

## **Taxing Foreign Assets**

**Kieran Twomey**

**Twomey Moran**

**7 April 2017**

## 1. Introduction

The world as we know it is getting smaller and more familiar in every way. From an investment perspective, gone are the days when it was rare to have a client with a foreign asset or a foreign investment. Today most tax advisers deal with foreign assets be it property, investment portfolios, bank accounts or holiday homes.

While we saw huge growth in the ownership of foreign assets in the “boom” years followed by a loss of some of those assets in the “bust” years, the reality is that clients continue to hold significant foreign assets today and I have no doubt this will increase going forward.

Whether your client holds;

- foreign property
- a foreign investment portfolio or foreign investments
- foreign bank account
- foreign holiday home,

you will have to deal with the taxation of those foreign assets in an Irish context.

In this paper, I will consider the Irish tax issues that arise for clients with particular types of foreign assets. My focus will be your typical Irish resident, ordinarily resident and domiciled client (the rules applying for Irish resident foreign domiciled clients are outside the scope of this paper).

This paper will consider the common foreign assets that we deal with in our firm and the issues that arise in respect of those assets.

This is a very significant area and for that reason this paper will not cover every point that arises on foreign assets. This paper focuses on three types of foreign assets:

- Foreign investment property
- Foreign investment portfolios
- Foreign bank accounts.

In looking at each of these asset types, there are a few key points that arise in relation to each asset i.e.:

- Can Ireland tax the foreign asset?
- The rules for calculating taxable income or gains in Ireland

- The extent of foreign tax costs
- The relevance of the relevant double taxation agreement
- Getting, or not getting, a credit for foreign tax in Ireland
- The global reporting environment that is upon us.

Throughout the paper I will focus on what I see as being the key question in all of the above and that is “can Ireland tax the foreign asset?”

All legislative references are to the Taxes Consolidation Act 1997, unless otherwise stated.

## 2. Foreign investment property

The first foreign asset I will consider is an apartment in Belfast purchased as an investment in 2006. The details are:

<b>Belfast apartment</b>	<b>GBP</b>
Cost	800,000
Purchased	2006
Bank debt	200,000
Rent - gross	50,000 p.a.
UK taxable rent	40,000 p.a.
Ownership	Jointly owned by husband and wife

In simple terms, the UK tax position is:

- (a) A UK tax return must be filed each year by both husband and wife because UK income tax is charged on the rent.
- (b) In 2015/16 UK income tax was paid on net taxable rent as follows:

	<b>GBP</b>
Husband	1,880
Wife	1,880

- (c) A sale of the property will, since 6 April 2015, be liable to UK capital gains tax with the property being rebased for UK capital gains tax purposes on 6 April 2015.

I will comment later in the paper on UK inheritance tax.

### **What is the Irish tax position?**

The Irish tax position is reasonably straightforward:

- (a) Husband and wife are liable to tax on the rent in Ireland because both are Irish resident and domiciled.
- (b) Article 7 of the Ireland/UK Double Taxation Agreement allows both Ireland and the UK to tax the rent.
- (c) The income is taxed under Schedule D Case III being income from a foreign possession.

*“The taxable rental income is calculated in the same way as taxable rental income from an Irish property with the same deductions and allowances being available”.*

- ### 315. Foreign Rental Income

Foreign rental losses may be offset only against foreign rental profits

- ## What issues arise in practice?

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- **Different tax years**

Ireland and the UK have different tax years, so how do you deal with net rental income and credits?

Revenue have not published anything on this point. For the 2016 Irish tax return our approach is to calculate the net rental income as follows:

- 2015/16 net UK rental income x 3/12
- 2016/17 net UK rental income x 9/12

- **Foreign currency**

How do you convert from GBP to EUR both for net rental income and credit for UK tax?

For the 2016 Irish tax return, our approach is to calculate the credit for UK tax paid as follows:

- 2015/16 UK tax paid x 3/12 - converted to EUR using Revenue published 2016 average GBP/EUR exchange rate
- 2016/17 UK tax paid x 9/12 - converted to EUR using Revenue published 2016 average GBP/EUR exchange rate

- **Irish rules on deductions**

This might be stating the obvious but the calculation of your net rental income must be completed using Irish computation rules, not the UK computation rules.

The big difference is wear and tear. In the UK, up to the 2015/16 tax year, it was possible to claim a wear and tear allowance for residential lettings equal to 10% of the net rent. From the 2016/17 tax year onwards, this wear and tear allowance is no longer available. You may instead be able to claim “Replacement Domestic Item Relief”.

- **Capital allowances**

You are entitled to capital allowances on foreign property in the same way that it applies in Ireland. This is a point that can be easily overlooked. For residential property, this will typically be:

- Furniture and other “loose items”
- Plant and machinery content of the property

- **Rental losses**

If a client has two foreign rental properties and one has a rental loss and one has a rental profit, the Revenue accept that the foreign rental losses taxable under Case III can be set against the foreign rental profit taxable under Case III (see the tax return extract earlier). The Revenue also permit foreign rental losses to be carried forward but only for offset against future rental income.

If a client has a foreign rental loss (Case III) but has foreign dividend income taxable under Case III, is the rental loss deductible against the dividend income? The Revenue will say that it is not deductible, but the rules are silent on this point. I have yet to be convinced that the Revenue position is correct.

- **Sale of property**

The sale of the Belfast property is straightforward from a CGT perspective. However, the issue that arises frequently on foreign property sales is the impact that movements in foreign currency has on the CGT position.

Let me illustrate this point by way of a sale of the Belfast apartment in my example earlier for GBP1million. The client has made GBP200,000 gain before costs so expects to pay in the region of GBP66,000 CGT (before costs, currency conversion and any credit for any UK CGT).

The CGT position is however:

	<b>GBP</b>	<b>EUR</b>
Sale price	1,000,000	1,160,000
(GBP to Euro fx of 1.16)		
Cost	800,000	<u>1,192,000</u>
(GBP to Euro fx of 1.49)		
<b>Allowable loss</b>		<b><u>32,000</u></b>

This tax result can be difficult to explain to clients. It is even more difficult to explain when a commercial loss produces a taxable gain because the currency has moved in the opposite direction to the above example.

The comments above are specific to the Belfast apartment example. However the position does not change significantly with residential property held personally in most other countries.

The one notable exception is countries where a tax is charged in the country of location of the property and that country levies a tax not covered by the double taxation agreement. The prime example of this is the US where each US State levies a state tax in addition to federal tax.

In the case of a US property, you will not get a credit for your state tax. Instead, you will get a deduction for the state tax against your net rental income. In the US, some state taxes are high (California is 13.3%) so this is a significant loss of a credit.

### **Corporate ownership**

The last point on the Belfast apartment is whether the analysis above changes if the owner is an Irish company rather than personal ownership.

From an Irish point of view, the calculation rules and double taxation agreement application remain the same. Obviously, the Irish company will pay corporate tax at 25% and surcharge on undistributable income if the income is not distributed but other than the rates of tax in Ireland there is no significant difference between corporate and personal ownership.

A point I will cover later in the paper is the fact that a non UK corporate owner keeps the asset out of the UK inheritance tax charge.

### **US commercial property**

The second foreign asset I will consider is a US commercial property. This is where it gets a little complicated.

<b>New York Office</b>	<b>USD '000</b>
Cost	15,000
Purchased	2006
Original Bank debt	15,000
Rent roll	800 p.a.
(All net rent reduces bank debt)	
Lease term	10 years
Tenant	CPA firm
Ownership structure	Delaware LLC
Owners	4 individuals – 25% each
	All Irish resident



Distributions to members	None
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Similar to most US commercial property purchases, the property was purchased in a special purpose limited liability company (LLC) governed by the law of the State of Delaware. The LLC has the following features:

- The LLC does not have shareholders, instead the LLC has members, which is similar to shareholders in an Irish context
- The LLC is governed by an operating agreement which is similar to our company constitution (or old articles of association).

### **US tax position**

In simple terms the US tax position is:

- (a) The LLC is a transparent entity for US tax purposes in that it is classified as a partnership. The LLC, which is the owner of the property, is not taxed in the US.
- (b) The members are taxed on the income of the LLC on a look through basis and each are required to file US federal and state tax returns.
- (c) There is a complicated system of tax deductions in the US that has little correlation with the Irish tax rules.
- (d) The US tax rates for this property are typically:

Federal tax income	39.6%
Federal tax gains	20/25%
NY State tax (income/gains)	8.82%

- (e) The asset is within the US estate tax charge, which for a non US resident is expensive.

### **What is the Irish income tax position?**

The 4 LLC members have never received any distributions or payments of any description from the LLC, so in very simple terms there is no income to tax. Is it this simple?

One of the complex questions which arises from an Irish tax point of view is the status of the LLC for Irish tax purposes. This is a complex point deserving of a paper in its own right. I will summarise the position as follows:

- (a) HMRC are on record for a long time stating that a US LLC is opaque for tax purposes and treated as a corporate [see HMRC “Foreign Entity Classification for UK tax purposes” publication].
- (b) It is understood that the Irish Revenue policy is to treat a US LLC as a body corporate.
- (c) A number of years ago, I got a written view from the Irish Revenue on a share for share transaction concerning a Delaware LLC and the Irish Revenue confirmed the following:

*“In relation to a Delaware Limited Liability Company (“DLLC”), I understand that Chapter 18 of the US Limited Liability Company Act provides that there is legal purpose authority for such entities to issue “shares”. Section 18-702(3)(c) of the US Limited Liability Act states that “in a limited liability company agreement, a member’s interest in a limited liability company may be evidenced by a certificate of limited liability company interest issued by the limited liability company”. If the DLLC issues “shares” in this way then I am prepared to accept that these may be regarded as share capital for the purposes of section 586 TCA 1997.”*

- (d) The UK decision in Anson in 2015 has raised a doubt on the treatment of a US LLC as opaque for tax purposes.

#### **George Anson v HMRC (2015 UK SC 44)**

The 2015 UK Supreme Court decision in Anson raises questions over the status of US LLC’s. While the Anson case concerned a claim for a credit for US tax paid on the LLC profits against the income taxable in the UK, the case considered how to treat the LLC in the UK. In brief, the Anson case and decision is summarised as follows:

Mr Anson was resident but not domiciled in the UK for UK tax purposes. He was liable to UK income tax on foreign income remitted to the UK.

He was a member of a Delaware Limited Liability Company ('LLC'), which was classified as a partnership for US tax purposes. He was therefore liable to US federal and state taxes on his share of the profits. Mr Anson remitted the balance to the UK, and was therefore liable to UK income tax on the amounts remitted, subject to double tax relief.

HMRC considered that Mr Anson was not entitled to double tax relief on the basis that the income which had been taxed in the US was not his income but that of the LLC. Mr Anson contended that even assuming that US tax was charged on the profits of the LLC, and that he was liable to UK tax only on distributions made out of those profits, the US and UK tax were nevertheless charged on 'the same profits or income', within the meaning of the UK/US double

tax treaty. He also argued that, as a matter of UK tax law, he was liable to tax in the UK on his share of the profits of the trade carried on by the LLC, which was the same income as had been taxed in the US.

The Supreme Court rejected the first ground, noting that the context of the treaty and its history did not suggest such a wide approach to the concept of income. However, in relation to the second ground, The Supreme Court found that Mr Anson was entitled to the share of the profits allocated to him, rather than receiving a transfer of profits 'previously vested in the LLC'. His 'income arising' in the US was therefore his share of the profits which was the income liable to tax both under US law and under UK law – to the extent that it was remitted to the UK. His liability to UK tax was therefore computed by reference to the same income as was taxed in the US and he qualified for double tax relief.

### **What does Anson change?**

Following the Anson decision, HMRC issued a statement that said:

*“HMRC practice announcement*

*On 1 July 2015 the Supreme Court gave judgement in favour of Mr Anson in the case of George Anson v HMRC (2015) UKSC 44. This case concerns the application of the double taxation agreement with the US to payments received by Mr Anson from a US Limited Company HarbourVest Partners LLC registered in the state of Delaware. Lord Reed delivered the unanimous judgement of the court and he made clear that he relied on the facts found by the FTT, in particular those regarding the rights of Mr Anson that arose from the Delaware LLC Act and LLC agreement.*

*The FTT made findings that the profits of the LLC did not belong to the LLC in the first instance but the members became automatically entitled to their share of the profits as the profits arose and before any distribution. The FTT also found that the interest of a member in the LLC was not similar to share capital.*

*HMRC has after careful consideration concluded that the decision is specific to the facts found in the case. This means that where US LLC's have been treated as companies within the group structure HMRC will continue to treat the US LLC's as companies and where a US LLC has itself been treated as carrying on a trade or business, HMRC will continue to treat the US LLC as carrying on a trade or business.*

*HMRC also proposes to continue its existing approach to determining whether a US LLC should be regarded as issuing share capital. Individuals claiming double tax relief and relying on the Anson v HMRC decision will be considered on a case by case basis”.*

There has been no comment or commentary from the Irish Revenue, so we do not know the Irish Revenue position. One must assume, in the absence of an eBrief or other official comment from the Revenue, that the Revenue position on US LLC's remains the same post Anson.

The Anson decision, assuming it would be followed in Ireland, may mean that some LLC's are not opaque for tax purposes. This is a point that should be considered for LLC's post Anson.

So back to the question I asked earlier. The four LLC members have never received any distributions or payments of any description from the LLC, so in very simple terms there is no income to tax. Is it this simple?

#### **Section 806**

Section 806 is the transfer of assets abroad rule and operates, in certain circumstances, to tax the income of foreign companies and trusts on Irish resident shareholders and beneficiaries.

Section 806 does not apply to the New York office example earlier because of the commercial exclusion in section 806(8). The acquisition of the New York office was a commercial transaction i.e. an investment. The vehicle used to hold the office building was a Delaware LLC, a very common structure used to hold US property. Both the transaction and structure used to hold the property were commercial and not tax motivated. For this reason the two conditions of section 806(8) are met, i.e.

- (a) avoiding Irish tax was not the purpose of the transfer abroad  
and
- (b) this was a commercial transaction not designed to avoid Irish tax.

In the New York office example, the commercial exclusion/non tax purpose exclusion of section 806(8) applies because the transaction was a 2006 transaction. The rules of section 806 on commercial exclusion/non tax purposes were changed in 2007 and are more complex since 2007. (The rules were also changed in 2015 (section 806(11)) to ensure section 806 was not anti-EU).

#### **Sale of the property**

What happens when the office building is sold? For US tax purposes the sale will be subject to US tax and the members will pay US federal tax and New York state tax. If the property is sold for USD25m, the US capital gains tax position will be approximately:

US tax position	USD '000
Sale price	25,000
Cost	<u>(15,000)</u>
Gain	<u>10,000</u>
US federal tax (20%) (ignoring depreciation recapture federal tax rate of 25%)	2,000
New York state tax	<u>882</u>
Total US tax	<u>2,882</u>

#### **What is the Irish capital gains tax position?**

I will consider this by reference to the position since 1 January 2016.

#### **Section 590 TCA 1997**

Section 590 is a capital gains tax anti-avoidance rule and provides that where a non-resident company (that meets certain conditions) realises a capital gain, then that capital gain is taxed on the Irish resident (or ordinarily resident) shareholders of the company. In order to be within the charge to section 590 the non-resident company must be a "close company".

In the example above, the LLC is a company which if tax resident in Ireland would be a "close company". Accordingly, gains made by the LLC, whilst non tax resident in Ireland, are within the rule of section 590 which would subject any gain (as computed under Irish capital gains tax rules) made by the company on a disposal of the assets to Irish capital gains tax.

The gain realised by the LLC is regarded as if it were a gain made by the shareholders in the company, i.e. the gains are attributed to the Irish tax resident/ordinarily tax resident shareholders. The shareholders in the company who are resident or ordinarily resident (and domiciled in Ireland if individuals) are taxed on their proportion or "share" of the gain.

Finance Act 2015 introduced a new exclusion from a section 590 (inserting subsection (7)(aa)) charge where the disposal is made for bona fide commercial reasons and the disposal does not form part of an arrangement one of the main purposes of which is the avoidance of liability to Irish tax.

Any third party sale of the New York property is a bona fide commercial transaction. On this basis, the exception provided under section 590(7)(aa) TCA 1997 means that section 590 would not apply because the sale is a commercial sale.

### **Sales and DTA's**

A point that frequently arises on the sale of foreign properties held in foreign companies where there is a section 590 charge is the extent to which the relevant double taxation agreement overrides section 590 where the foreign company is liable to capital gains tax in its country of residence. This point is less relevant since the introduction of section 590 (7)(aa) in Finance Act 2015.

In the New York office LLC example above, the interaction between the Ireland/US double taxation agreement and section 590 is complex, primarily because of the “look through” treatment applied to the LLC for US tax purposes. Whilst beyond the scope of this paper, the key questions to ask in respect of any double taxation agreement (in the context of section 590) are:

- Does the DTA contain a CGT article?
- Is the asset owner treaty resident in the foreign jurisdiction?
- Does the DTA override section 590 under the CGT article of the treaty?
- If the treaty does not override section 590 can you get credit in Ireland for the foreign CGT?

### **CGT on LLC distribution**

Going back to the New York office example, on a windup of the LLC, the LLC members will be liable to Irish capital gains tax on the net proceeds in the normal way. There is no US tax charge on the windup of the LLC.

In the example above, the LLC will distribute to its members:

	<b>USD</b>
	<b>'000</b>
Proceeds of sale	25,000
<i>Less:</i>	
Bank debt	(15,000)
US tax costs (federal and state)	<u>(2,882)</u>
Net distribution to members	<u>7,118</u>

Irish CGT @ 33%	<u>2,349</u>
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This brings US and Irish tax costs to:

	<b>USD</b>
	<b>'000</b>
US federal tax	2,000
New York state tax	882
Irish capital gains tax	<u>2,349</u>
Total US and Ireland tax	<u>5,231</u>
Commercial gain	10,000
Tax as a % of	<u>52.31%</u>

### 3. Foreign investment portfolio

The second asset I will consider is an investment portfolio with a London stockbroker. The details are:

Broker	London stockbroking firm
Portfolio value	GBP750,000
Set up in	2000
Portfolio type	Discretionary management
Ownership structure	Direct ownership by client
Portfolio charges	1% management fee Normal transaction charges

The portfolio includes the following investments:

- State Street Global Advisers “SPDR S&P 500 ETF” Trust Units
- First State Investments (UK) Stewart Inv Asia Pacific (“First State Asia Pacific”)
- Fidelity Funds SICAV
- UK Gilt Treasury Stock
- Schroder Oriental Income Fund
- Shares in L'Oréal SA, a French company
- Shares in Allianz SE, a German company
- Shares in Lotus NV, a Belgian company.

#### What is the UK tax position?

With the exception of UK inheritance tax which I will deal with later in the paper, there is no UK tax charged on the portfolio. The client is non UK tax resident (being Irish tax resident and domiciled) so there is no UK tax levied on the portfolio nor is there any requirement to file a UK tax return in respect of this portfolio.

#### What is the Irish tax position?

The Irish tax position is:

- (a) The client is taxable on all income and gains from the portfolio because the client is Irish resident, ordinarily resident and domiciled.
- (b) The double taxation agreement with the UK has no application here because the UK are not looking to tax any of the income or gains from the portfolio.



### What issues arise in practice?

The real issue that arises in practice with a foreign investment portfolio is determining the tax status of the different assets held in the portfolio (the same problem arises for an Irish portfolio). The income and gains that arise from a portfolio such as this can have a different tax treatment depending on the asset type i.e.:

- Dividends are taxed as dividend income in the normal way but certain dividends can receive a credit for underlying tax
- Capital gains on capital gain assets are subject to capital gains tax in the normal way
- Certain ETF's are subject to capital gains tax not exit tax
- Certain investment funds are subject to exit tax currently 41%
- Certain funds are subject to normal income tax rates.

The following table summarises the tax status of each of the investments in the portfolio.

Investment	Investment type	Irish tax status	Statutory reference	2017 max tax rate
SPDR S&P500 ETF	ETF subject to CGT	CGT	S.28	33%
First State Asia Pacific	EU fund	Exit tax	S.747D & S.747E	41%
Fidelity Fund SICAV	Offshore distributing fund	IT / CGT	S.747A	55% / 40%
UK Gilt Treasury Stock	UK Government bond	IT / CGT	Schedule D Case III S.28	55% / 33%
Schroder Oriental Income Fund	Offshore fund - bad	IT	S.745 (1)	55%
L'Oréal shares	Shares in French Company	IT / CGT	Schedule D Case III *	55% / 33%
Allianz SE shares	Shares in German Company	IT / CGT	Schedule D Case III *	55% / 33%
Lotus Bakeries shares	Shares in Belgium Company	IT / CGT	Schedule D Case III *	55% / 33%

**\* Underlying tax credit applies**

The tax analysis of the portfolio is as follows:

- SPDR S&P 500 ETF is an “unregulated” exchange traded fund domiciled in the US, subject to CGT. (reference – Revenue eBrief No 71/15 Exchange Traded Funds)
- First State Asia Pacific is a regulated offshore fund domiciled in the UK. This is subject to exit tax at 41% on income and gains
- Fidelity Funds SICAV is a distributing fund contained in the Revenue’s list of approved distributing funds. Annual payments from this investment are subject to tax at the marginal rate plus PRSI and USC. Gains are subject to CGT at 40%
- UK Gilt Treasury Stock is a UK Government bond. Interest payments from this bond are subject to tax at the marginal rate plus PRSI and USC. Gains are subject to CGT unlike the position with Irish Treasury Stock which are exempt from capital gains tax
- Schroder Oriental Income Fund is a non-distributing “bad” offshore fund domiciled in Guernsey. Fund gains on this investment are subject to income tax at the marginal rate plus PRSI and USC
- Shares in L’Oréal are shares in a French public limited company. Dividends from which are taxed at the marginal rate plus PRSI/USC and disposals are subject to CGT. There is a credit for underlying tax – see below
- Shares in Allianz are shares in a German public limited company. Dividends from which are taxed at the marginal rate plus PRSI/USC and disposals are subject to CGT. There is a credit for underlying tax – see below
- Shares in Lotus are shares in a Belgian public limited company. Dividends from which are taxed at the marginal rate plus PRSI/USC and disposals are subject to CGT. There is a credit for underlying tax – see below.

There are a number of important rules that we need to watch for in this portfolio:

### **8 year charge**

An 8 year charge will apply on “EU” funds (section 747E(6)) such as the First State Asia Pacific investment

For the “EU” fund, a disposal is deemed to occur on each 8<sup>th</sup> anniversary of a material interest in an offshore fund, based on the uplift in value of the investment in the 8 year period.

The key point to note is that with non Irish funds the onus is on the individual (and not the fund manager) to calculate the 8 year charge and include the gain from the deemed disposal on the individual’s tax return for that year. In light of the recent changes to the Revenue Code of Practice in relation to offshore matters, the consequences of a taxpayer (and their adviser) failing to identify an 8 year charge correctly could now be more severe.

### **Offset of losses**

Losses in Irish/EU funds cannot be used to offset capital gains. Most clients (understandably) would assume that if they lose money on an investment, they will obtain some tax benefit for the investment loss. Unfortunately, if the loss arises from an offshore fund located in an EU country, an EEA country or non OECD country with which Ireland has concluded a double taxation agreement (in this paper referred to as an “EU fund”), no loss relief is available for that investment loss (section 747E(3)(a)).

### **Charge arising on death**

The death of an investor triggers an exit tax charge for EU funds. Where an individual dies, and that individual’s assets held include units in an EU fund, the units are deemed to have been disposed of and immediately reacquired by the deceased individual for market value consideration (section 739E and 747B(3)(a)(ii)).

This tax cost can often be overlooked in terms of estate planning as it is in most cases assumed that no tax charge would arise where the individual passed the investments/assets held to their surviving spouse.

### **CAT offset**

The exit tax payable on the death of an individual for both Irish/EU funds is allowed as a credit against any inheritance tax (“CAT”) payable by the beneficiary of the fund investment.

As no inheritance tax is payable by the individual’s spouse, it is therefore not tax efficient for such fund investments to pass to the surviving spouse as the benefit of the credit for the exit

tax suffered is lost. Therefore, for this reason, there is merit in the deceased's children (or other family members) receiving such fund investments on the death of the investor in order to ensure the credit against CAT is obtained and not lost.

One point to note is that the exit tax on "EU funds" is available as a credit against both gift tax and inheritance tax (section 747E(5)). This contrasts with the position for Irish funds where the credit for exit tax is only available against inheritance tax but not gift tax (section 739G(5)).

### **Tax return reporting**

The tax return reporting for the above portfolio can be quite onerous because of the different reporting obligations for the assets in the portfolio i.e.:

- (a) Any 8 year charges must be reported for EU funds.
- (b) On the death of a client, the charge arising for EU funds must be included.
- (c) The dividends need to be calculated to include underlying tax credits.

As and from 1 May 2017, it will no longer be possible to obtain the benefits of a qualifying disclosure if any matters included in the disclosure relate directly or indirectly to foreign matters (or "offshore" matters to use the Revenue language).

This means that from 1 May 2017, individuals with liabilities from "offshore matters" will be liable to higher penalty rates, the settlement could be published in the quarterly list of tax defaulters and the person concerned could be subject to a criminal prosecution.

### **Credit for underlying tax on dividends**

Ireland's double taxation agreements with several countries allow Irish resident portfolio shareholders to claim, in addition to any foreign tax levied on dividend payments, credit for foreign tax paid in respect of the profits out of which dividends are paid (credit for underlying tax).

Where it is not possible for a portfolio investor to obtain from the company paying the dividends the information necessary to compute the double taxation relief the following aggregate dividend/underlying tax rates may be used instead:

Belgium	44%
France	43%
Germany	28%
Italy	38%
Japan	44%

### **CGT asset or a Fund?**

A question that can arise frequently for tax advisers is what is the difference between a CGT asset and a “fund” for tax purposes? This can often be a very complicated question and particular care needs to be taken to ensure that each individual investment is correctly categorised for tax purposes. Whilst it is beyond the scope of this paper to analyse in detail the definition of a “fund” for tax purposes, the following is worth noting:

- (a) Each investment in the portfolio needs to be carefully considered as to whether it is a fund or not.
- (b) The rules are different for “good” funds (EU/EEA/OECD countries with which Ireland has a tax treaty) and “bad” funds (funds outside “good” fund locations).
- (c) Typically, most investment vehicles used by stockbrokers to access equity/bond markets are considered funds for tax purposes.
- (d) To complete a definitive exercise on the correct category for tax purposes is a significant undertaking and can require legal opinions both in Ireland and the jurisdiction in which the fund is located to fully complete the exercise and determine whether the investment falls to be treated as a fund for Irish tax purposes or a capital gains tax asset. As a starting point, however, the following could be asked of the investment provider in the case of an investment in a company:
  - Is the underlying entity incorporated in a “good” fund country?
  - Is the entity similar to an authorised investment company in Ireland?
  - Does the entity hold an authorisation issued by the authorities in the foreign jurisdiction regarding regulation?
  - Does the entity raise capital by promoting a sale of its shares to the public?
  - Are the net asset value (NAV) and trading price of the shares/units close to each other?
  - Is it likely that investors in the investment will realise the value of their interest within seven years?

If the above conditions are satisfied, then it is likely that you are dealing with a fund for Irish tax purposes as opposed to a capital gains tax asset.

### **Portfolio costs – deduction for costs**

A portfolio will typically have costs in the form of any or all of the following:

- An annual management/advisory fee paid to the portfolio manager
- A management or performance fee paid to the manager of a fund
- Transaction costs on the purchase and sale of individual holdings in the portfolio
- Other incidental costs.

Are these costs deductible for tax purposes?

Section 552 provides a capital gains tax deduction for the incidental costs of acquisition or disposal of an asset. This is a capital gains tax deduction but bear in mind that fund gains are calculated using the CGT computational rules. To be deductible these costs must be fees incurred wholly and exclusively for the purposes of the acquisition (or disposal) of the asset, and must fall into one of a number of categories:

In the context of a stockbroker or similar portfolio such as the example above, it is difficult to see how a CGT deduction can be taken for an annual management fee unless that management fee is specifically incurred for the acquisition or disposal of certain assets. The wording of the management agreement will determine if a deduction can be claimed or not for CGT assets and fund gains.

There are two further points I would make on costs:

- (a) In the case of a fund such as an ETF the fund deducts costs at the fund level so typically the investor receives their investment return net of fund costs and it is on this net return that tax is charged.
- (b) Contracts for Difference (CFD's) are subject to CGT but because of the nature of the instrument there is a complex calculation of the gain or loss. Revenue eBrief 36/2007 set out the treatment to be applied on CFD's and allows a full deduction for all broker fees.

### **A better structure?**

Could the portfolio be structured better? There is no obvious "magic solution" here. The simple but efficient strategy is to ensure that where significant tax costs arise that these are matched with another tax cost being CAT.

The First State Asia Pacific fund is an EU fund subject to 8 year charge and a charge on death. Where either event occurs, the investment should be structured so that a credit for the exit tax is available against CAT.

#### 4. Foreign bank account (holding foreign currency)

In the dark days of the recession we saw significant money leave Ireland for foreign banks and in a lot of cases move from Euro to US Dollar, Sterling or Swiss Francs. The next foreign asset I will consider is a foreign bank account holding foreign currency.

This is a typical example.

Bank	Barclays UK
Date account opened	2011
Amount deposited	100,000
Currency	GBP 2011
	<i>Converted to</i> USD 2013
Interest	1% p.a.
Held	Individuals sole name
Withdrawals	None

If you open a foreign bank account you must report the opening of the bank account on your tax return. The obligation is wider than just reporting the opening of the bank account. Section 895(6) deems you to be a “chargeable person” for self-assessment purposes in the year you open a foreign bank account

The tax return requires you to include the following information on the tax return (this is an extract from the 2016 tax return)

320. **Foreign Bank Accounts** (S. 895) Give the following details for each foreign bank account opened in 2016 of which you or your spouse or civil partner were the beneficial owner of the deposits held

(a) Name & address of deposit holder (bank, etc.), include Eircode (if known)

Two sets of empty 2x10 grids for recording data.

(b) Date account was opened (DD/MM/YYYY)

(c) Amount of money deposited on opening the account

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(d) Name & address of intermediary through whom account was opened, include Eircode (if known)


The interest earned each year in the bank account is taxed under Case III in the normal way.

**What is the capital gains position?**

- (a) Foreign currency is an asset for capital gains tax (section 532(b)).
- (b) The rule in section 541 (dealing with debts) which provides that no chargeable gain arises on death does not apply in the case of a foreign currency debt owed by a bank (section 541(6)).
- (c) There is an exemption that takes certain foreign currency out of the charge to capital gains tax where the foreign currency is acquired by the holder (or holders family) for personal expenditure outside Ireland including expenditure on a foreign home (section 541(6)).
- (d) A disposal arises for capital gains tax on foreign currency where:
  - The foreign currency is converted not just to Euro but to any other currency
  - The foreign currency is moved from one bank to another. In the example above, if the Dollars were moved from the Barclay's Dollar account to say Lloyds this is a disposal for CGT purposes
  - Foreign currency is transferred from one bank account to another bank account within the same bank (although there are differing views on this point).

In the example above of the Barclays UK bank account opened in 2011, the position is reasonably straightforward in that:

- There is an opening of a foreign bank account in 2011 so this must be reported on the 2011 tax return
- Interest is earned (1% p.a.) each year so this must be included on the tax return each year
- Each year, you have an acquisition of a new asset in the form of the interest earned each year
- In 2013, there is a CGT disposal on the conversion from GBP to USD so a gain or loss arises in that year
- The foreign currency exemption in section 541(6) does not apply because the funds held with Barclays are not held for the personal expenditure of the account holder. The Barclays account was set up because of the concerns with Irish banks and the Euro risk.



The Barclays bank account example above, is not too complicated. However, in my experience the Barclays example I have used is in the minority of fx transactions that arise in practice.

Take the case where you have a client with a large investment portfolio perhaps with a foreign investment house like Goldman Sachs. The client has provided a discretionary mandate to Goldman Sachs to maximise investment returns.

As many of you will see every September/October when trying to analyse investment reports (particularly from foreign investment houses that have no Irish focus) there can be a considerable volume of transactions where shares, bonds and commodities are traded very regularly. It is not uncommon for a tax adviser to receive transaction reports in excess of 50 pages in length.

Clearly the fx gain or loss on assets denominated in foreign currency (say USD shares) is captured at the spot rate at the time of acquisition and disposal and that is rather simple to track as one has set dates and a quantifiable transaction amount.

However, each time an acquisition (say of shares) is made, funded from the USD account there is a withdrawal from an account. Each time a disposal of shares is made there is a lodgement to a foreign currency account.

Situations can arise where there are hundreds of transactions in say a USD account each year. Even if the currency stays in USD it does not matter, it is the trading activity in the account that causes a CGT exposure to arise.

Clearly the personal exemption in Section 541(6) cannot apply to your Goldman Sachs type scenario. Therefore every lodgement to the USD account is a 'spot rate' acquisition of a chargeable asset and every withdrawal from the account is a part disposal of this chargeable asset.

Foreign currency is a fungible asset, and therefore the FIFO rules apply to lodgements and withdrawals from foreign currency bank accounts. The addition of small amounts of interest are deposits into the account and FIFO rules apply to what can be immaterial amounts of interest. Whilst this (interest received) does not sound like an issue it can add considerable complexity to FIFO computations.

It can therefore be extremely difficult, if not impossible, to identify the fx gain or loss where there is considerable 'washing machine type' activity in a foreign bank account that is used for share dealing or investment dealing purposes.

The tax adviser is faced with the conundrum where:

- (i) they know what the strict law is in section 541 but
- (ii) may not have full detail – e.g. to do transactions properly one would need to have the date the account first opened and have tracked through from that very day to identify the FIFO basis.

How is a tax adviser who has acquired a new client going to try and identify such FIFO rules where they are effectively starting from the current tax year? The level of time invested to do this is not feasible for most tax advisers, as such costs will not be recoverable.

In many fx matters, the tax adviser is generally left with having to take a practical approach to calculations but having to advise their client of the risk that Revenue could seek to challenge a position where the CGT rules are not being strictly complied with.

Here is a suggested approach, depending on the fx transactions:

- **Client with very few foreign currency transactions**

In this scenario it should be a straight forward matter to track and apply the FIFO rules. This client profile is one who is speculating or hedging on foreign currency so there should be less transactions and they tend to be larger. The Barclays bank example earlier is a good example of this type of transaction.

In this fact pattern it should be possible to identify the FIFO rules and to apply them accurately.

- **Client with small to modest investment portfolio**

Again, if you have had the client for a considerable period of time then it may be possible to apply FIFO rules.

One may need to take a 'base year' and take the fx spot rate at 1 January of a given year and apply FIFO from that basis forward.

- **Client with large and active investment portfolio(s)**

It is simply impracticable for tax advisers to track through what can be 100's of movements in USD, GBP foreign currency bank accounts.

Instead, the only practical approach is for fx movements to be captured in the underlying disposals of assets. This is the only feasible solution to adopt in this scenario.

Indeed it is likely that the fx movements probably even each other out where a long term view is taken.

### **UK – leading the way**

The UK has moved away from the significant administrative burden that arises from treating foreign currency in a bank account as a chargeable asset. From 6 April 2012 foreign currency held at a bank account is no longer a chargeable asset for individuals, trusts or personal representatives.

Essentially the asset is treated the same way as a simple debt. This was done to remove the administrative burden being imposed on taxpayers and their advisers.

Indeed where the UK exemption does not apply (e.g. say there are pre April 2012 matters) a taxpayer may treat all accounts in their name containing a particular foreign currency as a single account and can therefore disregard transactions between the accounts.

At the time of proposals in the UK to change the law (late 2011) there was some generally available commentary that the changes were expected to reduce returns to the UK exchequer by the sum of GBP5m (and the UK is a considerably larger market than Ireland).

Therefore across the water this issue simply does not arise for most UK taxpayers anymore. This indeed makes it even more difficult when one is trying to obtain information from UK investment houses.

### **Losses on foreign investments**

Many of us have clients who lost considerable amounts of money on foreign investments, particularly syndicated investments.

For the most part these investments were structured where the equity was advanced as far as possible (bearing in mind local thin capitalisation rules) as debt. The reason being to facilitate returns during the life of the investment.

However, where client lost money one is often left explaining that no loss relief is available where that debt is a 'simple debt'.

Tax advisers should always examine the actual investment architecture in detail as in some instances the nature of the debt may not in fact be that '*simple*'. There may be characteristics of the debt such that it is a debt on a security. Indeed your client may not be the original creditor of the debt and in some limited scenarios loss relief may be available.

## 5. Foreign Estate Taxes

All of the foreign assets detailed earlier are located either in the US or the UK. So what is the US and UK inheritance tax or estate tax position in the US and UK?

This is best explained by using the examples detailed earlier.

<b>Belfast apartment</b>	<b>GBP</b>
Value today	900,000
Bank debt today	<u>(150,000)</u>
	750,000
Wife interest 50%	<u>375,000</u>
Husband interest 50%	<u>375,000</u>

On the death of husband or wife the asset passes to the survivor. Assuming both husband and wife are not UK domiciled then the UK inheritance tax spouse exemption applies so there is no UK inheritance tax on the first death.

On the death of the survivor of husband and wife, when the asset passes to children, the position is then:

	<b>GBP</b>
Assumed net value as above	750,000
Less current UK threshold	<u>(325,000)</u>
Taxable	425,000
UK inheritance tax @ 40%	<u>170,000</u>

This tax of GBP170k is payable by the UK estate not the beneficiaries. The tax is calculated on the date of death value (not a later date as is mostly the case for CAT).

The US estate tax position for the New York office is:

<b>New York Office</b>	<b>USD</b>
	<b>'000</b>
Value assumed today	25,000
Bank debt today	<u>(15,000)</u>
Net value	10,000

Each members interest	2,500
US estate tax is:	
60,000 @ 0%	0
1,000,000 @ 18% - 39%	346
1,440,000 @ 40%	<u>576</u>
Total US tax	<u>922</u>

In the US, unlike the UK, spouse exemption is not available. In the US, the estate is taxable. The beneficiary is not taxable and it is calculated on date of death values.

### **UK bank account**

The bank account with Barclays is a UK asset liable to UK inheritance tax in the same manner as the Belfast apartment example.

### **Credit for foreign estate taxes**

In the example above, foreign estate tax is payable as:

- Belfast apartment GBP170,000 UK IHT
- New York office USD922,000 US estate tax.

The question to consider is to what extent Ireland will allow a credit for foreign estate taxes. When it comes to foreign estate taxes, the matter must be considered under three categories:

- UK assets (DTA in place)
- US assets (DTA in place)
- All other countries.

### **UK Double Taxation Agreement**

Ireland has a double taxation agreement with the UK for gifts and inheritance taxes since 1977. The double taxation agreement applies to gift and inheritance tax in Ireland and is based on the OECD model tax convention. In the context of an Irish resident and domiciled client owning UK assets which are liable to UK inheritance tax then the position is:

- (a) Under the double taxation agreement both Ireland and the UK will impose tax under their normal domestic rules.
- (b) Credit is given for property held in the other country.

- (c) The credit available is determined by calculating the effective rate of tax in each country and credit is then given for the lower of the effective rates.

### **US Double Taxation Agreement**

Ireland has an old 1950 estate duty/federal estate tax agreement with the US that continues to apply today. A few points on this agreement:

- Both the US and Ireland allow the agreement to operate today
- It is based on domicile (which is no longer relevant for determining the Irish CAT charge). This leaves certain parts of the agreement open to interpretation
- It only applies to inheritance tax in Ireland, not gift tax
- It provides for certain exemptions from tax in one country, in certain situations
- There are special situs rules set down in the agreement. In the context of this paper, can I highlight that the agreement provides that a debt is situated where the deceased was domiciled.

### **All other countries**

Section 107 CATCA 2003 provides a credit where foreign tax is chargeable in connection with foreign assets. This unilateral relief allows credit for foreign estate taxes where a gift/inheritance is reduced by foreign gift or inheritance tax on the same property. Where this occurs credit is allowed for the foreign tax but similar to normal treaty rules the credit will be the lesser of:

- (a) the Irish tax  
or  
(b) the foreign tax.

In the case of UK and US assets, unilateral relief cannot be claimed if the UK or US treaty provides a credit.

### **The “credit crunch”**

The ownership of foreign assets is relatively new to Irish individuals. While we have seen clients hold UK assets (be it UK shares or UK property) for a number of years, ownership of assets in other jurisdictions is relatively new. For this reason, we have not yet experienced in practice the problems and real cost of foreign estate taxes. The problems that are likely to arise in practice are those where credit will not be available for the full amount of the foreign

tax or in some instances, any part of the foreign tax. This creates a very expensive tax position on asset transfers.

Let me illustrate this by way of some scenarios that can easily arise by reference to the examples used earlier in this paper.

- (a) The example of the New York office is a significant asset and in my simple calculations earlier, I calculated a US estate tax of USD922,000 arising on the death of one of the members who holds a 25% interest in the US LLC owning the property. Most married clients tend to have a Will where assets are left entirely to spouse and on the second death divided among the next generation. In the case where there is a US estate tax of USD922,000, there will be no Irish inheritance tax because of the spouse exemption in Ireland. Accordingly US estate tax of USD922,000 is a tax for which no credit is available in Ireland. This represents 36.88% of the asset value.
- (b) Taking the example of the property in Belfast, there is a UK inheritance tax of GBP170,000 in that example. If for example those clients have 5 children and have an equivalent Irish estate, then, with a combined worldwide estate of approximately EUR1.5m (I am ignoring currency conversions simply for the purposes of illustration) you have a UK inheritance tax cost of GBP170,000 but there is no tax in Ireland because you have 5 tax free thresholds of approximately EUR1.55m so here again you have a significant UK estate inheritance tax with no tax cost in Ireland.

This is a real problem. One solution is not to leave the asset to spouse but to leave it to children. If the children have a CAT liability then the US estate tax should be available as a credit. If there is no CAT liability because the asset is divided between a number of children with full tax free thresholds then there still may be a significant loss of credit.

### **Is there a solution?**

As a general rule, with both the UK and US it is possible to stay out of the UK and US estate tax system if the asset is not held directly by the Irish resident individual but instead by a foreign corporate. Obviously a company in a jurisdiction that does not levy inheritance tax is required. While this currently deals with the position in relation to inheritance and estate taxes in the UK and US, it is never as simple as that because it invariably raises other tax issues and you have both set up and annual costs associated with such a structure. However, where the amounts involved are significant and there is going to be a real loss of a significant credit for foreign estate tax then this is one possible solution.

**Questions to ask**

The position in relation to foreign estate taxes will undoubtedly give rise to complex issues when they arrive in practice. The key questions that need to be asked and considered are:

1. Do you have a foreign estate tax liability in the country of location of your clients asset?
2. If so, what is the extent of the liability, who is liable to pay it and when will it become due? Will there be liquidity problems?
3. Is there a CAT liability in Ireland in respect of the foreign asset? If so, does that liability arise at the same time as the foreign estate tax?
4. Can you get a credit for the foreign estate tax against the Irish CAT liability either under the relevant double taxation agreement or unilateral relief in section 107?



## 6. Global reporting – the new world?

In the context of the examples I have used in this paper, it is appropriate to mention global reporting. This is an extract from the OECD report on “Standard for Automatic Exchange of Financial Account Information – Common Reporting Standard”

*“As the world becomes increasingly globalised it is becoming easier for all taxpayers to make, hold and manage investments through financial institutions outside of their country of residence. Vast amounts of money are kept offshore and go untaxed to the extent that taxpayers fail to comply with tax obligations in their home jurisdiction. Offshore tax evasion is a serious problem for jurisdictions all over the world, OECD and non-OECD, small and large, developing and developed. Countries have a shared interest in maintaining the integrity of their tax systems. Cooperation between tax administrations is critical in the fight against tax evasion and in protecting the integrity of tax systems. A key aspect of that cooperation is exchange of information.”*

In the context of Irish residents holding foreign assets, it is relevant for us all to have an awareness and knowledge of what is happening globally on information sharing. I expect that clients with foreign assets are likely to have some or all of the information relating to their foreign asset(s) shared with the Irish Revenue at some point in the very near future.

In recent years, the world has moved to a place where it will soon be the norm for financial information on assets held in one country to be shared with the country of residence of the owner of the asset.

To date we have the EU Savings Directive (now repealed) followed by the US FATCA system. The global reporting that is now upon us is CRS. The Common Reporting Standard (CRS) commences to report in 2017 and over the next number of years, large volumes of information will be arriving in Revenue Authorities’ systems detailing assets held in other countries. What this will mean for us in practice will only become clear over the next few years.

### **What is CRS?**

The Common Reporting Standard (CRS), formally referred to as the Standard for Automatic Exchange of Financial Account Information, is an information standard for the automatic exchange of information developed by the OECD. The legal basis for exchange of data is the Convention on Mutual Administrative Assistance in Tax Matters and the idea is based on the USA Foreign Account Tax Compliance Act (FATCA) implementation agreements.

## CRS - The key points

This paper is not a technical analysis of CRS. Instead, I simply wish to highlight what is currently happening with CRS and how it might impact on our clients.

The key points are:

- This is an OECD initiative
- Over 100 countries have signed up and will operate CRS reporting
- CRS is an automatic exchange of information by one Revenue authority to another Revenue authority
- Financial institutions in each country have to report to their local Revenue authority
- There will be an annual reporting by financial institutions to their local Revenue authority
- Each Revenue authority will then share that information with the country of residence of the financial institutions customer.

## Reporting start years

The following countries have committed to start reporting in 2017 (list updated February 2017). What this means is that financial institutions will report to their local Revenue authority. The first report will be made 30 June 2017.

Anguilla	Greece	Norway
Argentina	Greenland	Poland
Barbados	Guernsey	Portugal
Belgium	Hungary	Romania
Bermuda	Iceland	San Marino
British Virgin Islands	India	Seychelles
Bulgaria	Ireland	Slovak Republic
Cayman Islands	Isle of Man	Slovenia
Colombia	Italy	South Africa
Croatia	Jersey	Spain
Curacao	Korea	Sweden
Cyprus	Latvia	Trinidad and Tobago

Czech Republic	Liechtenstein	Turks and Caicos Islands
Denmark	Lithuania	United Kingdom
Estonia	Luxembourg	
Faroe Islands	Malta	
Finland	Mexico	
France	Montserrat	
Germany	Netherlands	
Gibraltar	Niue	

The following countries have committed to start reporting in 2018 (updated February 2017):

Albania	Indonesia	Saudi Arabia
Andorra	Israel	Singapore
Antigua and Barbuda	Japan	Sint Maarten
Aruba	Kuwait	Switzerland
Australia	Lebanon	The Bahamas
Austria	Macao (China)	Turkey
Bahrain	Malaysia	United Arab Emirates
Belize	Marshall Islands	Uruguay
Brazil	Mauritius	Vanuatu
Brunei Darussalam	Monaco	
Canada	Nauru	
Chile	New Zealand	
China	Panama	
Cook Islands	Qatar	
Costa Rica	Russia	
Dominica	Saint Kitts and Nevis	
Ghana	Saint Lucia	
Grenada	Saint Vincent and the Grenadines	
Hong Kong (China)	Samoa	

The US is unusual. It has not signed up to CRS. The US currently receives information from around the world from financial institutions on US citizens.

**Who will report?**

Financial institutions are defined broadly under CRS and include:

- Depository institutions (including banks and other deposit takers)
- Custodial institutions (including brokers, intermediaries and nominees)
- Investment entities (including investment funds and other investment vehicles) and
- Certain insurance companies (relating to cash value and annuity contract business).

**What information will be exchanged?**

Each country will annually automatically exchange with the other country the following information.

- The name, address, taxpayer identification number and date and place of birth of each reportable person
- The account number
- The name and identifying number of the Reporting Financial Institution
- The account balance or value as of the end of the relevant calendar or, if the account was closed during such year or period, the closure of the account. Details of interest earned and other income must also be included.

**What does this mean for our clients?**

The answer to this question will only become known once information flows arrive in Ireland. However, at this stage, we should expect:

- Information on your client's assets/income with foreign institutions will be provided on 30 June 2017 to the Revenue authority of that country
- The foreign Revenue authority will send that to the Irish Revenue
- The Irish Revenue are likely to seek to "match" that information against your client's tax return
- Given the limited information on tax returns in terms of individual assets etc, it is highly likely that the Irish Revenue will undertake enquiries or verification checks on clients tax returns.



What this means in practice for clients with foreign assets will become clear over the next 1-2 years.

Thank you.