



MAINTAINING THE 12.5% CORPORATION TAX RATE ON IRISH TRADING PROFITS

Introduction

Since 1 January 2003, corporate income has been characterised into two distinct streams: trading or active income which is taxed at the 12.5% corporation tax rate and non-trading or passive income which is taxed at the 25% corporation tax rate. Since that date, the distinction between a company's activities (i.e. whether the activities constitute trading activities or whether they constitute passive activities) is an important one, as the Irish Revenue Commissioners ("Revenue") are cognisant of and will prevent low substance businesses (otherwise known as "brass plate operations") availing of the lower rate.

The issue as to what constitutes trading or trade is, in the absence of definitive rules, a contentious one. Whilst there is no useful definition of "trading" under Irish statute law, the legislation defines "*trade*" as "*every trade, manufacture, adventure or concern in the nature of trade*". The definition in itself provides little clarification, and it is perhaps unsurprising that Revenue guidance and case law has built up around the classification of activities as trading or non-trading. This article proposes to outline published Revenue guidance on the matter, whilst highlighting some issues which have arisen in respect of the new regime.

Published Revenue Guidance

In response to its request for clarity, Revenue has purported to provide some assistance in its publication of "*Guidance on Revenue Opinions on Classification of Activities as Trading*" (2003) ("Revenue Guidance")¹. Revenue states that rather than providing an all encompassing guide, the purpose of the note is to give general guidance as to how Revenue approaches the subject and to outline the type of information that should accompany a request for an opinion.

Whilst Revenue notes that in general, there will be no question as to whether a company is trading or otherwise, it does play homage to the "Badges of Trade" which are a set of rules drawn up in 1955 by the UK Royal Commission on the Taxation of Profits and Income as providing the principal test against which a company's activities are compared to determine their trading / non-trading status. However, given the year

¹ Copy of Revenue Guidance available at the following link: <http://www.revenue.ie/en/practitioner/tech-guide/trade.pdf>

of origin, it is perhaps fair to say that the Badges of Trade are limited in the sense that they fail to take into account and can seldom be aligned to relatively “new” trades such as, for example, the exploitation of intellectual property. This is in fact alluded to in the Revenue Guidance, which notes that in recent cases, the question of trading versus non-trading in the context of income from the exploitation of intellectual property (“IP”) is difficult to evaluate in terms of whether there is a trade being conducted or whether the income arises merely from the ownership of the IP. In an attempt to alleviate concerns and provide further guidance, the Revenue Guidance sets down a number of additional indicators that must be borne in mind when determining the trading status of a company:

➤ Trading Presupposes Activity

Revenue notes that trading presupposes that the company concerned is carrying on business activities from which its income derives. The activities will vary depending on the nature of the trade and will require people with the skill and authority necessary to carry them out. Helpfully, the Revenue Guidance states that outsourcing of activities would not necessarily prevent a company's income being taxed as trading income.

➤ Distinction Between Trading and Investment

The Revenue Guidance states that certain activities are more likely to be in the nature of an investment rather than a trade. Where a company owns an asset and the mere ownership of that asset produces income, the company's income from the asset would not be regarded as trading income. Whilst Revenue notes that this is particularly true in the context of IP companies, Revenue also expressly provides in its Guidance that a company whose sole activity is the management and exploitation of IP can be regarded as carrying out a trading activity. However, it does warn that because IP is an asset the mere ownership of which yields an income, there are significant hurdles to be cleared before income of a company from licensing such property could be regarded as trading income.

➤ Group Structures

The Revenue Guidance states that a company seeking trading status must establish that it carries on sufficient activity to be trading in its own right. This means that although a corporate group may be considered a trading group when looked at as a whole, it must be shown that the individual Irish entity is trading as part of the group.

In essence, whilst Revenue have certainly added to the Badges of Trade in providing a number of additional and perhaps more up-to-date indicators of what constitutes trading (particularly in the context of non-traditional trades), it is perhaps impossible for Revenue in one guidance note to enunciate all the factors which must be taken into account in determining whether a company's income is trading or non-trading income. It is, however, a useful guide to as it gives an indication of the factors Revenue would look at in giving an advance opinion on trading status.

Published Revenue Opinions

From 2002 (through to 2008), Revenue has published summarised details of cases submitted to Revenue for an opinion on the classification of activities as trading activities (the “Opinions”)². The Opinions reached by Revenue are a useful tool in determining what Revenue looks to in determining trading status, particularly in the context of non-traditional companies who are engaged in financial services activities or IP exploitation activities:

➤ Financial Services Activities

The Opinions published by Revenue in the context of financial services are primarily concerned with group financing and treasury operations. In one such case, Revenue opined that the company was trading on the basis that the company would be actively managing the business and would make the strategic decisions in relation to the financing and treasury operations. Furthermore, although the activities of the company were originally outsourced (i.e. no employees in the company), the outsourcing arrangement would be managed and controlled by Irish resident directors with the appropriate level of expertise in this area.

In another case involving a company providing agency treasury services to other group companies (investment and cash management services), Revenue confirmed that the company was trading on the basis that the company’s employees possessed the requisite skill and expertise to undertake the transactions and that the company exercises decision making and control and that the directors hold their meetings in Ireland. In a 2008 case involving treasury activities, Revenue decided that the activities constituted trading on the basis that the company will actively enter into and conclude group financing transactions, that the Irish Treasury Manager will have the necessary skills and qualifications to perform the day-to-day activities of the Treasury Manager function and that the board of directors will control the company and will have ultimate responsibility for policy and management of the company.

➤ IP Exploitation Activities

From a review of the available Opinions, the classification of IP exploitation activities as trading is largely dependent on whether the activities of the company will be undertaken by personnel located in Ireland and whether individuals with appropriate expertise and skills are employed by the company.

In a 2004 case, an Irish company was engaged in licensing third parties to exploit trademarks in Europe and Asia. The company intended to expand its activities to include distribution and the provision of shared services for other group companies. Revenue confirmed that the company’s activities constituted trading activities on the basis that the company would be actively trading with the licences. Furthermore, Revenue noted that the company employees were responsible for continuous monitoring and review of existing licences and licensees, seeking out potential new licensees and ensuring maintenance of brand image by driving and advising on marketing strategies.

The rationale for the Revenue decisions on trading status mirrors the judgement given in the UK case of *Noddy Subsidiary Rights Limited –v- CIR 43 TC 458* which concerned the granting of rights to the copyright and trademark in the fictional character, Noddy.

² Copy of Opinions available at the following link: <http://www.revenue.ie/en/about/publications/submitted-cases.html>

In a tax briefing on the issue, Revenue state that at one end of the scale is a company whose only activity is the licensing in the rights to IP and the on-licensing of such rights and this company is unlikely to be regarded as trading. At the other end of the scale, the income of a company that actually creates the IP by engaging in R&D, continues to develop it and bears the costs and risks associated and actively promotes and licenses out the rights for it use to multiple third parties would invariably be regarded as trading income. Both the tax briefing and Opinions should be alluded to when providing a client engaged in the exploitation of IP with advice.

Summary

Given Ireland has the lowest tax rate in western Europe, it looks likely that the enquiries as to how the trading rate operates and how to manage one's activities to avail thereof will continue into the future. This is particularly true in the case of multinational companies seeking to avail of the lower corporation tax rate, notwithstanding the additional benefits of relocating to Ireland including Ireland's holding company and favourable IP regimes. Where companies are seeking an advance ruling from Revenue as to whether their activities constitute trading, it is perhaps worth noting that Revenue have encouraged and continue to encourage inward investment, and thus will remain working with professionals and their clients in giving further clarity where required on the nature of activities that will qualify for the 12.5% rate of corporation tax.

For Further Information

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