Irish Tax Institute

Leaders in Tax

Residence Consultation
Capital and Savings Taxation Policy Unit
Economic and Taxation Division
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2

1 August 2012

Response to Consultation on Tax Residence Rules

Introduction

Like any other open economy operating in an international environment, Ireland has had to determine a policy for dealing with the taxation of individuals who are Irish resident and those who are non-resident which meets certain key criteria. The policy must reflect the careful balance that is required between:

a) the need to attract foreign direct investment (FDI);
b) the need to generate tax revenue;
c) the need to create an equitable tax system where both resident and non-resident taxpayers contribute an appropriate amount of tax based on their connection to the State and
d) the importance of being aligned with the OECD international framework for dealing with internationally mobile individuals.

The main tool that the Irish government has used to implement a policy that meets these key needs is the Statutory Residence Test set out in section 819(1), Taxes Consolidation Act (TCA 1997) - see Appendix 1.

(a) Attracting FDI

The importance of FDI to the Irish economy is well-documented and our track record is strong:

- At least 250,000 people in Ireland are employed either directly or indirectly as a result of FDI.
- IDA client companies contribute over half of Ireland's total corporation tax take.
- IDA-supported companies contribute €115bn in exports (over 70% of Ireland's exports).

- In 2011, 13,000 new jobs were created by FDI companies (up 20% on 2010).
- 2011 was the best year in more than a decade for FDI into Ireland, with 148 individual investments.
- 8 of the world's top 10 technology companies have operations in Ireland.
- 9 of the world's top 10 pharmaceutical companies have operations in Ireland.

By their very nature, most FDI projects, particularly in the set-up phase, rely on the involvement of individuals who are employees of the overseas parent organisation and not living in Ireland. Skills, capabilities and specific experience are often required for these projects which are scarce in Ireland and these skills need to be imported; for example, specialist technical or IT skills etc. Investment decisions often require the involvement of senior executives and decision makers from the company headquarters in order to successfully drive the new investment in Ireland.

At present, individuals coming to Ireland can clearly understand the statutory residence test, which is based on the number of days spent in Ireland. They have **certainty** as to whether they will be resident or not in any particular tax year. This certainty is extremely important, as the consequences of becoming Irish tax resident can be significant, both from a cost and administrative point of view.

Most companies investing into Ireland will operate a tax equalisation policy for employees assigned to Ireland. This means that any additional tax that may arise when an employee becomes tax resident will be a cost for the company rather than the employee. The ability to project with some degree of certainty the likely cumulative tax costs for the duration of the assignment is a key decision factor for the overseas parent. As Ireland is now a relatively high tax country, the costs can be significant and uncertainty on this aspect can harm our competitiveness in attracting FDI.

It is important to note that the vast majority of individuals sent on assignment to Ireland in a start-up scenario will be tax resident in Ireland under our existing tax residence rules, as typically such assignments will be for 15 months or more. Therefore they will be liable to tax in Ireland

It is critical that our tax policy on residence enables us to remain **competitive** in attracting this essential talent and provides **certainty** to the individuals and companies affected.

Uncertainty, in these circumstances, will influence and affect the people who are critical to securing the investment for Ireland in the face of intense competition from other countries.

(b) Generating tax revenues for the Exchequer

Irish resident and domiciled individuals are subject to Irish income tax on their worldwide income with a potential credit or deduction for overseas tax paid. However, it is also the case that significant tax revenues are generated in Ireland from non-resident individuals.

Non-residents pay Irish income tax, and in many cases USC and PRSI, on income they personally derive from Irish sources e.g. Irish rents, Irish directorships and certain employments exercised in Ireland. This is a direct contribution they make to the Irish Exchequer. In addition, many non-residents (both Irish nationals and overseas investors) have businesses in Ireland. They contribute jobs and indirectly contribute PAYE, employer's PRSI, VAT and corporation tax – an important contribution to the Irish economy and indeed to particular local regions in many instances.

The UK is currently looking at growth opportunities for the UK economy and has identified UK non-domiciled individuals as a means to increase the wealth and economic condition of their country. UK policy makers are specifically targeting this non UK domicile market for further business investment into the UK. In fact it is reported that many French investors are currently very focussed on the UK market, in light of increasingly high taxes in France. It is also interesting to note the focus of the current UK consultation on a statutory definition of tax residence. One of its specific aims is to encourage wealthy international non-domiciled investors to spend more time and money and create more jobs in the UK economy, as noted by the UK Chancellor:

> *"...provide a significant new incentive for non-domiciles to invest in the UK and simplify the rules to reduce administrative burdens. The current rules discourage non-domiciles from bringing their income or capital gains to the UK, creating barriers to potential investment in the UK economy. The Government's aim is to remove these barriers so that non-domiciles are encouraged to invest in UK business, contributing to its priority of generating growth and rebuilding the economy."*

More wealthy non-domiciled investors could bring much needed capital to Ireland; investing in our property market, spending money in our economy etc. They have a major contribution to make to economic recovery and we should recognise this contribution and welcome it as the UK are currently doing.

(c) An equitable tax system where both residents and non-residents contribute an appropriate amount of tax based on their connection to the State.

As well as supporting FDI and maximising the return to the Exchequer from non-residents, a good tax policy must ensure that residents and non-residents are treated fairly, where both contribute an appropriate amount of tax based on their connection to the State. Indeed it is also important from an EU perspective, and in the context of best practice internationally, that non-nationals are treated no less favourably than Irish nationals in applying tax rules.

Looking at our existing residence regime, a non-resident is fully taxable on income earned in Ireland (as outlined above) and this income is determined using all the same rules that apply to Irish residents. They receive no favourable tax treatment as regards how they are taxed on Irish-source income. In fact, they are generally not entitled to the personal tax credits and reliefs which are available to residents.[1] Furthermore, they may be subject to withholding taxes which do not apply to residents, for example, non-resident landlords may be subject to withholding tax on rents paid directly to them, unless they appoint a collection agent in Ireland.

While a non-resident is not subject to Irish tax on non-Irish source income this does not mean that the income escapes taxation. Because of the way that international taxing rights operate, this overseas income will be subject to tax in another jurisdiction which has taxing rights over such income. Where for example, a resident of France has Irish source income he/she will pay French tax on their worldwide income, including the Irish source income. Under the terms of the double taxation

[1] However, if certain facts are proven to the satisfaction of the Revenue Commissioners, non-resident individuals can avail of full or partial personal tax credits and reliefs.

agreement between Ireland and France they will be entitled to a credit against their French tax in respect of the Irish tax paid.

(d) Alignment with the OECD international framework

Many non-residents are highly mobile individuals who operate in an international arena and the OECD has developed a framework within which to tax them.

Ireland operates with a framework of 65 double taxation agreements which are based on OECD agreed principles. This means that we firstly apply our domestic statutory residence test to an individual taxpayer in Ireland. If that person is resident in Ireland under our rules, but is also resident of another treaty jurisdiction under their domestic rules, there is a tie-breaker test, which determines which country has the main taxing rights.

The framework for these tie-breaker rules is set out in international OECD guidelines. It is important also to recognise that irrespective of the domestic tax rules in Ireland, in the context of individuals who might operate in more than one jurisdiction, the provisions of the relevant double taxation agreement will determine which country has taxing rights and which country will be required to give credit or otherwise exempt income from taxation. Thus while an individual might not be living in Ireland, if they are tax resident in one of the many countries with which Ireland has a double taxation agreement then that jurisdiction is likely to have primary taxing rights on their personal income and capital gains. The rationale behind this approach is to give the country where the individual is most closely connected the main taxing rights, and to avoid double taxation by the country of residence giving a credit for tax paid in the other jurisdiction.

Other ways of determining residence

Not all countries have a statutory definition such as we do, for determining whether an individual is resident in that country. In some countries such as Canada, each case is decided on its own merits.

The absence of a statutory definition, or indeed a definition that is vague or ambiguous, ultimately leads to an abundance of cases being taken to court for a judgement on residence status. This is a time-consuming and costly process which leads to uncertainty and confusion amongst taxpayers. This has been the experience in the UK in recent years, which has been operating mainly on common law tests, without having a full statutory definition of residence. The tests which have emerged in the UK include day-counting tests, but with supplementary tests such as:

- Family ties,
- Social ties, including membership of clubs and societies,
- Business ties, including being an owner or director of a UK business,
- Property ties including a house or apartment owned or leased, or property held for investment which also provides the individual with accommodation when in the UK,
- The pattern and purpose of an individual's visits to the UK.

HM Treasury's consultation document on the statutory residence test notes that many of the key concepts within the rules are not defined, and this is creating uncertainty. For example, no certainty exists over the concept of coming to the UK temporarily. There is also considerable difficulty

concerning the extent to which an individual can have connections with the UK and still be considered non-resident. There is nothing to indicate the point at which these connections are sufficiently strong to be indicative of residence. Furthermore, there is no guidance as to what weighting should be attributed to the various factors in determining how they influence residence status.

The UK government is currently seeking to address the resultant uncertainty for internationally mobile employees through public consultation on the introduction of a statutory residence definition.

Prior to the introduction of the statutory residence definition in our Finance Act 1994, residence in Ireland was also determined by a combination of case law and legislation. In practice, this led to a significant degree of uncertainty. The following factors were among those which had to be taken into account in determining whether an individual was resident for a particular year:

- Actual residence in the State,
- Place of abode available for use,
- Physical presence, and
- Habitual visits for substantial periods of time.

The uncertainty and complexity of these residence rules were unhelpful in attracting mobile talent and wealth to Ireland.

The policy decision was taken at the time to bring certainty to the position with a statutory days-based test. This test was subsequently tightened in 2009, when the "midnight rule" was discontinued. We now have a workable test which addresses our tax policy needs and the Institute's view is that it would be a retrograde step to change this test and go back to the complexity and subjectivity we had 20 years ago.

Consultation questions

Views sought:

1. **Whether or not, and how, the current day-counting rules should be amended.**

The existing rules are simple and easy to understand and give both individuals and employers certainty as to when an individual is resident or not. With an open economy where so many individuals regularly travel into and out of the country for work or to develop overseas markets, any change in the basic tax residence rules at this juncture would not be desirable and could have unintended consequences for inbound and outbound assignees.

The policy options regarding the current day counting rules would appear to be as follows:

- Reduce the number of days an individual can spent in the State under the "look back" rule before becoming resident or
- Keep the existing day counting rules.

Reducing the number of days

Under current rules individuals can spent;

(a) up to 183 days in any one tax year,
(b) or 280 in aggregate in that year and the preceding tax year

Notwithstanding (b) above an individual who spends less than 30 days in the State will not be resident.

The 183 day rule is applied by most countries in the OECD with many countries having additional criteria to determine if an individual is resident. Some countries like Ireland use a "look back" rule in addition to the 183 day rule while others use more subjective tests like centre of vital interest

If the number of days in the look back rule were reduced from 280 days it is likely more individuals would become tax resident in the State. However this is unlikely to lead to a significant increase in tax revenues for a number of reasons:

1. Many individuals will continue to be exempt from tax due to the terms of double tax agreements.
2. Foreign source income would not be brought within the Irish tax net for non domiciled individuals.
3. Many non-residents working in Ireland are already paying Irish tax if their salary is paid from an Irish employer or if they have Irish source income, so their contribution to the Exchequer would not increase.

Tightening the rules on the number of days could lead to some non-residents reconsidering their Irish based connections and even relocating from Ireland. As such a change in the rules could be counterproductive and result in a loss of revenue to the Exchequer rather than an increase.

In addition, such a change could potentially impact on genuine commercial situations where individuals are assigned abroad either to generate new business opportunities for the Irish company or to gain more experience/skills overseas. If the "look back" test is revised so as to reduce the days test over the two year period, it could have the effect of making some of these individuals resident where they were previously non-resident - thus it could act as a disincentive for people who might otherwise take on an overseas assignment.

Keep the existing day-counting rules

The existing day-counting rules are easy to understand and are an important ingredient in attracting FDI. As changing the rules is unlikely to lead to any significant yield in tax keeping the existing day counting rules would appear to make sense.

2. The appropriateness of citizenship as a basis for taxation

Ireland currently operates a territoriality basis for taxation in line with OECD norms. To our knowledge, the only country that currently applies a citizenship basis for taxation is the US. The test

also applied in Eritrea at one stage and the Philippines operated a citizenship basis until they moved to a residence basis in 1997.

To introduce a taxation regime based on citizenship would be contrary to international norms, would represent a fundamental change in our tax policy and, having regard to the number of Irish nationals working in multinational companies around the globe, would undoubtedly lead to unintended and undesirable complexities for the Irish Diaspora, not to mention the significant administration required for such a system.

We strongly believe that Ireland is best served by operating its residence rules within the best practice guidelines of the OECD framework. We are a small economy by international standards and do not have sufficient critical mass to sustain a residence regime outside this international framework.

3. **Whether or not, and how, the conditions for and/or the range of application of the domicile levy should be changed**
4. **Whether or not the domicile levy should continue in place if the rules for determining residents were modified**

We appreciate that the number of individuals who paid the domicile levy in 2011 was low. As Appendix 2 demonstrates, there are a number of criteria which apply to the domicile levy and one of these criteria is that a person who already pays €200,000 or more of Irish tax is not required to also pay the domicile levy. A number of non-residents do not pay this levy because they are already paying significant Irish income tax.

The criteria for payment of the levy were widened in Finance Act 2012 so that a person is no longer required to be an Irish citizen to pay the levy. This may impact on the numbers paying the levy in 2012.

Other Alternatives

Changes in the residence rules could act as a barrier to wealth creation and investment. At this juncture Ireland needs to be "open for business". It may be useful for Government to consider ways the current environment could be used to incentivise wealth creation and investment in Irish business.

Government could initiate a review of other jurisdictions to identify current trends in ways to attract mobile capital and job creation. The Institute would be willing to assist you with such a review if you wished. It would also be productive to engage in discussions on policy ideas to encourage mobile capital to be invested in Ireland to create jobs and we would welcome the opportunity to have such discussions.

Conclusion

In our view, the current tax residence rules are:

1. Clear and unambiguous and provide very important certainty to mobile international employees and their employers.

2. Meet the economic needs of the country and support our competitive FDI position, which is vital in maintaining and creating new employment here.

3. Fully in line with international best practice.

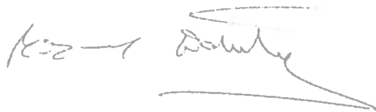
4. Fair and equitable in ensuring that all non-residents are subject to the same stringent rules of taxation on Irish source income.

5. Cost effective for business and the State to administer.

A broad sweeping change to the residence rules could adversely impact both Irish and non-Irish individuals of all income levels who choose to or who need to move in and out of the country to obtain work. This would be a damaging and unsatisfactory outcome for possibly thousands of people.

We are available to meet to discuss these issues at your convenience.

Yours truly



Bernard Doherty
President
Irish Tax Institute

Appendix 1

Statutory Residence Test

Statutory definition of "residence"

There is a statutory definition of tax residence set out in section 819(1), Taxes Consolidation Act (TCA 1997), which, in effect, provides two tests of residence:

1) the current year test: an individual is resident in Ireland if they are present in Ireland for 183 days in a calendar year; and
2) the two-year test: an individual is resident in Ireland if they are present in Ireland for 280 days taking the current and preceding calendar years together.

"Present in the state" for any tax year means

> *"an individual shall be deemed to be present in the state for a day if the individual is present in the state at any time during that day"*

Up to and including the tax year 2008, in computing the number of days in Ireland it was effectively the number of nights spent in Ireland which was relevant i.e. a day was counted if the individual was in Ireland at midnight. However, since the 2009 tax year an individual will be regarded as present in Ireland for a day if here she is present at any time during that day in Ireland.

Ireland does not tax individuals on the basis of their citizenship.

Section 819(1) TCA 1997:

For the purposes of the Acts, an individual shall be resident in the State for a year of assessment if the individual is present in the State-

(a) at any one time or several times in the year of assessment for a period in the whole amounting to 183 days or more, or

(b) at any one time or several times-

(i) in the year of assessment, and

(ii) in the preceding year of assessment,

for a period (being a period comprising in the aggregate the number of days on which the individual is present in the State in the year of assessment and the number of days on which the individual was present in the State in the preceding year of assessment) in the aggregate amounting to 280 days or more.

Appendix 2

Summary of Domicile Levy