Company Residence and Double Taxation

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Background
The rise and expansion of multinational enterprises has been a feature of the globalisation of markets. Increasingly companies are transacting business across international borders. From a taxation perspective, the issue arises as to where profits are earned and where they are taxed. The residence of a company is an important factor since residence will give a country taxing rights over a company's profits. Double taxation agreements exist between countries as a means of deciding, in which country a company will suffer taxation and to avoid a company being doubly taxed in two countries.

Company Residence
Where a company, which is:

1. Managed and controlled in the State or
2. Incorporated in the State after February 1999 (subject to certain exceptions).

The company is regarded as resident in the State for corporation tax purposes.

The concept of ordinary residence or domicile does not exist, In relation to companies.

Managed and Controlled

Where the management and control of a company is located is essentially a question of fact. The concept of central management and control is directed at the highest level of control of the business of a company and is not determined by the place where the main operations of the business are carried on. Instead, it is the place where the directors of the company meet that usually determines where central management and control is exercised since this is the place where policy is formulated and key decisions taken. Consequently this is most likely to be the place where the company is resident. However, this is not necessarily conclusive since the board of directors may, in fact, be simply carrying out the instructions of others. In such circumstances, it may be necessary to look to other tests. In general the tests would include:

The place where:

- Directors' meetings held.
- The majority of directors reside
- Important company policy is determined.

- Major contracts are negotiated and concluded
- The company seal, minute books, share register and other books of the company are kept.
- The company accounts are made up and audited.
- The bank accounts of the company are kept.
- The shareholders' meetings are held.
- The company's head office is located.
- Dividends are declared.

A number of these factors, taken together, will normally indicate the place of central management and control although obviously some of the issues will carry greater weight than others.

Exceptions to Incorporation Rule

The rule in relation to Incorporation does not apply if the company carrying on a trade (or a company related to a company carrying on a trade) in the State, provided it is:

- Controlled by persons (including another company) resident in an EU Member State or a country with which Ireland has a tax treaty, or
- A company (or by a company related to a company) whose shares are traded on a recognised stock exchange in an EU country or a country with which Ireland has a tax treaty.

Students will not be expected to know the definition of a “related company”.

If the incorporation rule does not apply, then the company is not resident unless it is managed and controlled in the State.

For example, Okay Ltd. is incorporated in Ireland. John and Mary Okay own 100% of the shares. The company carries on a trade in Ireland but is managed and controlled in the UK. Okay Ltd is not resident in Ireland.

Effect of Company Residence

An Irish resident company is liable to Corporation Tax in respect of its worldwide profits. This means that if a company is resident in Ireland and has branches in, for example, Germany and/or the UK, then it is liable to corporation tax in Ireland on the profits it makes in those countries. The profits it earns in those countries will, in all likelihood, also be taxable in the country where the profits arose and therefore double taxation may arise.

Relief is available if profits are taxable both here in Ireland and in the country in which the profits were made.

The relief from double taxation generally takes the form of

1. Credit for foreign under a double taxation agreement
2. Exemption of the income from taxation in one of the two countries
3. Unilateral relief.

Non Irish Resident Companies

Non-Irish resident companies will only be chargeable to corporation tax, in Ireland, if they carry on a trade in Ireland through a branch or agency. In such circumstances, profits earned in Ireland (including chargeable gains) will be charged to tax in Ireland under corporation tax. A company that has Irish income and gains but which does not carry on a trade in Ireland through a branch or agency may be liable to tax on income and gains earned here under Income tax and Capital Gains Tax.

Example

Bulldog Ltd. is a UK resident company that has a branch of its business in Mullingar. The branch carries on a trade of manufacturing golf balls. Bulldog is chargeable to corporation tax, in Ireland on the profits from its Mullingar branch. It must be noted that all its Irish Income would fall to be taxed under Corporation tax, not just the trade income.

Example

Wildcat Ltd is a UK resident company. Its only activity in Ireland is that it rents a property it owns, in Drogheda, to an Irish company. Wildcat is chargeable to Irish Income Tax on the rental income. If it sold the property, Wildcat would be chargeable to Capital Gains Tax on the gains arising.

Double Taxation Relief.

Ireland has entered into over 40 double taxation agreements with other States and that number will continue to grow.

Students will not be expected to know the countries with which Ireland has entered into a double taxation agreement. Where relevant, exam questions will clearly state, whether or otherwise such an agreement exists.

Relief as a credit

To calculate the amount of credit due for foreign tax the following steps are taken:

1 Determine the amount of the foreign income. In arriving at this figure, it is the rules applicable under Irish tax law that must be used to decide the assessable amount. Where differences arise in the computation of income under Irish or foreign legislation, students will be advised of those differences and the adjustments to make.

2 Establish the amount of foreign taxes paid on the foreign income.

3 Compute the foreign effective rate of tax [foreign tax / gross foreign income assessable under Irish legislation].
4 Determine the Irish effective rate [Irish tax / total profits].
5 Gross up the net foreign income at the lower effective rate.
6 The amount of the credit is
   - The regrossed amount minus the net foreign income, or
   - The amount by which the net foreign income has been grossed up.

Example

1	Foreign income	20,000	
2	Foreign tax	4,000	20%
3	Foreign effective rate	20%	
	Foreign income	20,000	
4	Irish tax @25%	5,000	Irish effective rate 25%
5	Gross up at lower rate	20,000	(20,000-4,000X100)/(100-20)
6	Credit for foreign tax paid	4,000	
	Net Irish tax due	1,000	

It is important to note that the amount of the Irish credit in respect of any foreign profits can never exceed the amount of Irish tax attributable to those profits (the amount of the credit is limited to the lower effective rate). In practice the Irish effective rate will almost always be lower than the foreign effective rate.

Example

1	Foreign income	20,000	
2	Foreign tax	3,000	30%
3	Foreign effective rate	30%	
	Foreign income	20,000	
4	Foreign tax rate	6,000	As previously Irish tax rate is 25%
	Net foreign income	14,000	
5	Gross up at lower rate	18,666	(14,000X100)/(100-25)
	Irish tax @25%	4,666	
6	Credit	4,666	(18,666-14,000)
	Net Irish tax due	Nil	

Exemption Of Income Under A Treaty

Some income may, under the terms of a treaty, be taxable in one country only.

Example

- The Ireland/UK treaty states that interest derived and beneficially owned by a resident of a Contracting State shall be taxable only in that State.

- The Ireland/US treaty states that royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State may be taxed only in that other State.

Students will not be expected to know specific articles, which grant exemption in one or other country.

Foreign tax as a trading expense

In cases where a double tax treaty is not in force, there can be no credit relief. Foreign tax may be suffered by a foreign branch of an Irish trading company. In such instances where credit cannot be claimed the foreign tax may be deducted from the foreign income in question.

Example

X Ltd. has foreign income from a country with which Ireland does not have a double taxation agreement.

Foreign income	20,000
Foreign tax	4,000
Foreign income taxable in Ireland	16,000
Irish tax @25%	4,000

Branch Profits – assessable under Case III or Case I.

Foreign source income is normally chargeable to tax under case III Schedule D. However, A trade carried on abroad is only taxed under Case III, if all the activities of the trade are carried on outside State and such activities are not controlled and directed from the State. If the owner of the trade is resident here and participates in its conduct either by carrying on some of its activities or by directing it the trade is regarded as partly carried on in the Ireland. Direction need not involve active interference; it may take the form of mere oversight regularly exercised even though actual involvement never becomes necessary. In such instances, the profits of the trade will be taxed under Case I. In practice, it is only in exceptional circumstances that the foreign branch profits of an Irish resident company will be charged to tax under Case III. Students must assume, unless otherwise advised, that the foreign branch profits of an Irish resident company are chargeable to tax under Case I schedule D. This is particularly important, since the rate of tax on income arising under Case I is 12.5%.

Example

Voulezvous Ltd. is a domestic appliance distributor. Apart from the trade that it carries on from its premises in Navan, it also has branches in the UK and Argentina. Its income is as follows:

Trade Navan	800,000
Trade UK	500,000
Trade Argentina	600,000
Interest from Irish bank	10,000
Interest from UK bank	5,000

Ireland has a double taxation treaty with the UK but not with Argentina. Under the Ireland/UK treaty, interest is taxable only in country, in which the company is resident. The UK tax suffered on the trade income was 150,000. No tax was suffered on the UK interest. The tax suffered in Argentina was 210,000.

Case I		
Trade Navan	800,000	
Trade UK (note 1)	400,000	
Trade Argentina (note 2)	390,000	1,590,000
Case III		
Interest from Irish bank	10,000	
Interest from UK bank	5,000	15,000
Corporation Tax	1,590,000@12.5%	198,750
	15,000@25%	3,750
		202,500
Credit Double Taxation Relief (note 1)		50,000
Tax Due		152,500

Note 1

1	UK Foreign income			500,000
2	Foreign tax			150,000
3	Foreign effective rate			30%
	Foreign income			500,000
4	Irish tax rate	12.5%		62,500
	Net foreign income			350,000
5	Gross up at lower rate		(350,000X100/(100-12.5)	400,000
	Irish tax @12.5%			50,000
6	Credit		(400,000 – 350,000)	50,000

Note 2

Argentina Foreign income	600,000
Foreign Tax	210,000
Net Foreign Income	390,000