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Taxation

Republic of Ireland



CHAPTER 1: THE TAXATION SYSTEM

Taxation is a major economic tool particularly in the current challenging economic environment and the operation of an efficient tax system is essential. This chapter looks at the basic of how tax law is formulated and the systems of collection that are utilised. The knowledge gained in this chapter will be the basis for much of the material covered in the next seven chapters.

LEARNING OUTCOMES

Upon completion of this chapter you should be able to:

1. Understand how tax law is formulated
2. Understand the various branches of the Revenue
3. The basics of Income Tax
4. The systems of tax collection for Income Tax
5. Understand the Self Assessment system

REVISION RESOURCES

SEMINAR: This topic will be reviewed and discussed in **Revision Seminar 1**.

EXAM QUESTIONS: **Pilot and Past papers** are available from the website of Accounting Technicians Ireland and are essential aides when studying Taxation I topics.

The System of Taxation

Taxation is very important economic tool, allowing the government to direct investment and savings into certain areas of the economy, or to encourage investment by certain types of industries. Example of this would be the 10% rate of Corporation Tax that existed or the tax relief available for Investing in Film productions.

Taxation as it is levied can normally take two forms:

Direct Taxation

This refers to taxation that is levied directly on an individual or a business and is proportionate to their earnings or gains. The main taxes that fall under this heading are Income Tax, Corporation Tax, Capital Gains Tax and Capital Acquisition Tax.

Indirect Tax

These taxes are levied on transactions, on the sale of goods and services. The most commonly know indirect tax is VAT, a sales tax that is charged on the sale of goods and services. Other indirect taxes are customs and excise duties.

Types of Taxes

There are a number of different taxes that are levied under each of the headings above. The following is a brief outline of each of the main taxes:

Income Tax	Charged to individuals on income earned.
Corporation Tax	Charged to companies on profits earned.
Capital Gains Tax	Charged mainly to individuals on capital profits on the sale of assets.
Capital Acquisition Tax	Charged to individuals on the value of gifts or inheritances received.
Value Added Tax (VAT)	Sales tax charged on the sales of goods and services.
Stamp Duty	Charged on the transfer of property.
Capital Duty	Charged on the issue and transfer of shares.

Customs Duty	Charged on the importation of goods.
Excise duties	Charged on certain goods, alcohol, tobacco, fuel.

Source of Tax Law

There are three main volumes of taxation law as follows:

Taxes Consolidation Act 1997 (TCA)

This piece of legislation combines all sources of tax law in relation to Income Tax, Corporation Tax and Capital Gains tax up to date. The Taxes Consolidated Act in 1997 brought together all of the legislation previously held in the Income Tax Act 1967, Corporation Tax Act 1976 and the Capital Gains Tax Act 1975 and all subsequent Finance Acts, and merged it into one comprehensive piece of legislation.

Each year the government will announce their new budget which contains any changes to tax law for the following tax year. These changes are then incorporated in the Finance Act, which when it is passed into law, will then be incorporated into the Taxes Consolidation Act 1997. Therefore, the TCA 1997 is updated each year to take account of changes to the taxation system as they are introduced.

Value Added Tax Act 1972

This Act was introduced in 1972 when VAT, as a condition of Ireland's entry into the EU at that time, was first introduced. This Act is also updated each year to include any amendments to tax law included in the annual Finance Act.

There are other pieces of legislation covering the other taxes but the two Acts listed above will be the areas that are covered in your Taxation I syllabus.

Tax Collection System & the Revenue

The responsibility for the management of the system of taxation lies with the Office of the Revenue Commissioners. This is a division of the Department of Finance and is ultimately under the control of the Minister for Finance.

Revenue Commissioners

The Revenue Commissioners is currently divided into branches, each branch dealing with a geographic region, e.g. Border Midlands West, Dublin, South & South East, South West. Each branch is subdivided into Revenue districts.

Inspectors of Taxes are appointed to run the day to day operations of each district. The districts are responsible for issuing and processing tax returns, issuing tax credit certificates and balancing statements. These offices effectively agree the amount of tax an individual owes to the Revenue.

Collector General

The Collector General's office is responsible for the actual collection of taxes. These taxes can be paid in two main ways, either by deduction at source or as a direct payment to the Revenue. All of the payments are paid through the Collector General's office and they are responsible for collecting the amounts that the Inspector of Taxes agrees as the final liability for the taxpayer.

Appeal System

Where there is disagreement between the Revenue and the taxpayer in relation to a tax charge it is possible to refer this to the Appeal Commissioners. The Appeal Commissioners have the power to hear the disputed cases and make a decision in relation to the correct calculation of tax.

Where a person is not satisfied with the decision of the Appeals Commissioners they may apply for a rehearing in the Circuit Court, or a case stated to the High Court on a point of law.

Basic of Income Tax

The Tax Year

The current Income Tax year runs in line with the calendar year – from 1 January to 31 December each year. The tax year is then referred to as the calendar year, i.e. the tax year from 1 January 2009 to 31 December 2009 is referred to as the 2009 tax year.

Prior to 2001 the tax year ran from 6 April to the following 5 April. Therefore the tax year from 6 April 1995 to 5 April 1996 was known as the 1995/96 tax year.

In 2001 the tax year ran from 6 April 2001 to 31 December 2001. This was referred to as the 2001 tax year, or the short year. This allowed the transition to the calendar tax year.

Classification of Income for Income Tax

Different sources of Income are classified in different ways, with different rules applying to how the tax is calculated on each source of Income. The main classifications of Income are as follows:

Schedule D

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| Case I | Income from a trade (a self employed carpenter) |
| Case II | Income from a profession (a self employed solicitor) |
| Case III | Investment Income not subject to tax at source
Foreign Income – foreign employments, foreign rental income and foreign investment income. |
| Case IV | Irish Deposit Interest subject to DIRT
Foreign Investments subject to Irish tax at source
Covenant income received |
| Case V | Irish Rental Income |
| Schedule E | Irish employments and pensions and directors fees |
| Schedule F | Dividends from Irish resident Companies |

Each different source of income outlined has a different set of rules applying in order to calculate the amount of the income from that source to be included in the Income Tax computation. The following chapters will go through each source of income and the calculations that relate to each one. You need to be very familiar with each source of income for your examinations.

Exempt Income

Certain income is exempt for Income Tax. The following are the most common of these:

- Social Welfare Child Benefit Payments
- Statutory Redundancy Payments
- Lottery and betting winnings
- Life Assurance Proceeds
- Interest paid on An Post Saving Certificates and Instalment Saving Scheme
- Qualifying Artists Income up to a certain limit
- Qualifying Patent Royalties
- Income from Childcare services up to €15,000 per annum

Payment of Income Tax – An overview

Income Tax is the second biggest contributor to the state finances (VAT is the largest contributor). In order to collect the taxes it is necessary to have in place an efficient system. For Income Tax there are two main ways in which it is collected by the Revenue Commissioners.

The PAYE System

PAYE is deducted at source from all income earned from employment. The employer has a responsibility to deduct the correct amount of Income Tax from an employee and pay this amount over the Revenue each month. Where an employee has no other sources of income all of their tax will be paid through this system. The PAYE system was covered in detail in Tax 1.

Self Assessment system

This applies to all income not covered by the PAYE system. It is where the taxpayer makes direct payments to the Collector General. This is dealt with in detail in this chapter.

In addition to the above two collection systems there are a number of withholding taxes that are applied to certain payments. These are amounts of tax deducted from the payment at source and are generally deducted at a flat rate. Where they are deducted they are normally available as a tax credit for the individual against the individual's total liability for the year.

Deposit Interest retention tax (DIRT)

This is deducted from interest paid on deposit accounts. The current rate is 25%. This rate has changed in 2009 and this will be covered in more detail in Chapter 8.

Professional Services Withholding Tax (PRWT)

This is deducted from payments for professional services from Government Departments or State Bodies. The tax is deducted at 20%.

Example

Where a hospital pays a solicitor for legal services they will deduct PRWT from the payment to the solicitor. If the total fee due to the solicitor is €10,000 the hospital will deduct 20% or €2,000 and pay the solicitor the remainder, €8,000.

Relevant Contracts Tax (RCT)

This is deducted from payments made by a principal contractor to a subcontractor in the construction, forestry and meat processing industries. The tax is deducted at a rate of 35%.

Self Assessment System

The self assessment system is a system of collection for Income tax. It applies to all 'chargeable persons'. A chargeable person is defined as any individual who has any source of income that is not taxed under the PAYE system. Therefore unless their

total income consists only of salary or wages they can be considered a chargeable person.

Where a PAYE individual has another source of income that is not subject to PAYE they have an option to have this incorporated into their tax credit certificate, thus ensuring the tax on the other source of income is collected through the PAYE system. Where this applies then the individual will not be considered a chargeable person.

This can only apply where the gross amount of the other income is less than €50,000 in a year and the net taxable amount is less than €3,174.

Therefore the individuals considered a chargeable person are:

- All self employed individuals.
- All employed individuals who have any income which not collected under the PAYE system.
- All Proprietary Directors. For tax purposes a director who own more than 15% of the share capital of the company is referred to as a proprietary director.

All chargeable persons have a number of obligations each year. Each of the following must be done by the 31 October of each year.

1. Filing Income Tax Return

They are obliged to file an Income Tax return with the Revenue Commissioners within specified time limits. The return shows:

- Details of all sources of income
- Claim for all allowances and credits
- Must be signed by the taxpayer

A self employed individual completes a Form 11 and an employed individual completes a Form 12. As the individual completes the return and calculates the tax the system is know as self assessment.

The Income Tax return must be filed by 31 October following the end of the year of assessment.

For example the Tax return for the 2008 tax year must be filed by 31 October 2009.

2. Pay the Balance of Income tax for the previous year

When filing the Income Tax return for the previous year the taxpayer must also calculate their total income tax liability for that year and pay the balance due by 31 October.

For example the balance of Income Tax for 2008 must be paid by 31 October 2009, together with the submission of the Income Tax return for 2008.

3. Preliminary Tax payment

Preliminary tax is an advanced payment of the tax liability for the current tax year. The taxpayer is obliged to calculate an estimate of their tax liability for the current year and pay that amount to the Collector General before the 31 October of that year.

For example an individual must estimate their 2009 Income Tax liability and pay this amount before 31 October 2009. Therefore, some of the tax has to be paid before the income is actually earned.

As it will not be possible to calculate the amount of tax due accurately before the end of the tax year the Revenue have provided a number of options for an individual to choose when deciding how much to pay.

The options available are as follows:

1. 90% of the final liability for the current year
2. 100% of the liability for the previous year
3. 105% of the liability for the pre-preceding year (if paying by direct debit)

Example

Preliminary tax for 2009 – due for payment on 31 October 2009 can be based on the lowest of the following:

1. 90% of the expected liability for 2009 (current year)
2. 100% of the liability for 2008 (previous year)
3. 105% of the liability for 2007 (pre preceding year)

Where the payment is made under the third option above the following rules must apply:

- The amount must be paid by monthly direct debit, over a minimum of eight months starting on the 1 May.
- If this option is being used for the first time then the payments can be done over three equal instalments from October to December.
- This option cannot be used if the liability in the pre preceding year was nil.

Where the payment is made under option one or two above they must be paid by 31 October in order to avoid interest charges.

Where the payment does not satisfy one of the rules above, or is made after the 31 October, interest will run from 1 November at a rate of .0273% per day.

Detailed example of Preliminary tax calculation

John Smith was employed and paid all of his tax under the PAYE system in 2007. In 2008 he commenced working as a self employed individual and his final income tax liability was €5,000 for the year. His liability for 2009 was €8,500.

His preliminary tax obligations are as follows:

2007

He is not a chargeable person so he does not have to make any preliminary tax payment.

2008

As he is a chargeable person he is obliged to make a preliminary tax payment by 31 October 2008. He must pay a minimum of the following:

- 90% of the 2008 liability - €5,000 x 90% = €4,5000 **or**
- 100% of 2007 liability – nil

Therefore he can pay nil preliminary tax in 2008.

2009

As he is still a chargeable person in 2009 he must make a preliminary tax payment by 31 October 2009. He must pay a minimum of the following:

- 90% of 2009 liability - €8,500 x 90% = €7,650 or,
- 100% of 2008 liability - €5,000 or,
- 105% of 2007 liability. This option cannot apply as there was nil liability in 2007.

He must pay a minimum of €5,000 by 31 October 2009 to avoid being charged interest.

Margin of Error

As there is a degree of estimation involved in both preliminary tax calculations and the balancing payment for a tax year, to allow for minor miscalculations, small underpayments of preliminary tax will not be penalised in certain circumstances.

The following conditions must be satisfied in order to avail of the relief:

1. The maximum allowable error is the greater of the following:
 - €635
 - 5% of the tax payable (subject to a ceiling of €3,175)

2. The return must be a complete return submitted within the deadline
3. Where there has been an error that fits into the above criteria then the additional amount must be paid by 31 December of that year

Where the additional tax is paid in accordance with the above rules then the payment is deemed to have been received by the Revenue by 31 October of that year.

Penalties for late filing of returns

Even where the full tax liability has been discharged (by preliminary tax payments or otherwise), a surcharge may arise where the tax return is not made by 31 October of the following year.

This surcharge is:

- 5% of the tax liability if the return is made within two months of the correct date (i.e. before 31 Dec) – with a €12,695 upper ceiling.
- 10% of the liability if more than two months late - €63,485 ceiling.

Example

John's final tax liability for 2009 is €10,000 and he paid preliminary tax of €9,000 in relation to this. He filed his tax return for 2009 on 1 December 2010. The return is late being filed and as a result of this he will have a surcharge imposed. His final liability for 2009 will now be:

Income Tax liability as calculated	€10,000
Add surcharge for late filing – 5%	€500
Total Liability	€10,500

Surcharge and Preliminary Tax

Where a surcharge is imposed for late filing not only can it increase the tax liability for the year but can then result in the preliminary tax payment being insufficient, giving rise to interest charges.

Example

If we take the example of John above, his final position is now as follows:

Income Tax liability as calculated	€10,000
Add surcharge for late filing – 5%	€500
Total Liability	€10,500
Preliminary tax paid	€9,000
Balance due	€1,500

As a result of his liability increasing when the surcharge is added on the following consequences arise:

1. He owes an additional €500 in surcharge tax.
2. His preliminary tax is no longer within the 90% rule. As a result he will be charged interest on the full balance outstanding of €1,500. This interest will be charged from the date the preliminary tax was originally due which is 31 October 2009. Therefore by the time he submits his return the interest will be calculated from 1 November 2009 – 1 December 2010.

