Foreign Entity Classification for Irish Tax Purposes

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Introduction

Where a foreign entity is involved in a transaction, the classification of that foreign entity can be central in determining any Irish tax implications.

In an Irish tax context, there are fundamentally two entity classifications; entities which are opaque for tax purposes, such as Irish companies, and entities which are transparent for tax purposes, such as Irish partnerships. By way of context, an opaque entity is an entity that is itself chargeable to tax while a transparent entity is one that is looked through for tax purposes such that tax is charged directly on the members rather than on the entity itself.

Foreign entities, however, can have nuanced and novel structures that do not fit neatly within the concept of an Irish company or an Irish partnership[1]. This can cause uncertainty when determining the treatment of transactions involving these entities in an Irish tax context.

The purpose of this TDM is to provide clarity on the approach taken by Revenue when classifying a foreign entity for the purposes of Irish tax law. In broad terms, Revenue's approach is to look at each foreign entity on its own merits and, based upon established principles set out in case law, determine whether the entity is more akin to an Irish company (and opaque) or more akin to an Irish partnership (and transparent) in the context of a specific Irish tax provision.

Where there is uncertainty, requests concerning the classification of a foreign entity should be submitted and dealt with using the RTS framework.

1 Entity Classification – Ireland

Before discussing foreign entity classification, it is first necessary to examine entity classification in an Irish tax context. Broadly, there are two types of business entities which commonly operate in Ireland, a company and a partnership.

[1] More complex entity types such as collective investment vehicles, trusts and pension funds are outside the scope of this manual. For details on the tax treatment of investment vehicles and pension funds, the reader is referred to paragraphs 1.4 of TDM Part 27-01b-02.

1.1 Company

For the purposes of the Corporation Tax Acts, the definition of a company is contained in section 4(1) of the Taxes Consolidation Act 1997 ("TCA") which sets out that "except where the context otherwise requires – "company" means any body corporate …".

A "body corporate" is a succession or collection of persons having in the estimation of the law an existence and rights and duties distinct from the individual persons who form it from time to time [Murdoch, Dictionary of Irish Law][2]. All companies incorporated in Ireland with or without limited liability, and those limited by share capital or by guarantee are regarded as a body corporate[3]. Co-operative societies registered under the Industrial and Provident Societies Acts are also regarded as a body corporate. Examples of bodies corporate also include government departments and local authorities.

The term "body corporate" is not defined for the purposes of Irish tax law, however, a discussion on the characteristics of bodies corporate is set out in Section 4 of this manual.

1.1.1 Taxation of a company

A company that is resident in Ireland for corporation tax purposes is, subject to specific exceptions, chargeable to corporation tax on all of its profits wherever arising.[4] In this regard, a company is opaque for Irish tax purposes.

The charge to corporation tax (and the general exclusion of income tax and capital gains tax) is set out in section 21 TCA which provides that corporation tax shall be charged on the profits and gains[5] of companies[6]. Members in the company (e.g. shareholders) are not taxed on the company's profits and gains but rather on distributions that they receive from the company.

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[2] Refer to TDM Part 01-00-02 for further detail.

[3] Incorporation can only be availed of so long as there is no fraud and no agency and if the company is a real one i.e. not fictional. If a court strips away the veil of incorporation, the officers, and in some cases the members could be held responsible for the obligations of the company. Should this arise, then it could potentially change how the entity would be viewed i.e. from opaque to transparent.

[4] Section 26(1) TCA refers. A non-resident company will be chargeable to Corporation Tax as follows:

(I) Where it is trading in Ireland through a branch or agency, in respect of-
   a) any trading income arising directly or indirectly through or from the branch or agency,
   b) any income from property or rights used by, or held by or for, the branch or agency, and
   c) chargeable gains attributable to that branch or agency. (Section 25 TCA)

(II) Where it is in receipt of income or gains and that income or gains are attributable to assets in the State, the income from which is chargeable under Case V of Schedule D.

Refer to TDM Part 45-01-04 and TDM Part 02-02-04 for further details.

[5] Subject to section 649 TCA.

[6] Refer TDM Part 02-02-05 for a discussion on the general scheme of corporation tax.

1.2 Partnership

A partnership is not defined within Irish tax law and therefore, when considering its key characteristics, one must refer to the framework laid down in the Partnership Act 1890.

Section 1(1) of the Partnership Act 1890 sets out that "Partnership is the relation which subsists between persons carrying on a business in common with a view to profit".

This definition has six elements:

i. The "relation" or relationship is a consensual contractual one, but the contract need not be in writing.
ii. It must be between "persons". A company, or even another partnership can be a partner.
iii. "Carrying on" a business requires that the business be extant, rather than a future proposal.
iv. There must be a "business".
v. The term "in common" goes to the heart of an Irish partnership. Each partner is liable for the acts of the other(s). Each is therefore a principal and each an agent for the other(s)[7].
vi. "Profit". The intention is to gain.

Section 1(2) of the Partnership Act continues by explicitly excluding from the definition the following –

> *"But the relation between members of any company or association which is—*
>
> *(a) Registered as a company under the Companies Act, 1862, or any other Act of Parliament for the time being in force and relating to the registration of joint stock companies; or*
> *(b) Formed or incorporated by or in pursuance of any other Act of Parliament or letters patent, or Royal Charter; or*
> *(c) A company engaged in working mines within and subject to the jurisdiction of the Stannaries:*
>
> *is not a partnership within the meaning of this Act."*

Therefore, in an Irish context, in broad terms, apart from those bodies that are registered/formed with a separate legal personality, all other persons carrying on a business in common with a view to a profit are generally considered a partnership.

[7] This is slightly modified by the Limited Partnership Act 1907, in that certain partners, who are not actively engaged in the business of the partnership, can have their liability limited to the amounts invested.

1.2.1 Nature of a partnership interest

As outlined previously, as there is no definition of a partnership within Irish tax law, one must refer to partnership law to understand it's nature. Some key points are set out in the following paragraphs to provide the reader with an insight that may be useful when considering foreign entities in the context of an Irish partnership.

A partner's interest in their firm is often referred to as that partner's 'share', however, it is not straightforward to define exactly what is the nature of this share. Case law and commentary on the subject indicates that a partner's share in a partnership is essentially a contingent right to certain monetary sums. Lord Lindley gave the classic definition of the partner's share in a partnership[8]:

> *"What is meant by the share of a partner is his proportion of the partnership assets after they have been all realised and converted into money, and all the debts and liabilities have been paid and discharged."*

This definition focuses on the nature of the interest being a contingent interest to a future monetary amount and will have relevance in terms of the disposal of a partner's interest. However, consideration must also be given to the nature of the continuing partner's interest.

Lindley & Banks describe the essential nature of a partner's interest in partnership property as follows (at para. 19-04):

> *"It is clear that, in the absence of some other agreement (express or implied) all the members of an ordinary partnership have identical and equal interests in its assets and that no partner is entitled, without the concurrence of all his co-partners, to insist that a particular asset (or an interest therein) is vested in him, either during the continuance of the partnership or following its dissolution."*

Therefore, while the nature of a partner's interest in the partnership assets will to an extent depend on the contents of the partnership agreement, the interest constitutes an undivided beneficial interest in the entirety of the assets of the partnership while the partnership is continuing.

Essentially, it may be said that during the currency of a partnership, each partner's share comprises a bundle of the different types of rights which the partner holds under the Partnership Act and the partnership agreement. Broadly, the rights could consist of:

[8] Lindley & Banks on Partnership (18th ed 2002), para 19-05

- a right for the partnership property to be used for the purposes of the partnership business while the partnership carries on (section 20 Partnership Act 1890),
- a right to a share of profits (section 24 Partnership Act 1890),
- on dissolution of the partnership, a right for the partnership property to be applied to discharge the partnership's creditors (section 39 Partnership Act 1890); and
- on dissolution of the partnership, a right for the partnership property to be realised and to receive a return of capital and a share in any surplus (section 44 Partnership Act 1890).

Therefore, the question as to the nature of a partnership interest is complex. As discussed, a partnership interest gives rise to a beneficial interest in all the assets of the partnership such that the partner's share is not an asset which is entirely distinct from the partnership property, in contrast to the case with a share in a company, for example. However, it is likely that a partner acquires something akin to an equitable chose in action on the acquisition of their interest in the partnership which is a future entitlement to a share of the monetary value of the surplus assets.

Foreign partnerships may or may not be established under laws that are similar to Irish partnership law, however, the above analysis may be useful when comparing a foreign entity to an Irish partnership.

1.2.2 Taxation of a partnership

In contrast to a company, a partnership is treated as transparent for Irish income and corporation tax purposes, and for capital gains tax purposes. Profits and gains arising to a partnership are not taxed on the partnership itself. Instead, the profits and gains are allocated (according to the terms of the partnership agreement) and taxed directly on the members i.e. the partners.

As outlined in the previous section, under Irish partnership law, partners are not legally entitled individually to exercise proprietary rights over any of the partnership assets. Instead, the partners are collectively entitled to each and every asset of the partnership, in which each of them has an undivided share. For the purpose of capital gains tax, however, Irish partnership property is treated the same way as any other property that is jointly owned by two or more persons i.e. regard is had to the effect of the disposal on the persons beneficially entitled. The Revenue position is to regard each partner as entitled to a fractional share of each partnership asset. It follows that where an Irish partnership disposes of an asset, each partner is treated for capital gains tax purposes as having disposed of a percentage share of the asset, as determined in accordance with the terms of the partnership agreement[9]. Similarly, in the case of income tax, the legal position is to regard each partner as entitled to a fractional share of the profits and gains of the partnership in accordance with the terms of the partnership agreement[10].

[9] Refer to TDM Part 02-03-03

The taxation of partners is set out in section 1008 TCA 1997 and section 30 TCA 1997.

Section 1008(1) states that –

> "*In the case of a partnership trade, the Income Tax Acts shall… apply in relation to any partner … as if … any profits or gains arising to that partner from the trade and losses sustained by the partner in the trade were respectively profits or gains of, and losses sustained in a trade … carried on solely by that partner…*".

While section 30 states that –

> *"Where 2 or more persons carry on a trade, business or profession in partnership—*
>
> *(a) capital gains tax in respect of chargeable gains accruing to those persons on the disposal of any partnership assets shall be assessed and charged on them separately, and*
> *(b) any partnership dealings in assets shall be treated as dealings by the partners and not by the firm as such."*

Where a partner is a company, then section 26(2) TCA provides that *"A company shall be chargeable to corporation tax on profits accruing for its benefit under any trust, or arising under any partnership, in any case in which it would be so chargeable if the profits accrued to it directly,…."*

1.3 Summary

In summary, in an Irish tax context, there are essentially two entity classifications, a company which is tax opaque and a partnership which is tax transparent.

[10] Section 1008(2) TCA.

2 Foreign entity classification

Foreign entities can have nuanced and novel structures that do not fit neatly within the concept of an Irish company or an Irish partnership. This can cause uncertainty when determining the treatment of transactions involving these entities in an Irish tax context.

The correct approach to foreign entity classification for the purposes of applying Irish tax law is to look at each foreign entity on its own merits, based upon established principles set out in case law, and determine whether it is more akin to a company (and tax opaque) or more akin to a partnership (and tax transparent) in the context of the specific Irish tax provision.

The case law and guiding principles are set out in Section 3 and Section 4 of this manual.

3 Case law

The landmark case on the matter of foreign entity classification is the UK case of Memec plc v CIR[11]. In this case, the UK courts confirmed the common law approach to classifying a foreign entity as opaque or transparent for UK tax purposes. This common law approach was subsequently confirmed in Irish law in the leading Irish case of Quigley v Harris.[12] Details of both cases are set out below.

3.1 Quigley v Harris

The leading Irish case on the classification of foreign entities is Quigley v Harris, which provides a detailed review of the approach to be adopted when looking at foreign structures for Irish tax purposes.

3.1.1 Overview of case

The foreign entity, in this case, was a Limited Partnership ("LP") registered under the laws of the Cook Islands. The Irish resident taxpayer, Mr. Harris, claimed he was entitled to offset against his general liability to income tax, expenditure incurred by him in his capacity as a partner in the LP.

Essentially, the issue was whether Mr. Harris, as a partner in the LP, met with the definition of a 'limited partner' within the meaning of Irish legislation, by falling within the term 'general partner' for the purposes of section 1013(1)(d) of the TCA.

3.1.2 The Court's approach

The case sets out that Irish common law recognises rights and obligations established under foreign law.

The court, in reaching its decision, endorsed the principles set out in the Memec case (outlined in Section 3.2). Justice Laffoy, in her judgement, stated that:

> "*…the taxpayer's argument…is that under the common law, that is to say, domestic law, the courts in this jurisdiction, where necessary, recognise and give effect to the rights and obligations of partners in a foreign limited partnership as determined in accordance with the law of the state in which the partnership is established. That proposition, in my view, is correct and it is reflected in the Memec decision.*"

In quoting a passage from Walker J's judgement in Memec, Justice Laffoy went on to say that the passage:

[11] Memec plc v CIR [1998] STC 754
[12] Quigley v Harris [2008] ITR 153

> "*…points to the existence of a binding common law rule… It is a rule which is necessary to give effect to domestic taxation legislation where the taxpayer's liability to tax is affected by a transaction …. or an agreement or arrangement (for example a partnership agreement), which is governed by foreign law. That common law rule, in my view, must be part of Irish law….*"

In reaching her determination Justice Laffoy stated that:

> *"… it is a two-stage process. The first stage is to determine the characteristics, rights and obligations of the taxpayer qua partner under the Partnership by reference to the law of the Cook Islands. … The second stage is to determine whether, applying Irish law, the characteristics, rights and obligations of the taxpayer qua partner match the characteristics, rights and obligations of a general partner within the meaning of para (d) in the context of s 1013 ….*".

3.1.3 Decision held

The outcome of the two-stage process in this case was that, as a matter of fact (including Cook Islands law), the characteristics, rights and obligations of the taxpayer in his capacity as a partner in the LP (primarily that his liability was not unlimited) meant that, as a matter of Irish law, he was not a general partner within the meaning of section 1013(1)(d) of the TCA.

3.2 Memec plc v CIR

The issue in this case was whether a German silent partnership (*stille* gesellschaft) was 'not transparent' for UK tax purposes.

3.2.1 Overview of case

A UK company, Memec plc ("Plc"), entered into a silent partnership with a German holding company, Memec GmbH ("GmbH"). GmbH held two German trading subsidiaries. Under the terms of the silent partnership, Plc was a silent partner while GmbH was the owner of the GmbH business. Plc also had a contractual right to receive most of the income of the partnership, being dividends from the two German subsidiaries. For the periods under appeal, Plc claimed relief from UK corporation tax in respect of trade tax (Gewerbesteuer) levied in Germany on the profits of the two German subsidiaries.

Essentially for the appeal to succeed (by virtue of the provisions of the DTA between the UK and Germany or the application of the relevant UK tax provisions) Plc had to show that either:

(i) the dividends paid by the subsidiaries could be treated as paid directly to Plc i.e. that the silent partnership was transparent or

(ii) the share of the profits of the silent partnership paid to Plc could be treated as a dividend paid by GmbH.

The second argument failed based on the meaning of the term "dividend" under the DTA and the relevant UK tax provisions. Essentially it was found that the meaning of "dividend" did not extend to include the share of profits of a silent partnership and therefore tax relief could not be granted on that basis.

To opine on the first argument, the courts were required to determine whether the German silent partnership was transparent, or not, for the purposes of UK tax.

3.2.2 The Court's approach

In the High Court, Walker J stated that:

> "*when an English tribunal has to apply the provisions of an United Kingdom taxing statute to some transaction, arrangement or entity which is governed by a foreign system of law, the tribunal must take account of the rules of that foreign system (properly proved if not admitted) in order to determine the nature and characteristics of the transaction, arrangement or entity. But having informed itself in this way, the tribunal must then apply the taxing statute as part of English law*".

On appeal in the Court of Appeal, Gibson LJ stated that:

> "*…what in my judgment we have to do in the present case is to consider the characteristics of an English or Scottish partnership which make it transparent and then to see to what extent those characteristics are shared or not by the silent partnership in order to determine whether the silent partnership should be treated for corporation tax purposes in the same way*".

Essentially both courts found that to classify a foreign entity (as transparent or not) for UK tax purposes regard must be had to the characteristics of that foreign entity by virtue of the foreign law and then those characteristics must be applied in a UK context.

3.2.3 Decision held

Both courts distinguished the features of a German silent partnership with those of an English or Scottish partnership.

Gibson LJ looked at the following in the context of an English partnership –

- the partnership is not a legal entity,
- the partners carry on business of the partnership in common with a view to profit,
- each does so both as principal and as agent for each other, binding the firm and his partners in all matters within his authority,
- each partner is liable jointly with the other partners for all debts and obligations of the firm, and

- the partners own the business, having a beneficial interest in the form of an undivided share, in the partnership assets, including any profits of the business.

In contrast, it was held that the German silent partnership had the following characteristics –

- the silent partnership did not carry on a business in common with a view to a profit as the business was that of GmbH as sole owner,
- Plc had no rights to the assets being the shares in the German subsidiaries that were the sources of the partnership's income as the shares were fully owned by GmbH, and
- the partners in the silent partnership were not jointly liable to the debts and obligations of the business (GmbH was essentially liable for the business debts in the first instance).

Based on this examination of facts, the courts found that the German silent partnership was not akin to an English or Scottish partnership and therefore held it to be 'not transparent'.

As such, Plc was treated as receiving the dividends as a contractual payment from the partnership rather than from the subsidiaries directly and therefore relief for German trade tax was not granted.

3.3 Anson v HMRC

For the purposes of clarification, it is worth also mentioning, in this section, the case of Anson v HMRC[13]. The case was heard in the UK Supreme Court in 2015 and, at that time, received much attention due to the court's findings.

Briefly, the case concerned the interpretation and application of the double taxation agreement ("DTA") between the United Kingdom and the United States of America involving a US Limited Liability Company ("LLC"). Specifically, Mr. Anson sought relief from double tax under the UK/US DTA in respect of his share of the profits of the LLC.

The case went all the way through the lower courts in the UK to the Supreme Court where, in reaching its decision, it placed its focus on the terms of the specific LLC agreement regarding profit entitlement. Lord Reed concluded that the fundamental factor in this particular case was that Mr. Anson was entitled to a share of the profits of the LLC as they arose. The Supreme Court therefore concluded that Mr. Anson was entitled to relief under the UK/US DTA on the basis that the income on which Mr. Anson paid US tax was the same as the income on which he was liable to pay UK income tax.

[13] Anson v HMRC [2015] UKSC 44

Although the findings of a UK court can be persuasive in an Irish context, they are not Irish law. The approach of the UK Supreme Court in this case was to focus almost exclusively on the particular question of whether members are entitled to a share of the profits as they arise. It should be noted that this approach is specific to the particular facts and circumstances of the Anson case, in the context of double tax relief, and should not be relied upon to have broad application[14]. Although profit entitlement is an important factor, the overall pattern of a foreign entity's characteristics should be examined, as outlined further in Section 4.

[14] The HMRC state that "*Individuals claiming double tax relief and relying on the Anson v HMRC decision will be considered on a case-by-case basis*".

4 Application of case law principles

As noted in Section 3, case law provides a set of guiding principles, or a two-stage test, to assist in determining the nature and characteristics of a foreign entity and therefore the Irish tax implications of a transaction involving such an entity.

4.1 Two-stage test

1. The first stage in the process is to determine the characteristics, rights and obligations of the foreign entity by reference to the laws of the territory in which it is established.
2. The second stage is to determine whether, applying Irish law, the characteristics, rights and obligations of the entity match the characteristics, rights and obligations of an Irish company or Irish partnership or are more aligned to one versus the other.

4.2 Factors to consider

Classification of an entity as tax transparent or tax opaque depends on whether the overall pattern of the foreign entity's characteristics is more typical of an Irish company or of an Irish partnership. Decisive importance cannot be attributed to any single characteristic. The foreign entity will be classified as tax opaque if, on balance, the characteristics are typical of an Irish company.

Factors which would be indicative of a foreign entity being classified as opaque for Irish tax purposes would include –

i. The foreign entity has a legal existence separate from that of the persons who have an interest in it.
ii. The foreign entity issues share capital or something else, which serves the same function as share capital.
iii. The business is carried on by the foreign entity itself rather than jointly by the persons who have an interest in it.
iv. The persons who have an interest in the foreign entity are not entitled to share in its profits as they arise, the amount of profits to which they are entitled depends on a decision of the entity or its members, after the period in which the profits have arisen, to make a distribution of its profits.
v. The foreign entity is responsible for debts incurred as a result of the carrying on of the business.

vi. The assets used for carrying on the business belong beneficially to the foreign entity and can be owned or transferred by the entity in its own right.[15]

vii. The foreign entity is capable of perpetual succession, its existence remains unaffected by the incapacity or death of its members.[16]

When carrying out the two-stage test, some of the factors may point in one direction i.e. that the entity is more akin to an Irish company while others may point in another i.e. the entity is more akin to an Irish partnership.

Depending on the relevant taxing provision some factors might have more significance than others.

An examination of an entity's constitutional documents and the legal framework within which the entity is formed will be required.

[15] Factors (i) to (vi) derive from the Memec principles.

[16] This specific factor was examined in detail in the TAC determination AC Ref: 17TACD2019