent quotations received from financial institutions indicate that the net effective cost of lease financing to the lessor ranged from a flat six percent per annum when the lessor received no grants on the purchase of equipment or machinery, to a negative six to eight percent per annum when the grant on the equipment or machinery was forty-five percent of the lessor's cost.[103]

Grant-aided leasing is expensive for the Irish Government as, in addition to the payment of the grant, the tax payments received from the lessor are reduced. Therefore, it is IDA practice to limit the grant-aided leasing by any single lessee to thirty-five percent of the grant-aided cost of new machinery and equipment.

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102. Finance Act, 1971, No. 23 of 1971, § 26.

103. This is an example of quotations received from financial institutions. Financial institutions will only quote interest rates in specific cases; general interest rates are not published. Both interest rates assume a five year primary lease with rent paid quarterly.

### C. Section 84 Loans

Section 84 loans, like lease financing, are of concern primarily to companies with low effective tax rates and little or no taxable profits against which interest expense can be offset. The lending institution, on the other hand, remains liable to pay the full Irish corporation tax rate of fifty percent on all interest earned from conventional loans.

Under section 84 of the Corporation Tax Act,[104] interest earned by a lending institution on certain loans is treated as dividend income for tax purposes. The interest expense incurred on these loans may not be deducted by the borrowing company and the interest income earned on these loans is not taxed to the lending institution. Interest income that qualifies for treatment as a dividend distribution includes any interest earned (a) on a loan, which is convertible directly or indirectly into shares of the borrowing company,[105] or (b) on a loan in which the amount of interest payable to the lender depends upon the financial performance of borrower's business.[106] A conventional term loan may be brought within the scope of section 84 by drafting a special clause that conforms to either or both of the above, while retaining the language of the normal conventional-term loan agreement in all other respects.

As with finance leasing, section 84 loans constitute an indirect national subsidy because the financial lending institutions ultimately pay less tax to the Exchequer.[107] Legislation has been in-

104. CTA, *supra* note 12, § 84.

105. *Id.* § 84(2)(d)(ii).

106. *Id.* § 84(2)(d)(iii)(I).

107. The interest payable on section 84 loans is typically calculated by way of the following formula:

I = A (1-B) + D + X%.

I = The interest payable.

A = The cost of three- or six-month funds on the Dublin Interbank Market.

B = The current Irish corporation tax rate expressed as a fraction.

D = The risk margin required by the lending bank factored by the present value of the future tax relief.

X = .001% of the profits of the borrowing company per annum.

With the cost of funds at 13%, the corporation tax rate at 50%, and the risk margin at approximately 1.75%, the cost of this type of low interest lending in Irish pounds equates to 8.5%. This interest rate compares very favorably with the rate for a conventional five-year term loan, which would be approximately 15.5% for a prime borrower. Conventional term loans typically yield a net retroduced to limit the access to this type of financing and to ensure that section 84 loans are available only to manufacturing companies, companies operating within the Shannon Free Airport Zone, and certain international service companies.[108]

### 1. *Foreign Branches*

The financial benefits of section 84 loans are available only for distributions between one Irish resident company and another.[109] It is important to note that residence requirements for companies under Irish law differ radically from those of the United States. In the United States, a company's place of incorporation is often the factor that determines residency, whereas under Irish law, a company is resident where its center of management and control is located.[110] Branches of foreign corporations, therefore, cannot be resident in Ireland. The use of foreign corporations for structuring investments in Ireland, however, is very popular, particularly with United States corporations.

An example of a suitable way for United States investors to structure their investment in Ireland is by trading through the Irish branch of a foreign holding company. For instance, a Dutch holding company conducting business in Ireland may or may not be considered a resident of Ireland for tax purposes. If a Dutch holding company has other investments or branches throughout Europe, it may not wish to be resident in Ireland. If, however, the sole purpose of the Dutch holding company is to facilitate an Irish manufacturing operation, it may want to establish residency in Ireland for tax and financing purposes. Regardless of whether the Dutch holding company establishes residency in Ireland for tax purposes, the company may still be able to obtain low-cost financing for a project. This could be achieved by having the Irish branch of the Dutch holding company enter into a special partnership agreement with a company incorporated in Ireland. The Irish incorporated company itself could be the subsidiary of a United States corporation, or owned by the Dutch holding company or some other suitable third party. The Irish incorporated company could qualify to receive a section 84 loan and contribute

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turn after tax of 7.75% for the lending bank. Both sides, therefore, gain by utilizing section 84 type financing.

108. Finance Act, 1984, *supra* note 52, § 40.

109. CTA, *supra* note 12, § 2.

110. *See* Swedish Cent. Ry. Co. v. Thompson, 1925 A.C. 495.

the proceeds of that loan to the partnership to use for financing a given project. A share of the partnership profits equivalent to the servicing cost of the loan would then be given to the Irish incorporated company. The partnership would repay the loan to the Irish incorporated company, who would in turn repay the financial lending institution in accordance with the predetermined repayment schedule.

## V. Corporate Structure and Repatriation of Profits

### A. Introduction

One of the fundamental objectives of the Irish tax incentives is to encourage foreign investment in Ireland. This objective is frustrated to some degree when profits or dividends earned on investments in Ireland are subject to taxation in another country. Under Irish law, there is no withholding tax on dividends paid by an Irish company to a foreign investor. The tax treatment of such dividends in the country of receipt depends upon the tax laws of that country and the terms of any tax treaty negotiated between that country and Ireland.

### B. Irish Double Tax Treaties

Ireland is party to a number of double tax treaties which provide that dividends paid out of Irish tax-relieved profits are either wholly or partially exempt from taxation in the country of receipt. These treaties further provide that even if those dividends are taxed, the country of receipt will apply a credit against those taxable dividends as if the full Irish tax had in fact been paid.

Agreements of this nature have been concluded with Australia,[111] Austria,[112] Belgium, [113] Canada,[114] Cyprus,[115] Denmark,[116] Finland,[117] France, [118] West Germany,[119] Italy,[120] Japan,[121] Lux-

111. SI No. 406 of 1983 (Taxes on Income and Capital Gains).
112. SI No. 250 of 1967 (Taxes on Income).
113. SI No. 66 of 1973 (Taxes on Income).
114. SI No. 212 of 1967 (Taxes on Income).
115. SI No. 79 of 1970 (Taxes on Income). In this treaty the exemption refers specifically to the old export sales relief legislation. Difficulties may arise with the 10% manufacturing rate.
116. SI No. 203 of 1964 (Taxes on Income and Capital).
117. SI No. 64 of 1970 (Taxes on Income and Capital).
118. SI No. 162 of 1970 (Taxes on Income).
119. SI No. 212 of 1962 (Taxes on Income and Capital and *Gewerbesteuer*

embourg,[122] the Netherlands,[123] Norway,[124] Pakistan, [125] Sweden,[126] Switzerland,[127] and Zambia.[128] Corporations resident in these countries are able to receive dividends from their Irish subsidiaries and are liable for little or no additional tax in the process. These treaties make it clear that the benefits derived from Irish tax incentives may even be enjoyed by foreign corporate shareholders.

The same benefits do not, however, apply to individual shareholders resident in these countries who are in receipt of dividends paid from the tax-relieved profits of Irish companies. Although some individual shareholders do receive a tax credit, the benefit of the Irish tax incentive relief to individual shareholders is significantly diluted. In most treaty countries, careful tax planning can minimize the negative effect of such dividend dilution.

Even though Ireland's two most important sources of foreign investment are the United States and the United Kingdom, neither country's tax treaties with Ireland provide for the exemption of dividends paid from the tax-relieved profits of Irish companies. Those dividends are fully taxable in the hands of both individual and corporate foreign resident shareholders, with tax credit allowed only for the actual tax paid in Ireland. This restriction has not significantly deterred these countries from investing in Ireland. Although investments from the United Kingdom have tapered off in recent years, the United States remains the largest foreign investor in Ireland.[129] It is important to recognize that as an alternative to receiving tax-relieved profits as dividends, a foreign investor may accumulate these funds in Ireland and use

(Trade Tax)).

120. SI No. 64 of 1973 (Taxes on Income). In the protocol to this treaty there is a time limit on the application of the tax relief which now has expired. Difficulties may arise until the time limit is extended.

121. SI No. 259 of 1974 (Taxes on Income). In this treaty the exemption refers to the old export sales relief legislation. Difficulties may arise with the 10% manufacturing rate.

122. SI No. 65 of 1973 (Taxes on Income and Capital).

123. SI No. 22 of 1970 (Taxes on Income and Capital).

124. SI No. 80 of 1974 (Taxes on Income and Capital).

125. SI No. 260 of 1974 (Taxes on Income). The 10% manufacturing rate poses a potential problem. *See supra* note 115.

126. SI No. 191 of 1960 (Taxes on Income and Capital).

127. SI No. 240 of 1967 (Taxes on Income and Capital).

128. SI No. 130 of 1973 (Taxes on Income).

129. INDUSTRIAL DEVELOPMENT AUTHORITY, ANNUAL REPORT (1982).

those earnings to expand its Irish operations or to invest in third countries.

Under Irish tax law, interest and royalty income earned by nonresidents is assessed a withholding tax of thirty-five percent. With the following exceptions, however, most double tax treaties contain provisions to exempt these payments from any withholding tax:

| | *Withholding from Interest (%)* | *Withholding from Royalties (%)* |
|---|---|---|
| Australia | 10[130] | 10[131] |
| Belgium | 15[132] | 0[133] |
| Canada | 35[134] | 35[135] |
| Italy | 10[136] | 0[137] |
| Japan | 10[138] | 10[139] |

### C. Corporate Structures for United States Investors

United States investors commonly use three basic corporate structures to minimize the overall tax exposure of their Irish investments.

#### 1. *Irish Manufacturing Subsidiary of United States Parent*

An Irish manufacturing subsidiary of a United States corporation is probably the most simple corporate structure that qualifies for the ten percent incentive tax rate until the year 2000.[140] The profits earned by Irish manufacturing subsidiaries can be used both to expand the Irish operation and to invest in overseas affili-

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130. Ireland-Australia Double Tax Treaty, *supra* note 111, art. 12(2).
131. *Id.* art. 13(2).
132. Ireland-Belgium Double Tax Treaty, *supra* note 113, art. 11(2).
133. *Id.* art. 12(1).
134. Ireland-Canada Double Tax Treaty, *supra* note 114. Royalties are dealt with in article 7 of the Ireland-Canada Double Tax Treaty. There are, however, no provisions in the Treaty for a reduction in the withholding tax on interest or royalties received from Ireland. The full withholding rate of 35% applies to interest and royalty income from Canada.
135. *Id.* art. 7; *see, e.g., supra* note 134.
136. Ireland-Italy Double Tax Treaty, *supra* note 120, art. 10(2).
137. *Id.* art. 11(1).
138. Ireland-Japan Double Tax Treaty, *supra* note 121, art. 12(2).
139. *Id.* art. 13(2).
140. *See supra* note 86 and accompanying text.

ates that reside in one of the countries with whom Ireland has signed double tax treaties. In addition, if a United States parent has subsidiaries in other countries with high tax rates, dividends paid from profits of the Irish subsidiary could provide a source of low tax income to absorb any excess foreign tax credits that might be available.

The disadvantage of this corporate structure is that if surplus funds are invested in Ireland, the investment income earned by the Irish subsidiary will be taxed at a fifty percent rate.[141] In addition, if the investment income exceeds ten percent of the total gross income of the company, it will also be taxed in the United States, causing a dilution of the foreign tax credit.[142]

### 2. *Two-Tier Irish Company*

Pursuant to Irish law a company is resident in the country where control over its central management exists.[143] Broadly speaking, a company's residency is deemed to be the place where its directors meet and decide company policy, not necessarily where the company's day-to-day operational decisions are made. A company resident in Ireland is liable for tax on its income earned worldwide, while a nonresident company is liable only for tax on the profits attributable to the branch or agency operations in Ireland and on any income earned from property or rights used or held for such Irish branch or agency.[144]

Under this corporate structure a United States parent corporation may own a nonresident Irish holding company, which in turn owns all the shares of a resident Irish manufacturing company. The Irish resident manufacturing company is required to pay only a ten percent tax on its manufacturing profits.[145] Although profits from the Irish manufacturing company could be distributed as dividends to its nonresident holding company, those dividends would not constitute subpart F income under United States tax law because both companies are incorporated in Ireland.[146]

A nonresident Irish holding company is able to invest the prof-

141. *See supra* note 34 and accompanying text.
142. *See infra* note 148 and accompanying text.
143. *See supra* note 110 and accompanying text.
144. CTA, *supra* note 12, § 8.
145. *See supra* note 86 and accompanying text.
146. *See* I.R.C. § 952.

its from its Irish manufacturing company subsidiary without suffering any direct Irish taxation on such investments because those investments are not attributable to a branch or agency in Ireland. Because the holding company is not resident in Ireland, it will not enjoy the benefits of the double tax treaties and will most likely be subject to a withholding tax on any investment income earned outside of Ireland. The effect of a withholding tax can be minimized by making investments which are exempt from such taxation under the laws of other foreign countries.[147] Investors must remember, however, that whenever a holding company's investment income exceeds ten percent of its total income, that passive income becomes subject to subpart F liability in the United States.[148] The costs associated with using this two-tier structure can be minimized by maintaining the holding company's residency in Ireland as long as the Irish group is in a net borrowing position, and becoming a nonresident holding company only when the Irish group possesses surplus funds.

This corporate structure can be varied slightly by making both the manufacturing and the holding companies nonresidents of Ireland. The advantage of this variation is that the manufacturing company is allowed to have investment income of up to ten percent of its gross income without suffering subpart F liability. Any surplus funds greater than the ten percent limit may be distributed as dividends to the holding company, ten percent of whose income is free from subpart F liability.

### 3. *Foreign Operations in Ireland Through a Branch*

In recent years, it has become very popular with United States concerns investing in Ireland to conduct their business through branch operations. The ten percent rate of taxation on profits realized from manufacturing operations also applies to branches of foreign corporations.[149] Profits earned from manufacturing operations in Ireland are automatically repatriated to the foreign corporation's head office, where those profits may not be subject to taxation depending upon the laws of the country in which the foreign corporation's head office is located. If the profits from Irish manufacturing operations are to be used for passive investments

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147. The interest earned on bank deposits is exempt from any withholding tax in various countries.

148. I.R.C. § 954(b).

149. Finance Act, 1980, *supra* note 85, ch. VI.

such as bank deposits, tax-haven countries like the Cayman Islands or the British Virgin Islands are often selected. If those profits are to be used for third-country investments, corporations have frequently chosen the Netherlands or Switzerland.

The Netherlands is particularly suitable for third-country investment because foreign branch profits earned in Ireland are not subject to Dutch tax due to the "participation privilege" available under Dutch tax law.[150] This participation privilege allows a corporation earning profits that are subject to corporate taxation outside the Netherlands to avoid taxation on those profits in the Netherlands.[151] Although Irish manufacturing profits are effectively tax-exempt in Ireland, for purposes of the participation privilege those profits are subject to tax in Ireland, and, accordingly, no Dutch tax is assessed.

In addition to foreign branch profits, certain dividend income received by Dutch companies also qualifies for the participation privilege. To qualify, the recipient company must be a Dutch resident taxpayer and must have continuously held at least five percent of the issued capital of the company paying the dividend since the beginning of its taxable year. The paying company must be subject to income tax in the foreign country and the investment must not qualify as a passive or portfolio investment in the Netherlands.[152]

This participation privilege allows a Dutch company to invest in shares of other companies without incurring Dutch taxation on the resulting income, provided that the investment meets the requirements outlined above. The position of a Dutch company with respect to the United States Internal Revenue Code, subpart F, is also favorable because foreign earnings may constitute ten percent of its gross income without coming within the scope of subpart F.[153] The Netherlands extensive matrix of double tax treaties is an added advantage of such an arrangement.[154]

There are two disadvantages of the Dutch participation privilege. First, surplus funds deposited in Holland are taxed at forty-

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150. *See* 1969 Corporation Tax Act (Neth.) art. 13.

151. *Id.*

152. *Id.* art. 13.6.

153. I.R.C. § 952.

154. The Netherlands has thirty-five double tax treaties. 7 EUR. TAX SERV. (Int'l Bureau of Fiscal Doc.).

eight percent by the Netherlands.[155] Second, a Dutch company or branch is obligated to file tax returns in the Netherlands[156] and is required to convert its balance sheet accounts into Dutch guilders each year. Any surplus funds derived from this currency conversion may be subject to Dutch tax on the theory that the additional funds did not arise out of activities in Ireland. With careful financial planning and structuring, however, a foreign branch can avoid ending up with any surplus funds after currency conversion.

Another nation suitable for third-country investment is Switzerland. An Irish branch or company incorporated in a suitable canton, such as Zug, pays tax on its capital, but not on income earned in Ireland.[157] One advantage of the Swiss corporate structure over the Dutch participation privilege is that interest income earned in Ireland by a Swiss corporation is treated as normal operating income. The primary disadvantage, however, is that many of the Swiss double tax treaties specifically prohibit foreigners from using Swiss corporations as conduits to obtain reduced rates of withholding tax in a foreign country.[158] It is imperative, therefore, that an Irish manufacturing operation structured as the branch of a Swiss corporation, perform such basic corporate functions as paying a minimum dividend in order to avoid being labeled as a mere conduit.

## VI. Currency Exchange Control Consideration

### A. Introduction

Currency exchange control in Ireland is administered by the Central Bank of Ireland. The main commercial banks have been designated "authorized dealers" and delegated the authority to supervise daily currency exchange transactions.[159] The administrators of Irish exchange control take a very commercial view of currency transactions, and foreign investors typically encounter little difficulty in obtaining the approvals necessary to allow their

155. 1969 Corporation Tax Act (Neth.).

156. *Id.*

157. Canton of Zug - Capital Tax. Switzerland is divided into Cantons that are similar to states in the United States. Each Canton has its own laws, including those on taxation, and Zug has the most favorable tax laws for foreign-owned holding companies.

158. Decree on the Abuse of Double Taxation Treaties (1962) (Switz.).

159. Exchange Control Reg. No. 2, para. 2. Exchange Control Regulations are promulgated by the Central Bank of Ireland.

Irish operations to function effectively. The primary exchange control regulations affecting overseas investors are described below.

### B. Residence

Any company incorporated in Ireland, regardless of its status for tax purposes, is considered to be a resident of Ireland for currency exchange control purposes.[160] The branch of a foreign corporation operating in Ireland is also considered to be a resident of Ireland for exchange control purposes.[161] Individuals are considered residents only if they have lived in Ireland for more than three years or are currently residents and intend to remain in Ireland for more than three years.[162]

### C. Control on Direct Investment in Ireland

Nonresidents must obtain Central Bank approval to invest in a private Irish company, to purchase an interest in an Irish partnership, or to establish a foreign branch in Ireland.[163] Central Bank approval is readily obtained if the investment appears likely to benefit the Irish economy, such as providing additional employment or increasing foreign earnings. Nonresidents, however, must obtain equity or loan capital from sources outside Ireland to finance the purchase of fixed assets unless they are residents of an EEC country.[164]

### D. Foreign Currency Loans

All Irish residents, whether individuals or companies, must obtain permission from the Central Bank to borrow any type of currency from nonresidents or to accept loans in foreign currency from any source.[165] Permission is readily given for foreign denominated loans that have a productive purpose. Companies resident in Ireland that are owned and controlled by nonresidents, however, may not borrow Irish pounds from a bank in Ireland without permission of the Central Bank, although that permission is

160. Exchange Control Reg. No. 1, para. 8.
161. *Id.*
162. *Id.*
163. Exchange Control Reg. No. 13.
164. *Id.*
165. Exchange Control Reg. No. 4, para. 57.

also easily obtained.[166]

## E. Repatriation of Profits

Investors that have been granted permission to repatriate profits are also guaranteed any interest or surplus funds obtained from the liquidation of foreign branches in Ireland.[167] In order to repatriate dividends, a foreign-owned company or branch in Ireland must have sufficient undistributed profits available to cover the dividend.[168] If for tax reasons the parent company prefers to repatriate profits through intercompany loans, the Central Bank will usually grant its permission. These loans may then be repaid in accordance with the repayment schedule approved at the time of the original exchange control consent. The payment of royalties to nonresidents also requires permission of the Central Bank, but this permission is readily obtained as long as the royalties are not excessive.[169]

## F. Imports and Exports

The Central Bank usually grants the required approval for all payments to overseas suppliers provided that all the necessary supporting documentation is supplied to the Central Bank prior to the approval request.[170] Credit terms for exports should not normally exceed six months unless specific permission has been obtained from the Central Bank.[171]

## G. Foreign Currency Accounts

Entities resident in Ireland are required to convert all surplus foreign currency funds into Irish pounds unless specific approval has been granted to maintain funds in foreign currencies.[172] The Central Bank will usually grant approval if the applicant can establish that there will be a substantial two-way flow of the particular foreign currency in terms of the value and the number of transactions.

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166. Exchange Control Reg. No. 7, para. 24.
167. Exchange Control Reg. No. 13, paras. 24-25.
168. *Id.* para. 24.
169. *Id.* paras. 28-30.
170. Exchange Control Reg. No. 4, paras. 12-13.
171. *Id.* para. 22(b).
172. Exchange Control Reg. No. 1, para. 10.

## VII. Taxation of Foreign Expatriates

### A. Introduction

The establishment of an overseas project in Ireland will often require expatriate corporate executives to reside in Ireland, thus, bringing these individuals within the scope of Irish personal income taxation. Although the effective level of Irish income taxation is high by international standards, careful planning can minimize the negative effects of taxation on the foreign corporate expatriate.

### B. Residence and Domicile

Two important elements in the determination of an individual's Irish income tax liability are residence and domicile. In general, a nonresident is only liable for Irish tax on income earned from Irish sources.[173] A resident individual's tax liability may also be reduced if that individual is not domiciled in Ireland.[174]

An individual is regarded as resident in Ireland for Irish tax purposes in any year in which: (1) the taxpayer has a dwelling place of any kind available for his use and is physically present in the country for one or more days; or (2) if no dwelling place is available for use, the taxpayer spends more than 183 days in the country; or (3) the taxpayer is physically present in the country for more than ninety days in each of four consecutive years.[175]

Domicile under Irish law involves a concept of permanence by broadly recognizing the individual as being domiciled in that country in which his permanent home is situated and to which he intends to return irrespective of where he may temporarily reside and work. While an individual's residence may vary from year to year, an individual's domicile changes only under exceptional circumstances. An individual has a "domicile of origin" in the country in which his father was domiciled on the date of the individual's birth. After attaining majority at the age of twenty-one, a different "domicile of choice" may be obtained if the individual makes his permanent home in another country and does not intend to return to the country that is his domicile of origin.[176] A

173. ITA, *supra* note 13, §§ 199-206.
174. *See infra* notes 175-77 and accompanying text.
175. ITA, *supra* note 13, § 206.
176. For a helpful description of the concepts of domicile of origin and domicile of choice, see, for example, *In re* Estate of Iowa, 192 Iowa 78, 182 N.W. 227

foreign expatriate taking up employment in Ireland for a period of years, but intending to go abroad again when his employment in the country is completed, does not normally acquire an Irish domicile of choice regardless of the length of his stay.

On the assumption that a foreign executive is resident but not domiciled in Ireland, he will pay Irish tax on all income earned from Irish sources, all income earned from United Kingdom sources, and all other foreign-sourced income remitted to Ireland.[177] This scheme is commonly known as the remittance basis of taxation.

## C. Rates of Irish Personal Income Tax

The tax planning strategy for United States expatriates working in Ireland prior to 1981 was to reduce Irish income taxes to a level where the taxpayer could avoid paying Irish income tax in excess of the maximum amount which could be applied as a credit against his United States tax liability. The Foreign Earned Income Exclusion[178] subjected Irish-sourced earnings only to Irish, and not United States income tax. The primary emphasis in Irish tax planning continues to be maintaining Irish income taxes at their lowest possible level.

The table below illustrates the tax payable at different levels of income. For comparative purposes, the table also shows the equivalent United States tax, which is significantly lower.

Taxes Payable by a Married Couple with No Dependents.[179]

| Gross Income ($) | Effective U.S. Rate (%) | U.S. Taxes Due ($) | Effective Irish Rate (%) | Irish Taxes Due ($US) |
|---|---|---|---|---|
| 20,000 | 13.0 | 2,611 | 35.2 | 7,200 |
| 30,000 | 16.9 | 5,072 | 44.5 | 13,800 |
| 40,000 | 20.8 | 8,313 | 49.7 | 19,860 |
| 50,000 | 24.0 | 12,014 | 52.7 | 26,360 |
| 100,000 | 33.7 | 33,710 | 58.7 | 58,860 |

The effective Irish rates are higher not as a result of the basic tax rates, the highest of which is sixty-five percent, but because of

(1921).

177. ITA, *supra* note 13, § 76.

178. I.R.C. § 911 (1982).

179. Finance Act, 1984, *supra* note 52, § 283; 1984 U.S. MASTER TAX GUIDE (CCH). One Irish pound equals 1.15 United States dollars.

the relatively low level of allowances and deductions available to individuals under Irish tax law.

### D. Remittance Basis

For Irish income tax purposes, only remittances of foreign income are taxable. Consequently, remittances attributable to capital funds are excluded.

The income of a typical foreign expatriate employed in Ireland is, in large part, made up of employment compensation. Any dividends, interest, or other income received by the individual is not likely to be a material portion of the total taxable income.

To minimize Irish income taxes, an expatriate should structure a portion of his employment compensation as non-Irish-sourced income. This may be accomplished by having the foreign-based corporation retain the expatriate as an employee and paying at least part of the individual's compensation into a non-Irish bank account. Unless the expatriate is required to remit all foreign-sourced compensation to Ireland, this payment structure will reduce Irish tax liability.

Some United States corporations with Irish operations keep their Irish-based United States employees on the payroll of the United States parent corporation. Others operate under the "split payroll" concept, in which the expatriate is employed by; and derives compensation from, both an Irish affiliate and a non-Irish corporation. The individual is taxed on the full amount of compensation paid in Ireland plus any compensation paid outside the country which is remitted to Ireland. From an Irish tax viewpoint this split payroll structure is acceptable provided that a genuine contractual relationship exists between the expatriate and the non-Irish corporation.

### E. Capital Gains Tax

Taxation of capital gains realized from the sale of assets was first introduced in Ireland on April 6, 1974.[180] In calculating the taxable gain on the sale of an asset acquired prior to that date, the gain is computed on the basis of the increase in value from that date to the date of disposition.[181] The basic capital gains tax rate is forty percent, with higher rates applied against short term

180. Capital Gains Tax Act, 1975, *supra* note 31, § 3(2).
181. Capital Gains Tax (Amendment) Act, 1978, No. 33 of 1978, § 3(2).

capital gains[182] and gains from the sale of development land.[183]

In calculating the taxable gain on the sale of an asset held for more than twelve months, the base cost of the asset is adjusted upwards by an index multiplier to remove the inflationary element in the gain.[184] The index multiplier is based upon the proportionate inflationary increase in prices measured by the Irish Consumer Price Index. The same multiplier is applied regardless of whether the asset is situated in Ireland or elsewhere.

Individuals resident in Ireland are liable for a capital gains tax on profits realized from the sale of any property or assets not specifically exempted by Irish tax law.[185] It is important to note that any gain which is included in the computation of individual or corporate income, and which is subject to Irish income tax, is excluded from capital gains tax liability. Individuals not resident in Ireland may still be liable for capital gains arising from the disposal of certain specified Irish assets, including land and buildings located in Ireland, mineral rights in Ireland, assets used for the purposes of a trade carried on in Ireland through a branch or agency, and unlisted shares of stock that derive their value from land, buildings or mineral rights in Ireland.[186]

Individuals who are resident, but not domiciled in Ireland are taxable on (1) capital gains on the disposal of assets situated in Ireland at the time of sale; (2) capital gains on the disposal of assets situated in the United Kingdom at the time of sale; and (3) monies remitted to them in Ireland from capital gains realized on the disposal of assets situated outside Ireland or the United Kingdom.[187] The most important exemption from the Irish capital gains tax is probably the gain realized from the sale of an individual's principal, private residence, including any gardens or grounds up to a maximum area of one acre.[188] An exception is made to this exemption if the price paid for the residence or property reflects significant development potential. The portion of the gain realized from the sale that is attributable to the development potential will be subject to capital gains taxation.[189]

182. Finance Act, 1982, *supra* note 31, § 30.
183. *Id.* § 36.
184. Capital Gains Tax (Amendment) Act, *supra* note 181, § 3 & sched. 1.
185. Capital Gains Tax Act, 1975, *supra* note 31, § 4.
186. *Id.* § 4(2).
187. *Id.* § 4(3).
188. *Id.* § 25.
189. Finance Act, 1984, *supra* note 52, § 67.

### F. Capital Acquisitions Tax

The Capital Acquisitions Tax Act consists of a gift tax and an inheritance tax. A nonresident, or the estate of a nonresident, is generally liable for this tax only if (1) the nonresident makes a gift of Irish property, except Irish Government Stock; or (2) the nonresident makes a gift of any property under a legal contract governed by Irish law; or (3) Irish property is inherited from the estate of the nonresident upon his death.[190] Only gifts whose value exceeds certain tax-free thresholds will be taxed. A separate, lifetime, tax-free threshold applies for gifts between a donee and specific classes of donors. The threshold for a gift from the donor class consisting of parents, spouses and children is £150,000, while the thresholds for other relationships is far lower.[191] An acquisitions tax is levied on gifts or inheritances valued in excess of the tax-free threshold at progressive rates ranging from fifteen to fifty-five percent.[192]

190. Capital Acquisitions Tax Act, 1976, No. 8 of 1976, §§ 6, 12.
191. Finance Act, 1984, *supra* note 52, § 111A.
192. *Id.* § 111B.