The Domicile Levy

Introduction

An area to which Revenue has turned its attention in recent times is liability to the domicile levy. Letters have been received by tax agents asking them to review a client's potential liability to the domicile levy.

The domicile levy was introduced by the Finance Act 2010. In his budget speech on 9 December 2009, the Minister for Finance, Brian Lenihan, said as follows:

> 'Our tax treatment of non-resident individuals is broadly in line with that of most other OECD countries. But we must ensure that every wealthy Irish domiciliary who pays little or no income tax makes a contribution to the State, especially during times of economic and fiscal difficulty.
>
> For this reason we will introduce measures which will impose on all Irish nationals and domiciled individuals, whose worldwide income exceeds €1 million and whose Irish-located capital is greater than €5 million, a requirement to pay an Irish domicile levy of €200,000 per annum regardless of where they are tax resident.'

In the Dáil on 1 June 2010, Joan Burton TD asked the Minister for Finance about the progress of the implementation of the domicile levy, as set out in the then Finance Bill 2010, in particular asking about the numbers who had self-declared to date, the number of non-resident persons who had filed tax returns for 2008 and 2009 and the number of these persons likely to be subject to the levy. The Minister responded commenting on the number of individuals' returns in 2008 which indicated that one or more spouses were non-resident and saying that it was difficult to estimate the numbers which could be liable as some of those would have foreign domiciles.

It is clear from the above that the Government's intention in introducing the levy was to put in place a tax charge for non-resident individuals. Despite the Government's clear intention, the legislation as implemented did not refer to the tax residence of the individual and the Revenue has applied the legislation to all Irish domiciled individuals who satisfy the conditions set out in the legislation including Irish resident individuals.

Conditions to be satisfied for domicile levy to be payable

The domicile levy is payable by an individual for a tax year if the individual satisfies the following conditions in relation to that tax year:

- the individual is domiciled in the State;
- the individual's 'world-wide income' is more than €1,000,000;
- the individual's liability to income tax in the State is less than €200,000; and
- the market value of the individual's 'Irish property' on 31 December is in excess of €5,000,000.

Meaning of 'world-wide income'

The above seems fairly straightforward, or is it? Firstly, there is the definition of 'world-wide income'. TCA 1997, s531AA uses a similar strangely-worded definition to that used for 'relevant income' for the purpose of universal social charge. Subsection 1 provides that 'world-wide income' means an individual's income

'without regard to any amount deductible from or deductible in computing total income, from all sources as estimated in accordance with the Tax Acts and as if any provision of those Acts providing for any income, profits or gains to be exempt from income tax or to be disregarded or not reckoned for the purposes of income tax or of those Acts'

The subsection goes on to say that this calculation is 'without regard' to certain deductions, being deductions in respect of double rent allowance, 'section 23' type relief, and certain donations, and 'having regard to' certain deductions, being deductions for certain maintenance payments. In the case of a non-resident individual the calculation is to be determined as if the individual were resident.

Revenue would interpret the above as meaning that world-wide income is calculated without taking into account deductions for capital allowances and losses (either carried forward or current year losses) however it is far from clear that this is the case. The legislation dealing with relief for capital allowances and losses does not refer to either of these items as being deductible 'from or in computing total income' so there is no reason for it to be concluded that such items are not taken into account in computing an individual's income. Furthermore, looking at the items which for which the legislation states that income is to be calculated 'without regard to' e.g. donations to sports bodies, the fact that income is to be calculated without regard to such a deduction confirms that in the absence of this provision a deduction would be included in calculating the individuals income. TCA1997, s 847A provides that relief is given for a donation within the section to an individual by deducting the donation from any income of the individual. Thus arguably 'worldwide income' is calculated after deducting allowances or losses which may be offset against particular sources of income and only deductions specifically prohibited, i.e. deductions in respect of double rent allowances, certain maintenance payments and donations are not deductible.

Revenue's interpretation would bring within the charge to the domicile levy individuals whose income tax liability has been reduced below €200,000 due to the offset of current year trading profits against other income. Current year trading losses are real losses. An individual with say, rental income and current year trading losses in excess of net rental income actually has no net income for that year. The trading losses are a real cost and not just a tax reducing mechanism.

In the same way, based on Revenue's interpretation, a sole trader's income would be his income before taking into account capital allowances due. Again, capital allowances for a sole trader are just the manner in which relief is given for actual expenditure on capital items. These are actual costs incurred by the sole trader and there is no rational reason why such allowances would not be taken into account in calculating the trader's income.

Liability to income tax

In order for the levy to be payable one of the conditions is that the individual's liability to 'income tax' must be less than €200,000. TCA 1997, s 531AA provides that 'liability to income tax' means 'the amount of income tax due and payable by the individual for the tax year in accordance with the Tax Acts and in respect of which a final decision has been made'. The question is what does 'income tax' mean? As we all know, individuals can have significant USC liabilities. Revenue however would argue that USC is not 'income tax'. Again, however, whether or not USC is 'income tax' is not entirely clear. The Tax Acts mean the Income Tax Acts and the Corporation Tax Acts, and the Income Tax Acts mean the enactments relating to income tax (TCA 1997, s 1). TCA1997, s 3 provides that in the Income Tax Acts, 'tax' means 'income tax'. TCA1997, s 531AM provides that USC is a tax. The argument is quite a circular one in that in order for a tax to be income tax it must be provided for in legislation dealing with income tax! The question is where does the circle begin?

Whether or not USC is 'income tax' is also relevant in determining the final liability to the levy in that the €200,000 levy due can be reduced by the individual's liability to 'income tax'. As we are all too aware, an individual's USC liabilities can be quite significant. The idea behind introducing the levy was to ensure that wealthy individuals pay a certain amount of tax. Not allowing a credit for USC liabilities would seem to be totally contrary to the reasoning behind its introduction.

In addition, the legislation only allows for a credit for Irish income tax and not for any foreign tax paid. The absence of an allowance for a credit for at a minimum income tax paid in EU countries would appear open to challenge under EU law.

Case taken to Appeal Commissioners

We understand that in May 2016 the Appeal Commissioners heard an appeal against an assessment to the domicile levy which included some of the technical arguments outlined above. A decision on this appeal has not yet been published. There is a 21-day period within which the Appeal Commissioners are required to notify the parties of their determination. Their decision must then be published within 90 days of notifying the parties (TCA 1997, s 949AJ). Under the new reformed tax appeals system introduced by The Finance (Tax Appeals) Act 2015, which came into effect from 21 March 2016, there is no time limit within which the Appeal Commissioners must determine an appeal. TCA 1997, s 949AJ simply states that 'as soon as practicable after the completion of their adjudication, the Appeal Commissioners shall determine the appeal'.

Assets held outside a corporate structure

In addition to the fact that the legislation as implemented clearly goes far beyond was what originally intended by Government, the legislation also penalises individuals who hold assets outside a corporate structure.

In order for an individual to become liable to the domicile levy in any particular tax year, the individual's liability to income tax for the tax year must be less than €200,000 and the market value of the individual's Irish property must be in excess of €5 million.

Irish property does not include shares in a company which exists wholly or mainly for the purpose of carrying on a trade or trades and shares in holding companies which derive the greater part of their value from trading subsidiaries. There is no exclusion, however, from the definition of Irish property for property used for the purpose of a trade carried on by an individual as a sole trader or in partnership.

One group of traders which have been particularly penalised are fishermen who own fishing trawlers in their own names. These trawlers, together with the associated tonnage or fishing rights, can be valued at in excess of the €5m which automatically means that such individuals will have the required level of assets to come within the ambit of the domicile levy. If such an individual were to hold the asset through a corporate entity the asset would not be taken into account in determining whether the individual has sufficient assets to be potentially liable to the domicile levy.

Furthermore, in calculating whether an individual's assets exceed the €5m limit no deduction is made for any debts or encumbrances. Thus in the case of our sole trader fisherman, not only are his trading assets taken into account but no account is taken of the borrowings taken out to acquire the trawler in question. Thus a fisherman with a trawler valued at say, €20m who has a corresponding debt of €20m taken out to acquire the trawler will be deemed to have Irish property of €20m and so potentially within the charge to the domicile levy.

The same issue can arise where a sole trader or partnership own a building which is in use for the purpose of the trade. In the current market, the value of many modest properties used for trading purposes can exceed €5m. While one might argue that such individuals still have to satisfy the income test in order to become liable to the domicile levy, the principle remains that individuals are being treated differently depending on whether they carry on their trading activities in their own names or in partnership with others or through a company.

Land dealers

Individuals who carried out land dealing activities in their own names are particularly hard hit by the domicile levy provisions. In determining whether the individual satisfies the €5m asset test, the value of the land held as trading stock is included without taking into account the debts owed by such individuals which in many cases will be far in excess of the value of the land held. If the land dealing had been carried by a company the value of the shares would not in the first instance be taken into account in determining if the individual exceeds the €5m asset test and even if they were taken into account, their value would be nil which would be a more accurate value of the individual's interest in the asset.

Land dealers are also potentially within the charge to the levy when a debt which was incurred in the purchase of land held as trading stock is written off. Such a write-off is treated as a receipt of the trade in the year in which the debt is released. If the debt is released in the same year in which the land is sold and the land has not previously been written down in the accounts of the land dealer, the loss on the sale of the land will be offset against the amount of the debt treated as a trade receipt in calculating the trader's income for that year. Thus even if the debt write-off exceeds €1m, it should not create Case 1 income for the trader of in excess of €41m. If, however, the trader has written down the value of land held as trading stock in a previous year, the write-down will create trading income equal to the amount of the write-down for the trader. While the trader may not have taxable income because the amount of the land written down in previous years will be treated as a trading loss carried forward, as set out above, Revenue's view is that trading losses carried forward are not taken into account in determining whether the €1m income limit is exceeded. So the situation can arise where an individual carrying on a trade of dealing in land has debts exceeding the value of his land and has incurred a loss on the disposal of the land is, Revenue would argue, within the charge to the domicile levy.

Future of the domicile levy

Revenue's annual report does not separately disclose how many taxpayers paid the domicile levy or indeed the yield from the tax. (The annual report breaks down total receipts between the various taxes. There is no separate heading for domicile levy. One speculates that it has been included under the heading 'income tax'!). We understand however that the numbers paying the levy have been quite small, the annual yield therefrom has been less than €2m and that furthermore it has been largely Irish residents who have been paying it.

As a measure to ensure wealthy tax exiles make a contribution to the Irish economy it has been a spectacular failure. Arguably the reason for the low yield has been because existing tax rules are sufficient to ensure that individuals on high incomes pay high levels of taxation so that no charge arises. The High Earner's restriction was introduced to ensure that wealthy individuals who had availed of tax incentives should pay a minimum level of tax. The fact that the State encouraged these same individuals to make these investments using their money rather than State funds was ignored. Accordingly, under normal tax rules there should not be individuals who pay small amounts of tax on high levels of income. The concern is that if there is pressure on for political reasons to increase the yield from the tax, in such circumstances the temptation could be to target individuals who may be brought within the legislation by interpreting its provisions in a narrow manner to bring within the charge to tax individuals who under normal tax rules would not be required to pay tax of €200,000.
There are too many anomalies in the legislation dealing with the domicile levy. As a result of these anomalies the levy would appear to arbitrarily catch some individuals rather than others. If the intention is to make wealthy individuals pay more tax this should be done through the general tax system which taxes all individuals on the same basis.

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