

Academic Year 2009/2010

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Taxation

Republic of Ireland



PART A – CHAPTER 1: THE TAXATION SYSTEM

Taxation is a major economic tool and the operation of an efficient tax system is essential. This chapter looks the systems that apply to looking at the following:

- The rules to decide who is liable to pay Income tax in Ireland.
- How tax law is formulated and implemented.
- An outline of the various systems used to collect Income Tax.
- A detailed analysis of the self assessment system.

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. The rules of residence & ordinary residence and the implications of these
2. Understand the source of tax law and the functions of the branches of the Revenue
3. The system used to collect Income tax
4. The Self Assessment system, calculation of preliminary tax and surcharges
5. Understanding of the system of Revenue Audits

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 II topics.

The Role of Taxation

Taxation performs a number of functions for a government and should ideally satisfy the following criteria:

- Taxation is used as a tool to raise finances to pay for essential state services like health care, education and infrastructure.
- It is also a 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, as this industry provides high levels of employment.
- Taxation policy can be used to discourage or encourage certain social activities for non economic reasons. Examples of this is high excise on tobacco and alcohol to curtail the consumption of these, or the reduced tax imposed on certain hybrid cars to encourage reduced emissions from motor vehicles.
- Finally, taxation policy is used as a tool to redistribute wealth among individuals in order to support the economically disadvantaged in society like the elderly, sick or unemployed.

The formation of Taxation policy

As taxation policy changes on an annual basis, with the introduction each year of a new budget, some of the rules in taxation will change from one year to the next. This is what makes studying taxation challenging and interesting. However, it also means that when doing any tax calculations it is important to ensure that you refer the rules that are applicable to the tax year the computation is required for.

Due to the deterioration in economic circumstances experienced in the last 12 months the Government was forced to introduce two budgets in relation to the 2009 tax year. As a result of this we have seen some of the largest changes to the tax system in a number of years. The first budget was held in October 2008 and announced certain changes with effect from 1 January 2009. However a second budget on 7 April 2009 introduced another set of changes to tax law, some effective

from that date and some effective from 1 May 2009. For this reason studying the 2009 tax year will be challenging. In order to understand the broader issues in relation to taxation it is important to be familiar with the general forms that taxation can take and the types of taxes that fall under these.

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.

In this subject you will be studying the rules in relation to Income Tax, Corporation Tax, Capital Gains Tax and VAT.

Source of Tax Law

As explained above the taxation rules for a particular tax year are announced in the Budget for that year. However, tax law goes back many years and the announcements in each year's budget are the amendments to that legislation. Historically there were pieces of legislation introduced covering each different type of tax, the Income Tax Act 1967, Corporation Tax Act 1976 and the Capital Gains Tax Act 1975. Each year there were amendments made to these laws based on the budget announcements. However, in 1997 all of these pieces of legislation were combined to give us the Taxes Consolidation Act 1997 (TCA).

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. Once it was introduced, containing the combined legislation from the Income Tax Act 1967, Corporation Tax Act 1976 and the Capital Gains Tax Act 1975, it is updated annually for all subsequent changes to the law each year. This means there is a different version of the TCA 1997 for every tax year since then, with each version containing the rules that were applicable for that particular year.

The process for producing the annual TCA is achieved in the following way: Each year after the government announces their new budget these changes are then incorporated in the Finance Bill. The Finance Bill will then be debated in the Dáil and some amendments may be made to it at this stage. Therefore, what is announced in the budget will not always end up being the final rules for a tax year. The Finance Bill will eventually be voted through the Dáil and become the Finance Act. When this is passed into law it 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.

The other main piece of tax legislation is the *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 will be covered in this 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. This is divided into a number of sections, each with their own area of responsibility.

Revenue Commissioners

The Revenue Commission 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.

Inspector 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, balancing statements and assessments. 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 collection 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 tax charge it is possible to refer this to the Appeals Commissioner. The Appeals Commissioner has 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 Commissioner they may apply for a rehearing in the Circuit Court, or a case stated to the High Court on a point of law.

Tax Residence & Domicile

Before we start looking at the rules in relation to the calculation of Income Tax it is important to understand who is liable to pay Income in Ireland. As many people move from one country to another there are certain rules that are followed in order to decide in which country they will account for Income Tax on their earnings. Each country has its own rules, and the following are the rules that are used in the Republic of Ireland. The liability to Income Tax will be based on three different factors:

1. Residence
2. Ordinary Residence
3. Domicile

It is necessary to understand the rules that apply in deciding if an individual is resident, ordinarily resident or domiciled. Once it is possible to distinguish what their status is it is then possible to work out based on this what income they are liable to pay income tax on.

Residence

An individual will be considered to be resident in Ireland where they are present in Ireland for either:

- 183 days in a tax year or
- 280 days over two tax years, the current and the preceding tax year

Example 1

Where less than 30 days spent in a tax year then will not be resident. If I left Ireland on 10 January 2009, after living here for a number of years, I would always be considered Irish resident in 2009 under the 280 days rule. However, this rule will override that and deem an individual to be non resident in a year if they are here for less than 30 days in that year, regardless of the 280 day rule.

A day is counted as a day present in the State where the individual is present here at any time during that day. This rule was introduced with effect from 1 January 2009. Prior to this date an individual is only considered present in the State for a day if they are present at midnight.

Example 2

An individual is present In Ireland for the following number of days:

2009	20 days
2008	365 days

In 2009 he is not considered resident in the State. Although he is present in the state for more than 280 days for 2008 & 2009 combined as he is present for less than 30 days in 2009 he will not be considered resident.

In 2008 he is considered resident as he is present in the state for more than 183 days.

Example 3

An individual is present In Ireland for the following number of days:

2009	31 days
2008	229 days

In 2009 he is not considered resident in the state as he is not present in the state for more than 280 days for 2008 & 2009 combined. The total for the two years is 260 days. In 2008 he is considered resident as he is present in the state for more 183 days.

Example 4

An individual is present in Ireland for the following number of days:

2009	100 days
2008	175 days
2007	120 days

In 2009 he is not considered resident as he does not have more than 183 days in 2009 and does not have more than 280 days between 2008 & 2009.

In 2008 he is resident as, even though he has less than 183 days in 2008, he has in excess of 280 days (295 days) in 2007 & 2008 combined.

Elect to be resident

An individual can elect to be resident if they arrive in Ireland in one tax year, with the intention of being resident in the following tax year. This would be used where an individual would not satisfy either of the residence rules above and wanted to be considered resident in the year.

Example

John arrives in Ireland on 1 October 2009 to live here for three years. As he is only present in Ireland for 92 days in 2009 he is not considered resident. However, he can elect to be resident for 2009 as he intends to be resident in 2010 also. An individual would elect to be resident as they will then be entitled to claim tax credits when calculating their tax liability.

Ordinary Residence

An individual is treated as ordinary resident where they have been resident for the three preceding tax years.

Example

If an individual is resident for 2007, 2008 and 2009 they will become ordinarily resident on 1 January 2010.

An individual will not cease to be ordinarily resident until they have been non resident for the three preceding tax years.

Example

If he is ordinarily Resident in 2006 and is non resident in 2007, 2008 & 2009 then he will cease to be ordinarily resident on 1 January 2010. Therefore, he will remain ordinarily resident for three years after he leaves the country. In the above example if he returned to live in Ireland in 2009, he would never cease to be ordinarily resident.

Domicile

Domicile is a legal concept that is not defined in the taxes Act. Generally a person is regarded to be domiciled in the country which he considers to be his natural home.

The principles of domicile are:

- No person can be without a domicile.
- No person can have more than one domicile.
- An existing domicile is presumed to continue until it is proven that a new domicile has been acquired.

There are three types of domicile:

- Domicile of Origin – you are born with domicile of origin, normally that of the father. A domicile of origin cannot be abandoned. It can only be lost by the acquisition of a new domicile of choice.
- Domicile of Dependence – until a person is 16, his domicile is dependant on his father, or his mother where the parents are not married.
- Domicile of Choice – An individual can acquire a new domicile by a combination of residence and intention. They must establish a residence with the new country with no intention of returning to the old country.

A person will be born with a domicile of origin and the only way that this can be changed is to show that they have established a new domicile of choice. This would mean they have to clearly demonstrate that they have permanently moved to a new country and have no intention of ever returning to the country of origin.

It is quite difficult to prove a change of domicile and where an individual does not change their domicile they will always revert to their domicile of origin.

Consequences of Residence, Ordinary Residence and Domicile

Once you have established an individual status is in relation to each of the above it is then possible to work out what sources of income are liable to Income Tax in Ireland.

They are broken down into a number of categories as follows:

Category 1

Resident, Ordinary Resident & Domiciled

An individual who is all three is liable to Income Tax on their worldwide income.

Category 2

Resident, Not Ordinarily Resident & Not Domiciled

An example of this is a foreign national coming to Ireland for up to three years.

Resident, Not Ordinarily Resident & Domiciled

An example of this are Irish citizens returning from abroad.

Resident, Ordinarily Resident & Not Domiciled

An example of this is foreign national coming to Ireland for more than three years.

All of the individuals in this category will be liable to Income Tax on the remittance basis. Where this applies it means the individual is taxed on the following:

- All Irish Source Income.
- All other foreign income only to the extent it is brought into Ireland (with the exception of certain employment income). From 1 January 2008 foreign income includes UK income. Prior to that date UK income was taxable in Ireland whether remitted or not.
- Employment Income – where the duties of an employment are exercised in Ireland the salary relating to the duties is taxable in Ireland, even when paid outside of Ireland and not remitted.

Category 3

Not Resident, Ordinary Resident & Domiciled

An example of this is an Irish person who moves abroad to work for a few year. In the first three years after they leave they will continue to be ordinarily resident.

Not Resident, Ordinary Resident & Not Domiciled

An example of this is a foreign person who lived in Ireland for more than three years, and after they leave they will continue to ordinarily resident.

Each of the individuals in this category will be liable to Income Tax on the following:

World-wide Income with the exception of:

- The income from a trade, profession or employment where all of the duties carried on outside the state.
- Any foreign Investment income up to €3,810.

Therefore, if an individual leaves Ireland and all of their income arises from either an employment or a trade they carry on outside of Ireland they will not be taxed on this in Ireland.

In addition if they have foreign investment income up to €3,810 they will have no Irish tax liability on this. If the foreign investment income exceeds this amount all of the investment income is taxable in Ireland.

Category 4**Not Resident, Not Ordinary Resident, Not Domiciled**

An individual in this category will only be liable to Irish Income Tax on Irish source Income.

The chart below gives a summary of these rules.

Consequences of Residence (R), Ordinary Residence (OR) & Domicile (D)

<u>Status</u>	<u>Income Taxable</u>
R / OR / D	Liable on Worldwide Income.
R / NOR / ND	Remittance Basis.
R / NOR / D	Remittance Basis.
R / OR / ND	Remittance Basis.
NR / OR / D	World-wide Income except.
NR / OR / ND	Trade, Profession or employment income where all of the duties carried on outside the state. Foreign Investment income up to €3,810.
NR / NOR	Irish source income only.

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 reference to 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 – The Schedular System

Different sources of Income are classified in different categories and different rules apply to each category of Income. The rules can vary for each category in relation to the calculation of the income, the allowable expenses and the basis of assessment for that income.

The main classifications of Income are as follows:

Schedule D

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.

The following chapters will go through each source of income and the calculations that relate to each one.

Exempt Income

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

- Social Welfare Child Benefit
- 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 Child care services up to €15,000 per annum
- Rent a room relief (covered under Case V)

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 Taxation I.

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 later.

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 their total tax liability for the year. The use of them as tax credits will be covered in Chapter 2 below but the following sets out the rules of the most common withholding taxes.

Deposit Interest retention tax (DIRT)

This is deducted from interest paid on deposit accounts by banks and building societies in Ireland. All payments of interest on deposit accounts are subject to DIRT, unless specifically exempt.

The current rate of DIRT is 25%. The rates for the last few years were:

- Up to 31 December 2008 – 20%
- From 1 January 2009 – 7 April 2009 – 23%
- Since 8 April 2009 – 25%

The operation of DIRT and how the interest is taxed will be covered in more detail in Chapter 2.

Professional Services Withholding Tax (PRWT)

This is also referred to as Professional Services Retention Tax. This is a withholding tax on professional services fees paid by government and government bodies. Where an 'accountable body' makes a payment to an individual or a company in respect of professional services they must withhold 20% of the payment and pay it over to the Revenue.

Accountable Person

The deduction must be made by an accountable person in order for the withholding tax to apply. Generally this covers any payments out of public funds, from state bodies. It includes payments from:

- All Government departments
- HSE
- RTE
- ESB
- An Bord Bia
- Semi state bodies
- State sponsored bodies

Professional Services

The withholding tax is only deducted from payments for professional fees. This includes fees for the following services:

- Medical, dental, pharmaceutical, optical, veterinary
- Architectural, engineering and surveying
- Accountancy, auditing, financial services, marketing, advertising and consultancy
- Solicitors, barristers
- Training services on behalf of FAS

When the payment is made the net amount is paid to the individual and they are provided with a form F45, giving details of the amount of the gross payment and the tax deducted. This form can then be used to claim a credit for the tax deducted.

A credit is given against the income tax arising on the profits earned in the basis period. The credit is given as a refundable tax credit to the taxpayer and if the amount of Income Tax owed is less than the withholding tax deducted then the excess can be refunded.

Example

John, a solicitor provided legal services to an accountable person in June 2008 for €10,000. When he submits his invoice he will receive a payment of €8,000

and they will withhold tax of €2,000 on the payment. He will be provided with a Form F45, showing details of the gross payment and tax deducted.

John does his annual accounts up to 30 September 2008. These accounts will form the basis of assessment for the tax year 2008.

His income tax computation will include the income paid of €10,000 in the Case I figure. He will also have a refundable tax credit on the computation of €2,000. If John invoiced the accountable person more than once during his accounting period he would include all of the income in his tax return. All of the amount of refundable credit would be the total of the tax deducted from his payments.

Relevant Contracts Tax (RCT)

Relevant contracts tax applies mainly to subcontractors working in the construction industry. It is a system of withholding tax introduced in an effort to ensure that the subcontractors were paying the correct amount of Income Tax and VAT on the amounts they were invoicing.

The system places an obligation on a 'principal contractor' to deduct 35% income tax from payments to sub contractors in relation to a 'relevant contract'. This amount is paid over to the Revenue on behalf of the subcontractor who is then entitled to use it to offset against liabilities owed to the Revenue.

The principal contractor will provide the sub contractor with a C2 form, which will show details of the gross payment and the relevant contracts tax deducted. These forms can then be used by the subcontractor to claim a credit for the tax deducted at source.

In order to understand the application of RCT there are a number of definitions that you should be familiar with.

Principal Contractor

A principal contractor includes any of the following:

- A builder or other contractor in the construction industry who sub contracts all or part of his contract.
- A person carrying on business which includes the erection of buildings, meat processing, forestry and sawmilling.
- A local authority.
- A Minister of State.
- Any board established under statute.
- A person who carries on any gas, water, electricity, dock, canal or railway undertaking.

Relevant Contract

This is a contract where one person is liable to another person to:

- Carry out relevant operations.
- Be responsible for carrying out such operations.
- To furnish his own labour to carry out the operations.

Relevant Operations:

This includes any of the following:

- Construction, alteration, repair, extension, demolition of buildings.
- Installation in a building of a system of heating, lighting, air conditioning, sound proofing, ventilation, power supply, burglar or fire protection.
- The development of land.
- Construction, alteration, repair, extension, demolition of any works forming part of the land, including walls, roadworks, power lines, telecommunications systems, water mains.
- External or internal cleaning of a building so far as carried out as part of the construction, alteration, repairs, extension of the building.
- Forestry operations & Meat processing operations.

Certificate of Authorisation – C2 certificate

It is possible for a subcontractor to avoid the withholding tax deduction and receive his payment gross. In order to do so he must obtain a certificate of authorisation from the Revenue Commissioners. The Revenue Commissioner can issue certificate of authorisation, known as a C2 certificate, on application from the sub contractor if the following conditions are met:

- The sub contractor can show they are engaged in relevant operations and they are engaged in a relevant contract.
- They must keep proper books & records for the business.
- They must have a satisfactory tax record with all taxes paid to date.
- The trade must be carried on from a fixed place of business with adequate equipment, stock etc.

Where the sub contractor obtains a C2 certificate the following steps must be taken:

- The subcontractor provides the principal contractor with the C2 certificate.
- The principal contractor will then apply to the revenue for a relevant payments card. This application should be signed by the subcontractor.
- On receipt of the card the principal contractor can then pay the sub contractor gross. However they must continue to deduct the 35% withholding tax until the card is received.

Tax Deducted from Sub contractor

As the amount of withholding tax is quite significant it can be offset against any taxes due by the subcontractors – VAT, PAYE or Income Tax / Corporation Tax. The sub contractor should receive a form C45 with each payment from the principal contractor showing the amount of the payment and the tax deducted.

Self Assessment System

The Self Assessment system applies to all 'chargeable persons'. A chargeable person is defined as "all individuals unless their total income consists of salary or wages dealt with under the PAYE system".

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 other source of income where the tax is not collected under the PAYE system.
- All Proprietary Directors - A proprietary director is one who owns in excess of 15% of the share capital of a company. There are special rules relating to such directors and these are set out below.

Duties of a chargeable person

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

1. Filing Income Tax Return

A chargeable person is obliged to file an Income Tax return with the Revenue Commissioners within specified time limits.

The return shows the following information:

- Details of all sources of income.
- Claim for all allowances and credits.
- It must be signed by the taxpayer, or an agent of the taxpayer.

A self employed individual completes a Form 11 and an employed individual completes a Form 12. A copy of a Form 11 is attached at **Appendix A**.

The Income Tax return must be filed by 31 October following the end of the year of assessment. This gives a taxpayer 10 months after the end of a tax year to collate all of the information required and finalise any accounts figures, before he must file their tax return.

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

Where a taxpayer fails to file a valid Income Tax return within the specified time limits a surcharge is imposed. A valid return will contain a true and correct disclosure of all sources of income and all expenses and allowances relating to that tax year. The details of the surcharge are set out later.

Expression of Doubt

Where a taxpayer is filing their Income tax return and they are unsure about the treatment of a particular item on the return they are obliged to draw the Revenues attention to the matter. They do this by making an 'expression of doubt'. Where a taxpayer does an expression of doubt the return that they make will be deemed to be a valid return, even where the treatment of the item is incorrect.

For example if a taxpayer is unsure of how to tax certain income or whether an expense qualifies for a deduction they can draw the Revenues attention to the item by doing an expression of doubt about the treatment of the item. This will allow to Revenue to examine the item in question and decide on the correct treatment. Where the taxpayer has treated the item incorrectly there is no surcharge applied and any balance of tax arising will not be subject to interest.

Where an expression of doubt is not done in relation to any item of income or expenses and these are subsequently deemed to be incorrectly treated in the accounts then the taxpayer can have a surcharge imposed as they have failed to file a valid return by the specified date, and they may also be charged interest if an underpayment arises.

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 any balance due by 31 October. As the individual completes the return and calculates the tax, the system is known as self assessment.

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

3. Preliminary Tax payment

An individual must also calculate and pay an amount of Preliminary tax by the 31 October each year. There are a number of options available for calculating preliminary tax and this tends to be the area that taxpayers have most difficulty getting correct.

Preliminary tax is an advanced payment of the tax liability for the current tax 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.

However, as it is not 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 or
2. 100% of the liability for the previous year or
3. 105% of the liability for the pre-preceding year. This option is only available if the following conditions are satisfied:
 - 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 installments from October to December.
 - This option cannot be used if the liability in the pre preceding year was nil.

The taxpayer must ensure they pay at least the lowest minimum of the three options listed above. They can always pay an amount in excess of this if they wish.

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 option one or two above it 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 payment.

2008

As he is a chargeable person 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 - $€5,000 \times 90\% = €4,5000$ or,
- 100% of 2007 liability – nil.

Therefore he can pay nil preliminary tax in 2008 as this is the lower of the two figures. If he pays nil preliminary tax on 31 October 2008, he will pay the full liability for 2008 on 31 October 2009 when he files the tax return for 2009. However, there will be no interest on this payment as he has satisfied the minimum preliminary tax requirement.

2009

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

- 90% of 2009 liability - $€8,500 \times 90\% = €7,650$ 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. Again the balance of Income tax due for 2009 will be paid on 31 October 2010. Assuming John pays the $€5,000$ preliminary tax for 2009 the balancing payment will be $€3,500(€8,500 - €5,000)$.

Assuming John remains in business he will also have a preliminary tax payment for 2010 to be paid on 31 October 2010. Lets assume this is based on 100% of the 2009 liability so it will be $€8,500$.

A summary of the payments required are as follows:

<i>31 October 2008</i>	
Preliminary tax for 2008	€0
<i>31 October 2009</i>	
Balancing payment for 2008	€5,000
Preliminary tax for 2009	<u>€5,000</u>
Total	<u>€10,000</u>
<i>31 October 2010</i>	
Balancing payment for 2009	€3,500
Preliminary tax 2010	<u>€8,500</u>
Total payment	<u>€12,000</u>

Income Levy & Preliminary Tax

For the 2009 tax year when an individual is paying preliminary tax based on 100% of the 2008 liability they must calculate the 2008 liability as if the Income Levy was in place for that year. Therefore, their liability must be increased by the amount of Income Levy that would have been paid on their income for that year. The calculation of the Income Levy is covered in more detail later.

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 - 31 October.

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.

Surcharge 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 that can be applied is:

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

The surcharge is calculated on the final Income Tax liability, including PRSI and Levies and after all refundable tax credits but before taking into account the amount of preliminary tax paid for that year.

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

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.

Issue of Assessments

The Inspector of Taxes is entitled to issue an assessment to a taxpayer:

- Before the 31 October if a return has been delivered prior to this date or,
- Any time after 31 October following the tax year.

The assessment will be based on the details contained in the return made by the taxpayer unless the Inspector did not receive a return or was not happy with the return received. In this case the inspector can issue an estimated assessment.

The assessment for a tax can be amended by the Inspector at any time within four years after the end of the year of assessment it relates to, provided a full and correct return of information was made.

Where a taxpayer is unsure of the correct treatment they can make an expression of doubt claim on the return. In this case, as they have drawn the Revenue's attention to the item, the return will be treated as having made a full disclosure.

Appeals against assessments

A taxpayer cannot appeal against an assessment if they contain the information included on the tax return.

Where the inspector issues an estimated assessment the taxpayer can appeal once they satisfy the following conditions:

- The outstanding tax return must be lodged.
- They must pay the correct amount of tax outstanding based on the return.
- The appeal must be lodged within 30 days.

A valid appeal must be:

- In writing.
- Identify each item in the estimated assessment being appealed.
- Specify the grounds for the appeal in respect of each item.

Proprietary Directors and Self Assessment

A director who owns in excess of 15% of the share capital of a company is referred to as a proprietary director. These directors will be in receipt of a salary from the company and will have PAYE deducted from this salary. However, the tax system still treats them similar to a self employed individual.

There are additional rules that must be taken into account when calculating the tax liability for a proprietary director.

- A proprietary director is not entitled to a PAYE credit when calculating his income tax liability.

- A proprietary director will often be subject to PRSI at the self employer rates. However this will not always be the case.
- A proprietary director is obliged to file a tax return each year, regardless of the fact that all of the income tax is paid through the PAYE system. In order to ensure that the director is brought into the self assessment system there are special rules that apply to the calculation of a surcharge for a director. The normal rule for surcharge calculation is to impose an additional 5% / 10% of the tax due, as an additional penalty for late filing. This amount is calculated on the tax due after deducting all refundable tax credits. Where a director is in receipt of a salary only, often there will be no liability outstanding at the end of the year. If there is no liability then the surcharge will be nil and the director is not penalised for not filing his return.

In order to ensure that this does not arise the surcharge amount for a director is calculated on the tax liability, before taking into account the PAYE paid. Therefore a director could have paid the correct amount of tax through the PAYE system and still owe tax due to a surcharge.

Example

Frank is a proprietary director and the only income he is in receipt of is his salary of €80,000. During the year he paid PAYE of €22,480 on this and equals his Income tax liability for the year. Frank does not file a tax return for 2009 until February 2011 as he was not aware he needed to do so. His final position for 2009 will now be as follows:

Total Income Tax	€22,480
Surcharge for late filing	€2,248
	€24,728
Less PAYE paid	(€22,480)
Tax due	€2,248

Revenue Audits

As the self assessment system is based on the taxpayer's calculations and declarations the Revenue need to have a system in place to verify the amounts being returned by taxpayers to ensure they are including the correct figures on the

return. This system is known as the Revenue Audit. A Revenue Audit gives the Revenue the opportunity to do a more detailed examination of the items on a tax return to ensure that the income and claims for allowances and credits are correct.

The Revenue will normally use one of the following criteria to select tax returns for Revenue Audit:

1. Selection on a random basis. The revenue states that a certain portion of all Revenue audits each year are randomly selected.
2. Selection is based on an investigation into a particular trade or activity. The Revenue will frequently carry out investigations into particular industries that may focus on certain practices within the industry. Involvement in an industry that is part of an investigation can result in a Revenue audit of a taxpayer.
3. Selection is based on third party information received. This information can often be obtained by the Revenue as a result of an audit of another taxpayer, or from information provided by financial institutions as part of special investigations by the Revenue. Examples of this would include the special investigations into non resident bank account and insurance products.
4. Selection is based on inconsistent figures contained in the tax returns. The Revenue will collect and collate information in relation to certain industries, relating to standard costs and gross profit margin. Where details in the taxpayers accounts vary from the standards this can result in a Revenue audit.

Except where there has been fraud or neglect, there is a time limit within which a return may be audited. This is currently 4 years from the end of the year of assessment in which the return is submitted.

There are two types of audit that can be carried out.

A desk audit normally involves the Revenue raising a query about a specific item in a tax return. This is usually done by letter or telephone. An example of this would be where the Revenue asks the taxpayer to provide all of their medical receipts as evidence of the claim submitted.

A field audit is a more extensive examination. This will involve the Revenue visiting the taxpayer and doing a detailed examination of all the books and records of the business, plus any relevant documentation in relation to amounts claimed as allowances or credits in their tax return.

There are certain procedures that will be followed when a Revenue Audit is being carried out.

The taxpayer will receive notification of the Revenue Audit from the Revenue in writing. This will give the taxpayer a period of time in which to prepare for the audit.

At the initial meeting for the audit the taxpayer has an opportunity to do a voluntary disclosure. A qualifying voluntary disclosure will set out in writing any errors or omissions in relation to the income declared or allowances or expenses claimed in the relevant period. This must include details of the amounts involved and a calculation of the tax, interest and penalties arising on these items. The statement must be signed by the taxpayer and have payment for the amount outstanding included.

Where a taxpayer makes a qualifying voluntary disclosure at the beginning of a Revenue audit this may entitle them to a reduction in penalties on the final settlement. The standard penalty that can be charged is 100% of the tax underpaid. However, with a voluntary disclosure and cooperation this can be reduced to 15%. The taxpayer is required to pay the full amount of the tax and interest on the underpaid tax. In addition to this by making a voluntary disclosure the taxpayer can avoid publication of the settlement.

In the initial Revenue audit meeting the Revenue will ask the taxpayer about their personal expenditure commitments and details of all assets that the taxpayer owns, including cars and holidays home. The purpose of this is to collate information in relation to the taxpayer that would not appear on a tax return and to see if the level of earnings returned by the taxpayer is reasonable in comparison to the expenditure and wealth of the taxpayer.

The Revenue will also ask detailed questions about the operation of the business, getting a detailed analysis of goods sold or services provided types of customers and an outline of how the accounts system is managed in relation to this.

The Revenue will then either take the books and records away, or if the taxpayer has accommodation to facilitate it, they will spend a number of days at the taxpayer's premises, examining the books and records.

After the detailed examination of the books and records the Revenue may have further queries that they will require answers to. On receipt of the answers, and assuming the answers are satisfactory to the Revenue they will either:

- State they are satisfied and agree no further liability arises.
- State they are satisfied and issue a computation of the final liability they consider to be outstanding.
- State they are not satisfied and seek further clarification.

Generally it should be possible to reach agreement with the Inspector who is carrying out the audit. However, the taxpayer has various rights of review with regard to the audit procedure. Where the taxpayer and the Inspector cannot reach agreement it can be referred to the Internal Review procedure, or for appeal to be heard by the Appeal Commissioners who are government appointed non-judicial tax experts.

Further appeal, in the form of a full rehearing, lies to the Circuit Court / High Court / Supreme Court.

The audit settlement, where one arises, will involve unpaid tax as well as interest and penalties. Penalties range from 3% to 100% of tax underpaid and interest is charged at a rate of .0273% per day.

Tax Clearance Certificates

In certain circumstances a taxpayer may be required to obtain a tax clearance certificate from the Revenue Commissioners. The certificate will only be issued to the taxpayer if all tax liability have been paid up to date and all relevant returns have been correctly filed.

A clearance certificate is normally required in order to tender for work from government departments and semi state bodies. It will also be required in order to apply for certain licenses, for publicans and auctioneers, and for the application for certain grants.

Revenue Online System (ROS)

In an effort to improve the efficiency of the tax administration system the Revenue have introduced the Revenue Online System, or ROS as it is referred to. This system allows the taxpayer to file most returns electronically, thus eliminating the need for large volumes of paper.

The use of ROS is not compulsory and a taxpayer has the right to continue to file a paper return. The returns filed through the ROS system will require the same information as the paper returns. The system will allow a taxpayer to file PAYE, VAT, corporation tax and income tax returns on the system. It can also facilitate the payment of tax liabilities electronically.

In certain circumstances the taxpayer may be given additional time to file returns using the ROS system. An example of this would be the annual Income Tax return filing date of 31 October. For the past number of years this date has been extended by approximately two weeks where a taxpayer uses the ROS system to file their return. This particular extension is granted by concession annually. However, from the beginning of 2009 the filing date and payment date for all other taxes is extended to 23 day of the month where the filing and payment is done through ROS. For example if a taxpayer files the monthly P30 using ROS then this will be due by the 23 of the following month rather than the 14 of the month as the paper return is. The extension only applies where the return and the payment are made using the ROS system.

SAMPLE QUESTIONS & SOLUTIONS PROGRAMME

The following questions examine the key areas you are expected to know for this particular subject, and will assist you significantly in your preparation for your examination in May/August 2010. In addition to the questions below, please also refer to the Summer 2009 examination paper which is contained in this manual for your reference. Pilot papers for this subject can be downloaded from www.AccountingTechniciansIreland.ie

Question 1:

State the rules for deciding an individual's residence in Ireland for a tax year?

Outline the taxation implications of the following:

- Being Irish resident and Irish Domiciled
- Being Irish resident and not Irish Domiciled
- Being Non Resident but Ordinarily resident in Ireland

Question 2:

Bill, a French domiciled person, arrives in Ireland on 1 August 2006 and stays until 12 January 2011.

- Explain to Bill the rules relating to Ordinary Residence?
- Outline, giving reasons for your answer, the years for which Bill will be considered Irish ordinarily resident under Irish domestic law.

Question 3:

Greg, a US citizen works for a US multinational company. In 2007 he was asked to come to Ireland for a short stay and since then he has spent the following days in Ireland.

2007 – Total 32 days

2008 – Greg moved to live in Ireland on 19th July

2009 – Greg lived in Ireland for the year. However, he spent 40 days on holidays outside of Ireland.

Prior to coming to Ireland in 2007 he had never been here before.

Explain his Irish residence position to him in each of the three years?

In 2009 Greg has the following income:

Salary from US multinational - €350,000 paid from the US. He remits €120,000 of this.

UK dividend income - €4,200 lodged into his UK bank account.

US rental income - €18,000 lodged directly into his US bank account.

Explain to Greg what income figures will be used to calculate his Irish Income Tax liability in 2009?

Question 4:

Explain how the withholding tax system for sub contractors operates. Your answer should refer to the following:

- Who the system applies to?
- What type of work it applies to?
- How it is possible to avoid the withholding tax?

Question 5:

Mary has contacted you stating that she has had Professional Services Retention tax deducted from a payment in the business. You are required to explain to her who is obliged to deduct PSRT and what type of services it relates to, giving some examples.

Question 6:

Andrew has been self employed for many years. His income tax liability for 2008 was €30,000 and for 2009 is €10,000.

- Outline the due dates for the payment of Andrew's 2009 income tax liability and the amount he would pay on each date?
- By what date must he file his Income Tax return for 2009 in order to avoid a surcharge.
- Assume Mark files his Income Tax return for 2009 on 3 January 2011 calculate the surcharge due?

Question 7:

Explain the rules for calculating Preliminary Income Tax?

Explain briefly the purpose of a Revenue Audit?

Solutions to the chapter questions above will be available online for students from January 2010 (in order to have provided you with sufficient time to have covered certain parts of the course.)

For those of you of wish to attempt any of the above chapter questions (and without looking at the solutions online!), you can email your answers to solutions@accountingtechniciansireland.ie from January 11th, 2010. Detailed feedback* will be provided to you within 3 working weeks of receipt. (These questions will not in any way count towards your summer examination marks.) This is a free service to our students and you are strongly advised to avail of it as past students have noted the benefits.

**** Proof of purchase of this manual may be required.***

