

## **Application of Capital Acquisitions Tax to Multi-Jurisdiction Situations**



## **1. Changes for non-domiciliaries on 1 December 2004**

The gift and inheritance tax position of foreign domiciled individuals living in Ireland changed on 1 December 2004.

Finance Act 2000 changed the basis on which gift and inheritance tax is charged. It moved from a system where gift or inheritance tax was charged if the donor was domiciled in Ireland for tax purposes, to a system where gift or inheritance tax is charged if either the donor or the recipient is resident or ordinarily resident in Ireland.

When the legislation was introduced, it provided that, until 1 December 2004, individuals who are not Irish domiciled will not be considered resident or ordinarily resident for tax purposes. Until that date, gifts or inheritances can still pass from one non-domiciled person to another without any Irish CAT consequences.

With effect from 1 December 2004, the position of non-domiciliaries has changed. From this date, a foreign domiciled individual will be within the CAT net if he or she is resident or ordinarily resident in Ireland and has been tax resident in Ireland for the five previous tax years.

### ***Who will this impact on?***

This new rule will have an impact in a number of different circumstances:

1. The concept of domicile exists in Ireland and the UK. The taxation system that applies to foreign domiciliaries is an attraction for foreign domiciliaries being seconded to work in Ireland. For the first time, this new rule puts Ireland at a disadvantage to the UK.
2. Those foreign domiciliaries living in Ireland with a degree of wealth are now considering whether Ireland should continue to be their country of residence if they will be in the Irish CAT system.

### ***Practical Example***

The following examples illustrate the effect the change will have on non-domiciled individuals living in Ireland:

#### ***UK executive commuting to Ireland***

A UK domiciled individual has been working in the Republic of Ireland for the past five tax years. His family has remained in the UK and he commutes over and back to Ireland.

His daughter wishes to purchase a house in the UK and he wants to give her EUR100,000 to purchase the house.

- (a). If the gift of EUR100,000 is made before 1 December 2004, there are no issues as the recipient (the daughter) is not resident or ordinarily resident in the Republic of Ireland, and the donor (the father) is non-Irish domiciled.
- (b). With effect from 1 December 2004, the gift of EUR100,000 is potentially taxable in the Republic of Ireland as the father has been resident in the Republic of Ireland for the past five years.
- (c). If the father were to move to Northern Ireland or return to the UK, the gift could be made without any tax consequences. This is because, although the individual is UK domiciled, there is no gift tax in the UK provided the donor survives at least seven years from the date of the gift.

If the individual's estate is significant, and he wishes to pass it to his children during his lifetime, rather than on death, the proposed changes to the Irish CAT rules could be sufficient impetus for the individual (and his businesses) to relocate to Northern Ireland or Great Britain.

#### *US executive – 5 year secondment*

An executive comes to Ireland for a five year secondment from the US.

The executive is tax resident in Ireland for five consecutive tax years. This means the executive is ordinarily resident from Year 4.

In Year 6 the individual returns to the US.

In Year 6, the individual is no longer resident in the Republic of Ireland but is still ordinarily resident in Ireland.

If the individual dies in Year 6, the individual's entire estate will be liable to Irish inheritance tax because the individual is ordinarily resident in Ireland (and has been tax resident here for the previous five tax years). This will be the case even if in Year 6 the individual is not Irish tax resident, has no Irish assets in his or her estate and leaves his or her entire estate to non-Irish resident and domiciled individuals.

By contrast, an individual does not come within the UK inheritance tax net until he or she has been tax resident in the UK for seventeen out of the previous twenty tax years.

#### *Area of Concern*

The Institute is aware that expatriates living in Ireland, and those planning to come to Ireland are genuinely concerned about the impact that the new rules will have.

At a company level, multi-national companies will view this rule negatively for secondments to the Republic of Ireland because the typical period of secondment (five to seven years) is sufficient to bring executives within the scope of Irish inheritance tax. We believe companies will make direct comparisons with Northern Ireland and

Great Britain where individuals can remain for up to seventeen years before coming within the inheritance tax net.

### ***Recommendation***

In order to present a “level playing field” we suggest that the Irish rules be aligned with those in the UK so that a non-domiciled individual is not considered resident or ordinarily resident for CAT purposes unless they have been resident here for seventeen of the previous twenty tax years (rather than the five year test that is due to come in on 1 December 2004).

This change will, we believe, have limited impact on CAT revenues, as only gifts or inheritances of non-Irish property taken by one non-Irish domiciled individual from another will remain outside the scope of CAT. The cases where this will have application are relatively few, but yet we believe the potential application of Irish inheritance tax to executives on short term secondments will be a deciding factor for multi-national companies deciding whether to locate in the Republic of Ireland.

### ***Second Recommendation***

We have dealt with the issue of the extension of unilateral credit for gifts and inheritances below. We suggest that, at the very least, the application of the CAT rules to non-domiciliaries should be postponed until the limitations inherent in the unilateral system are corrected.

### ***Third Recommendation***

In some cases, it will be very difficult for the Irish State to collect any CAT from a non-domiciled person who is not resident, but is ordinarily resident in Ireland. In such a situation, there may be no Irish presence and no Irish assets. The Institute recommends that consideration is given to the cessation of CAT exposure once the non-domiciliary is no longer resident in the State.

## **2. Capital Taxes – Double Taxation Treaties**

Ireland has two capital taxes treaties, with the US and UK.

### **2.1 Ireland/USA Double Taxation Treaty**

This treaty came into force on 20 December 1951 and applies only to taxes on inheritances.

The treaty operates so that where one country imposes tax because the deceased was domiciled there, on property located in the other country, the first country must give credit for tax suffered in the second country.

For example, a US citizen owns a house in Ireland. He leaves this house to his son, who is resident in the US. The value of the house will be taxable both in Ireland (on the basis that it is situate Irish here) and in the US (as the deceased is a US citizen). The US will give credit for the Irish tax.

#### ***Issue***

If the deceased is deemed domiciled in both Ireland and the US, proportionate credit relief is given. This means that a proportional allowance is made by each territory to such an extent that the total duty payable in both is equal to the greater of the amounts that would otherwise be payable in the two territories separately.

A second example will clarify the point. A US citizen dies in 2005. Although he is US domiciled, he died resident in Ireland, and was resident for five complete tax years preceding his death. As an Irish resident, his entire estate is subject to CAT. As a US citizen, he is subject to US federal estate taxes on his worldwide assets.

As outlined above, the US will give credit for CAT suffered on any Irish situate property. The other assets in the estate may then be subject to a double tax charge. Article V (2) of the Double Taxation Treaty provides for proportionate credit where the tax charge is imposed because the deceased is domiciled in both countries.

However, the deceased did not die domiciled in Ireland, merely resident there. In these circumstances therefore, it is arguable that proportionate credit does not apply, and tax must be paid separately in both Ireland and the US.

#### ***Recommendation***

If the period of time before a non-domiciliary comes within the Irish CAT regime is extended, as advocated above, then this issue will most likely be deferred for future years.

However, resolution will be required either immediately or in future years. In light of this, the Institute recommends that the Ireland/US Double Taxation Treaty is renegotiated to take into account the Irish charge to CAT on the basis of residence.

## ***Second Recommendation***

The Ireland/US DTA applies only to inheritances.

If the treaty is renegotiated, we recommend that consideration should be given to including gifts within its ambit. This would ensure that that treaty is inclusive and has scope to deal with lifetime wealth transfers.

### **2.2 Ireland/United Kingdom Double Taxation Treaty**

This treaty came into force on 2 October 1978. Unlike the US treaty, it applies to both gift and inheritance taxes.

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

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

#### ***Area of Concern***

The rules for determining the state that has the subsidiary taxing rights are contained in Article 5(2). This provides that this is the country where the deceased was not fiscally domiciled under Article 4(2). However, Article 4(2) determines fiscal domicile in circumstances where a person is domiciled in both Ireland and the UK.

As CAT is now imposed by reference to residence and not domicile, there is an anomaly in the rules for determining the State with subsidiary taxing rights in relation to property situated in a third territory.

#### ***Recommendation***

The Institute recommends that the Ireland/UK Double Taxation Treaty is renegotiated to take into account the Irish charge to CAT on the basis of residence.

### **3. Unilateral Relief**

Under S107 CATCA 2003, Revenue are authorised to grant unilateral relief from double taxation where a tax treaty is not in force. This unilateral relief may be granted only in respect of a tax imposed by a foreign state on property situate in that foreign state. Therefore, it applies only to gifts and inheritances of foreign situate property which are subject to tax in two separate jurisdictions including the State.

For example, an Irish individual owns a holiday house in Germany, which he gifts to his son. The individual is resident in Ireland, and so there will be a charge to CAT. As the property is located in Germany, there will also be a charge to German gift tax. Full credit should be given in Ireland in respect of the German tax under the provision of S107.

However, relief is not available if a third jurisdiction is involved.

Continuing the example above, the same donor gifts a painting located in Switzerland to his niece. She is living in Spain. Switzerland will not impose gift tax as the donor is not domiciled there. Ireland will impose CAT as the donor is Irish resident, and Spain will tax the niece as she is a Spanish resident, in receipt of a benefit.

Relief will not be available under S107 as the property is not located in Spain.

#### ***Recommendation***

The Institute recommends that the relief available under S107 is extended to situations where foreign tax is levied on property located in a jurisdiction other than the one in which the donor and donee are resident.

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## **Summary of Recommendations**

### ***Changes for non-domiciliaries on 1 December 2004***

- We suggest that the Irish rules be aligned with those in the UK so that a non-domiciled individual is not considered resident or ordinarily resident for CAT purposes unless they have been resident here for seventeen of the previous twenty tax years
- We suggest that, at the very least, the application of the CAT rules to non-domiciliaries should be postponed until the limitations inherent in the unilateral system are corrected.
- We recommend that consideration is given to the cessation of CAT exposure once the non-domiciliary is no longer resident in the State.

### ***Ireland/USA Double Taxation Treaty***

- We recommend that the Ireland/US Double Taxation Treaty is renegotiated to take into account the Irish charge to CAT on the basis of residence.
- If the treaty is renegotiated, we recommend that consideration should be given to including gifts within its ambit.

### ***Ireland/United Kingdom Double Taxation Treaty***

- We recommend that the Ireland/UK Double Taxation Treaty is renegotiated to take into account the Irish charge to CAT on the basis of residence.

### ***Unilateral Relief***

- We recommend that the relief available under S107 is extended to situations where foreign tax is levied on property located in a jurisdiction other than the one in which the donor and donee are resident.

