02TACD2018

BETWEEN/

NAME REDACTED

Appellant

V

REVENUE COMMISSIONERS

Respondent

DETERMINATION

Introduction

1. This is an appeal against amended assessments to corporation tax dated **[DATE REDACTED]** 2006 in the sum of €188,196, relating to accounting periods ended 31 December 2004 and 31 December 2005.

2. The issue for determination is whether foreign withholding tax incurred by the Appellant (in excess of the measure of foreign withholding tax relieved by the provisions of the relevant Double Taxation Treaty or Agreement 'DTA') comprises monies '*laid out or expended for the purposes of the trade*' in accordance with s.81(2)(a) of the Taxes Consolidation Act 1997 as amended (hereafter 'TCA 1997'), or whether such monies may be treated as a loss in accordance with s.81(2)(e) TCA 1997.

Background

3. The Appellant carries on the business of the provision of software solutions to the world market. The Appellant owns the majority of world-wide rights to the said software. In the course of its trade, the Appellant licenced to customers the right to use certain software in exchange for a licence fee or royalty.

4. In some countries, including both double tax treaty countries and non-double tax treaty countries, the royalty is paid subject to deduction of a withholding tax operated at source by the payor of the royalty.

5. The rate of withholding tax applied to royalties depends on the particular country from which they are paid (the "source State"). However, where the source of the royalty is a double tax treaty country, the applicable treaty sets out a maximum rate of withholding tax that may be applied to the royalty income. The maximum rate per the treaty will apply if it is less than the rate applicable under the domestic law of the source State.

6. Relief available for foreign withholding tax suffered on royalties charged to corporation tax as trading income under Schedule D, Case I, may be by way of credit relief (*i.e.* foreign tax may be offset against Irish corporation tax payable) or relief by reduction of income (*i.e.* income for Irish corporation tax purposes may be reduced by the foreign tax incurred) or a combination of both. The treatment varies depending on whether or not the foreign withholding tax has been applied in a country with which Ireland has a double tax treaty.

7. Where the withholding tax on royalties has been applied in a double tax treaty country and the relevant treaty provides for a credit in circumstances where an income stream is taxable in both countries, the Taxes Acts provide for double tax relief by way of credit in accordance with section 826 and Schedule 24 TCA 1997. Paragraph 4(1) of Schedule 24 provides that the amount of allowable credit shall not exceed "*the corporation tax attributable to that income.*"

8. References to '*income*' for the purpose of the Taxes Acts, as for accountancy purposes, generally refer to net income (see Section 76, TCA 1997). Paragraph 4(2) of Schedule 24 TCA 1997 provides that '*income*' for the purpose of calculating credit relief is income computed in accordance with the Taxes Acts (referred to as "the relevant income").

9. Where the foreign effective tax rate is higher than the Irish effective tax rate (such that not all of the foreign withholding tax may be credited against Irish corporation tax), a measure of double tax relief will be available for the non-creditable foreign tax by way of reduction of the income in accordance with paragraph 7(3)(c) of Schedule 24 TCA 1997.

10. If the foreign withholding tax arose in a non-double tax treaty country, there is no entitlement to a double tax credit in respect of royalties received prior to 1 January 2010. The Respondent submitted that in practice, the Revenue Commissioners allowed the Irish measure of the royalty income received from a non-double tax treaty country to be reduced by the amount of the foreign withholding tax.

Legislation

11. The question to be determined in the within appeal relates to the interpretation of the provisions of section 81 TCA 97 in the context of double taxation legislation (including section 826 TCA 97 and Schedule 24 TCA 1997) and in particular, the following sub-sections;

<u>Section 81 TCA 1997 - General rule as to deductions</u>

'(1) The tax under Cases I and II of Schedule D shall be charged without any deduction other than is allowed by the Tax Acts.

(2) Subject to the Tax Acts, in computing the amount of the profits or gains to be charged to tax under Case I or II of Schedule D, no sum shall be deducted in respect of –

(a) Any disbursement or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade or profession;

...

(e) Any loss not connected with or arising out of the trade or profession'

Submissions

12. The Appellant submitted that foreign withholding tax suffered on foreign royalty income (which is in excess of the foreign withholding tax relieved under the provisions of the relevant DTA) is available as a deduction under s.81(2)(a) TCA 1997, on the basis that the foreign withholding tax is incurred wholly and exclusively for the purposes of the trade of the Appellant, being part of the cost of doing business in a foreign territory.

13. The Appellant contended that because the amount of foreign withholding tax is applied to gross income receipts, it does not take into account whether a profit or loss

is generated by the Appellant in a given year of assessment and thus the Appellant is compelled to incur the withholding tax in order to trade with its customers in the foreign territory, even where the Appellant makes a loss. Further, the Appellant submits, there is no mechanism for recovery of the withholding tax in the foreign territory. The Appellant submitted that if the excess foreign withholding tax is not determined to be a deduction pursuant to sub-section 81(2)(a), then it comprises a loss in accordance with s.81(2)(e) TCA 1997.

14. The Respondent submitted that foreign withholding taxes paid by reference to gross royalty income received during the course of a trade are not monies '*laid out or expended for the purposes of the trade'* in accordance with s.81(2)(a) TCA 1997 and are not losses for the purposes of s.81(2)(e). The Respondent submitted that taxes deducted abroad in relation to royalty income are in the nature of taxes on income and that that there is no authority for the proposition that taxes calculated as a percentage of a gross royalties comprise deductible expenses in relation to the carrying on of a trade.

Analysis

15. The questions arising for consideration are as follows;

    (1) Whether foreign withholding taxes on royalty income in a source State bears the nature of a tax on income
    (2) Whether foreign withholding tax levied as a percentage of gross royalties characterises the tax as a charge other than a tax on income
    (3) Whether withholding tax deducted from royalty income comprises a deductible expense laid out or expended for the purposes of the trade in accordance with s.81(2)(a) TCA 1997
    (4) Consideration of the relevant case law
    (5) Whether the foreign withholding tax comprises a loss in accordance with section 81(2)(e) TCA 1997

(1) Whether foreign withholding taxes on royalty income in a source State bears the nature of a tax on income

16. The parties were in agreement in relation to the fact that the royalty receipts are income in nature. The Respondent submitted that a withholding tax deducted from those royalties is therefore a tax on income.

17. The Appellant contended that the foreign withholding tax was not in the nature of a tax on income as it was levied on the gross amount as opposed to on profit. Senior Counsel for the Appellant stated: *'And so, whether you call it rates, substitute tax, withholding tax, cost of entering the country, whatever you want to call it, if it's not on your profit, then it's not an income tax as we understand income tax and as is required under the schedule'*.

18. The Respondent submitted that the basis upon which double tax relief is available under Ireland's double tax treaty provisions and under Sch 24 TCA 1997 (in relation to foreign withholding tax on royalties) is that the foreign withholding taxes constitute taxes on this income.

19. The Respondent contended that the Appellant's position that the foreign withholding tax is *not* a tax on income is contrary to claims made by the Appellant for double tax relief in respect of foreign withholding tax it incurred on royalty income received from treaty countries. The Respondent submitted that if the foreign withholding tax was not in the nature of a tax on income but was a deductible expense in computing taxable income as the Appellant contends, the foreign withholding tax would not qualify for relief in accordance with s.826 and Schedule 24 of TCA 1997. The Respondent stated that the Appellant availed of its full entitlements in accordance with s.826 TCA 1997 and Schedule 24 of TCA 1997. The amount in relation to which a s.81 TCA 1997 deduction is claimed relates to the excess withholding tax suffered, *i.e.* the amount which is not available for relief under the DTA provisions. The Respondent stated that the Appellant's submission that foreign withholding taxes are not taxes is contrary to the scheme that exists both in Irish tax law and in international double tax treaties, for relieving double taxation.

20. The Appellant's position was that the excess foreign withholding tax not relieved under the DTA, should be regarded as a deductible trading expense in arriving at taxable trading income in accordance with section 81 TCA 1997. The Respondent

submitted that the Appellant, to succeed in its appeal, must establish that foreign withholding tax deducted from royalty income is not in the nature of a tax on income.

21. The Appellant relied on the case of *Ashton Gas Company v the Attorney-General [1906] AC 10* as authority for the proposition that income tax is a charge on the profits of a trade, that it is levied on profit and that the thing to be taxed is the profit. At page 12, the Earl of Halsbury stated: *'Now the profit upon which the income tax is charged is what is left after you have paid all the necessary expenses to earn that profit. Profit is a plain English word; that is what is charged with income tax.*

22. The Respondent submitted that as the Appellant comes within and has accepted relief under the DTA for a significant amount of the foreign withholding tax on royalty income earned, the Appellant must accept the proposition that the character of the foreign withholding tax is that it is in the nature of a tax on income. The Appellant in its submissions accepted relief under the DTA but did not accept that the excess amount could not be relieved in accordance with s.81 TCA 1997. The Appellant advocated that the excess withholding tax on royalty income was not in the nature of a tax on income for the purposes of s.81 TCA 1997.

23. The Respondent highlighted Spain as an example in support of its submissions. The Ireland-Spain tax treaty permits Spain to tax royalties derived by a resident of Ireland, even though they may have been taxed in Ireland. It provides that the tax charged '*shall not exceed'* the percentage of '*the gross amount of royalties'* depending on the nature of the royalty concerned. In this regard, the Appellant's tax computation demonstrates that the Appellant availed of the maximum rate of 5% permitted by article 12 of the treaty. Having incurred withholding tax on the royalties it has received from Spain, Article 23(2)a. of the Ireland-Spain double tax treaty provides that: *'Subject to the provisions of the laws of Ireland regarding the allowance as a credit against Irish tax of tax payable in a territory outside Ireland (which shall not affect the general principle hereof): a. Spanish tax payable under the laws of Spain and in accordance with this Convention on profits, income or gains from sources within Spain (excluding in the case of a dividend tax payable in respect of the profits out of which the dividend is paid) shall be allowed as a credit against any Irish tax computed by reference to the same profits, income or gains by reference to which the Spanish tax is computed*.' On the basis that the withholding tax is covered by the Ireland-Spain double tax treaty, double tax relief is provided by Ireland in accordance with section 826 TCA 1997 and Schedule 24 TCA 1997.

24. The Respondent submitted that the reason a preferential rate of withholding tax was available to the Appellant in respect of the royalty income it received from Spain, was because (i) the royalties comprise income within the scope of Article 12 of the Ireland-Spain double tax treaty; and (ii) the withholding taxes deducted from those royalties are taxes that are covered by the terms of the Ireland-Spain double tax treaty, being taxes on income.

25. On the question of whether the foreign withholding tax comprises a tax in the nature of a tax on income, I am persuaded by the submission of the Respondent. Both parties were agreed that royalties are income in nature. It follows from that, that foreign withholding tax on royalties are in the nature of taxes on income. For the reasons set out above and taking into account an analysis of the relevant case law below, in particular *Yates (Inspector of Taxes) v CGA International Limited* [1991] STC 157, I determine that foreign withholding taxes on royalties in a source State are in the nature of a tax on income.

(2) Whether foreign withholding tax levied as a percentage of gross royalties characterises the tax as a charge other than a tax on income.

26. The Respondent submitted that withholding taxes are usually imposed in circumstances where it would be difficult for a source State to exercise control over a non-resident in receipt of income, profits or gains from that State and also to regulate the collection of taxes from that non-resident. The Respondent likened the withholding tax to a crude mechanism for approximating the liability due on royalty income in order to satisfy an underlying tax liability in the source State. However, the Respondent did not accept that a tax on gross income altered the nature of the charge, being a charge to tax on income. During the hearing, Senior Counsel for the Respondent stated: '*The fact that foreign countries, for practical purposes, for practical reasons, calculate their income tax on the basis of a turnover doesn't deprive them of the basis of the nature of income tax*. '

27. As detailed below, the Respondent's submission in this regard is supported by the case of *Yates (Inspector of Taxes) v CGA International Limited* [1991] STC 157, which recognised that a Venezuelan turnover tax could correspond to UK income or corporation tax in the context of double taxation.

28. The Respondent submitted that the Appellant produced no authority in support of its submission that because the foreign withholding tax was levied on the gross royalties, it did not comprise a tax on income. The Appellant is entitled to have this submission considered in full notwithstanding that a discrepancy arises in how the Appellant itself has regarded the character of the royalty income, accepting for the purposes of the DTA that the withholding tax is in the nature of a tax on income but submitting for the purposes of s.81 TCA 1997 that the excess unrelieved amount may be re-characterised as an expense laid out or expended for the purposes of the trade.

29. I agree with the submission of the Respondent that the foreign withholding taxes are in the nature of a tax on income and, taking into consideration the case law analysis below in particular *Yates (Inspector of Taxes) v CGA International Limited* [1991] STC 157, I determine that the fact that the foreign withholding taxes are calculated on gross income or gross receipts does not deprive them of their nature as taxes on income.

(3) Whether withholding tax deducted from royalty income comprises a deductible expense laid out or expended for the purposes of the trade in accordance with section 81 TCA 1997.

30. Sequence is an important aspect in this analysis. Expenses deductible for the purposes of s.81(2)(a) are incurred in the course of a trade *prior* to the generation of income in the form of sales. For example, in the Appellant's trade, the cost of developing the software is first incurred, with sales subsequently generated in relation to that software once the software is brought to market. Tax is payable on the monies generated through sales. Usually that tax will be on profits, *i.e.* income after deductions, however, the fact that deductions are placed after income in the calculation of net profit is simply an accounting practice to assist in the computation of income for the purpose of, *inter alia*, ascertaining tax. In real time, the deductions/expenses are incurred prior to sales/turnover in that they comprise the cost of generating the product that is to be sold. Similarly, the cost of sales occurs before those sales are generated. Once the product has been made, it is brought to market and sold, turnover is generated and tax applied.

31. The Respondent submitted that foreign withholding taxes on royalties are taxes on income generated by the Appellant's trade and are not expenses laid out wholly and exclusively for the purposes of earning profits of the trade and I accept this

submission. Senior Counsel for the Respondent stated; '*... it is a logical impossibility to describe a tax withheld as a consequence of earning receipts to be an expenditure laid out to earn those receipts. … So, when looked at in this light, and this is how Irish law says profits must be calculated, it is quite impossible to regard a tax on receipts as being expenditure laid out to earn those receipts. And the Revenue case is really that simple. I mean, this is a straightforward, logical impossibility*.'

32. The fact that withholding tax is levied on a gross income figure in the foreign territories does not transform the tax into an expense or a tax deductible expense. The character of the foreign withholding tax is that it is in the nature of a tax on income. It is not a deductible expense. This finding is supported by an analysis of the case law below.

(4) Case Law

33. The Appellant relied on the cases of *Carroll Industries plc v O'Culachain (Inspector of Taxes)* IV ITR 135 and *Cronin (Inspector of Taxes) v Cork & County Property Co. Ltd*. III ITR 198, in relation to the proper meaning of the word '*profits'* and how profits are calculated, in circumstances where the Appellant contended that the foreign tax had the characteristics of being a payment extracted in order for the Appellant to do business in the relevant jurisdiction. Each of those authorities quoted the following passage by Lord President Clyde in *Whimster & Co v The Inland Revenue* [1926] SC 20;

"*In computing the balance of profits and gains for the purposes of income tax, or for the purposes of excess profits duty, two general and fundamental commonplaces have always to be kept in mind. In the first place, the profits of any particular year or accounting period must be taken to consist of the difference between the receipts from the trade or business during such year or accounting period and the expenditure laid out to earn those receipts. In the second place, the account of profit and loss to be made up for the purpose of ascertaining that difference must be framed consistently with the ordinary principles of commercial accounting, so far as applicable, and in conformity with the rules of the Income Tax Act, or of that Act as modified by the provisions and schedules of the Acts regulating excess profits duty, as the case may be. For example, the ordinary principles of commercial accounting require that in the profit and loss account of a merchant's or manufacturer's business, the values of the stock in trade at the beginning and at the end of the period covered by the account should be entered at cost*

or market price, (whichever is the lower); although there is nothing about this in the taxing statutes."

34. There is no real dispute between the parties in relation to the meaning of the term profits. Rather, the question is whether foreign withholding taxes which are calculated on gross income, or gross receipts (as opposed to on net profit) are not of the nature of taxes on income. I have determined above that the withholding taxes are in the nature of taxes on income. This determination is supported by the case of *Yates (Inspector of Taxes) v CGA International Limited* [1991] STC 157.

35. The question which arose in *Yates* is whether a turnover tax levied under Venezuelan law was entitled to relief under the UK provisions relating to double tax relief. The relevant provision of the UK law was section 498 (I) of the UK Income and Corporation Taxes Act 1970 Act which provided:-

'...relief from income lax and corporation in respect of income shall be given in respect of tax payable under the law of any territory outside the United Kingdom by allowing the last-mentioned tax as a credit against income tax or corporation tax "

Also relevant was s.498(6) which provided as follows:-

' ..*references to tax payable or paid under the law of a territory outside the United Kingdom include any references to taxes which are charged on income and correspond to income tax or corporation tax in the United Kingdom "*

36. The case is significant insofar as the issue was whether a turnover tax could correspond to UK income tax or corporation tax in the context of double taxation. Scott J. held that it could and did, in part. Having quoted article 54 of the Venezuelan tax code, Scott J. stated:-

''The purpose behind art 54 is, in my opinion reasonably apparent from the language and context of the article. The article is dealing with profits of taxpayers 'not resident or not domiciled in Venezuela'; profits, that is to say, of foreign individuals or entities. There are obvious difficulties in obtaining full tax returns from foreign tax payers. The difficulty is dealt with in art 54 by simply providing for 10% of gross receipts to be deducted in order to produce the taxable income – the 'net profits' to use the expression employed in the article.'

Scott J. continued:

"But it is not said that no tax expressed as a charge on a percentage of gross receipts can, for s.498 purposes, correspond to United Kingdom income tax or corporation tax. And it is not, in my judgment, practicable to exclude a particular tax on the ground that the percentage to be deducted was not high enough to represent the likely level of expenses incurred by the foreign taxpayer in earning its gross receipts. Moreover, there were no facts before the Special Commissioner to justify a conclusion either that the 10% percent deduction was unrealistic in relation to the majority of business activities falling to be taxed under Article 54 or that the 10% deduction was unrealistic in relation to the extra expense incurred by the company, over and above its normal establishment expenses, in executing the Maraven contract.

37. The authority of *Yates* recognises that a withholding tax may correspond to tax on income profits, even in circumstances where the authorities in the withholding country do not seek to calculate the actual profits of the recipient.

38. A case upon which the Appellant placed significant reliance is *Harrods (Buenos Aires) Limited v Taylor — Gooby (HM Inspector of Taxes)* [1963] 41 TC 450.

39. The facts of the case are that the Appellant company, which was incorporated and resident in the United Kingdom, carried on the business of a large retail store in Buenos Aires. In consequence, the company was liable in Argentina to a tax known as a substitute tax. The tax was charged annually at the rate of one per cent on the company's capital and was payable whether or not there were profits liable to Argentine income tax. Under Argentine law there were sanctions available to remedy non-payment of the tax. On appeal against an assessment to income tax under Schedule D for the year 1959-60 it was contended on behalf of the company that it paid the substitute tax solely for the purpose of enabling it to carry on business in the Argentine since, if it had not paid it, it would have been unable to carry on its business there, and the tax was therefore deductible as *"money wholly and exclusively laid out or expended for the purposes of* [its] *trade*", within the meaning of Section 137 (a), Income Tax Act, 1952. It was held by the Court of Appeal that the Argentine tax was incurred wholly and exclusively for the purposes of the company's trade.

40. The tax in *Harrods* was charged, not on the basis of profits, nor on the basis of income, but was charged entirely on the basis of certain capital of the company that was employed in the trade, and it was payable whether or not the company generated any income or made any profit at all. Secondly, non-payment of the tax

TAX APPEALS COMMISSION

could result in sanctions under Argentine law, one of which was that the company could be precluded from trading. Buckley J. stated, in relation to the tax that:-

'*The tax is not, in my judgment, a tax which is of the same character as Income Tax or Excess Profits Tax; it is not a tax which can only be measured and the liability to which can only be ascertained after the profits position of the Company has been finally determined in any year. Payment of that tax is not, as it seems to me, an application of the Company's profits, nor* [is] *it a payment which in its nature could be said to fall to be made out of the earned profits of the Company, for it is not a tax the liability to which depends upon the Company having earned any profits. It is a liability which the Company has exposed itself to, or undertaken, in order that it may be able to carry on its business in the Argentine. And so it is, in my judgment, a liability which the Company has undertaken for the purposes of its trade, and the payment of the tax is, in my judgment, a payment wholly and exclusively made for the purposes of the Company's trade….'*

41. Buckley J. further stated that: " *Failure to pay the tax would bring into play under Argentine law two possible forms of sanction. The fiscal authority could, in the first place, obtain what is called a preventive embargo under an order of the appropriate court, and such an embargo could be placed on any of the assets of the Company including its banking account ….. which would prevent the Company operating that account, and this would necessarily seriously hamper the Company's business. ….'*

42. Dankwerts L.J. in the Court of Appeal stated: *'The 'substitute tax' was something which the company was compelled to pay if it was to carry on business in Argentina, and if it could not carry on business in Argentina it could not earn profits. Consequently, it was an expense which was necessarily incurred by it in order to carry on its trade and was wholly and exclusively laid out or expended for the purpose of the trade of the Company'*

43. While the Appellant relied on *Harrods,* citing that the key factor in terms of drawing reference between that case and the within appeal was that the tax was not a tax on profits and was payable regardless of whether profits were earned or not, the Respondent submitted that the case was wholly distinguishable on the basis that the tax in that case was levied on capital, not on income.

44. The Respondent also submitted that incurring a deduction by way of withholding tax in the within appeal was not comparable to a 1% charge on capital as a pre-condition of doing business in Argentina in the Harrods case. In addition, the Respondent

submitted that, in general, if a payor of a royalty in a source State fails to operate withholding tax in the source State, the payor in that source State will be generally be assessed for the withholding tax not deducted. The Respondent submitted that it is not the case that the entity entitled to receive royalties would be precluded from trading or from receiving royalties in the future; rather, sanction would fall on the defaulting payer.

45. I accept the submission of the Respondent that where a company is subject to foreign withholding tax on royalty income, this does not constitute a pre-condition of doing business in that State and is thereby not comparable to a 1% charge on capital as per the facts in *Harrods*. In the within appeal, the withholding taxes are not expended for the purposes of earning the royalties but arise as a consequence of royalties having been earned. For the taxes to arise, the royalties must first be generated. The foreign withholding tax in this appeal does not constitute a mandatory pre-condition to carrying out business in the source State the way the capital tax did in *Harrods;* it is simply a consequence of having carried out business in the source State.

46. In *IRC v Dowdall O'Mahony & Co. Limited* 33 TC 259, the taxpayer company contended that in computing the profits of the English branches it was entitled to deduct that proportion of the Irish taxes attributable to those profits. The Special Commissioners held that it was a necessary expense for the taxpayer company in carrying on part of its trade at branches in England to incur Irish taxes, and they allowed the appeal. The decision was overturned on appeal and the House of Lords held that the Irish taxes were not wholly and exclusively laid out for the purposes of the company's trade in the UK and that no part of such taxes comprised an admissible deduction in computing its trading profits.

47. In that case both Lord Reid and Lord Radcliffe refer to the judgment of Lord Davey in *Strong & Co. v Woodifeld* [1906] AC 448. Lord Reid quoted the following extract from the speech of Lord Davey dealing with the meaning of the words '*for the purposes of the trade*' set out in the Income Tax Act, 1842 stating that those words:-

'... appear to me to mean for the purpose of enabling a person to carry on and earn profits in the trade, etc. I think the disbursements permitted are such as are made for that purpose. It is not enough that the disbursement is made in the course of, or arises out of, or is connected with, the trade, or is made out of the profits of the trade. <u>It must be made for the purpose of earning the profits.'</u> [emphasis added]

48. Lord Reid stated that *'This explanation has always been regarded as authoritative and is difficult to reconcile with the respondents' contention.'*

49. The Respondent submitted that while it might be possible to argue that the withholding tax payment is suffered '*in the course of, or arising out of, or is connected with, the trade*', it is difficult to see how it can be argued that the withholding tax is paid '*for the purpose of earning the profits*'.

50. The foreign withholding tax in this appeal was deducted as tax from royalty income received during the course of the trade. It was not incurred in the process of generating the income of the trade. It was not a disbursement made for the purpose of earning the profits per the dicta of Lord Davey in *Strong & Co. v Woodifeld*. I accept the submission of the Respondent that the foreign withholding tax does not bear the hallmarks of an expense that is deductible in accordance with Section 81(2)(a) TCA 1997.

51. Senior Counsel for the Appellant stated that *Dowdall* can be distinguished because the Irish tax which the taxpayer sought to deduct in that case was in fact a tax. The Appellant accepted that a tax on net profits could never constitute a deduction. In the within appeal, the Appellant contended that the withholding tax, though described as a '*tax*' could equally be called a '*withholding payment*' or a '*withholding amount*' because it is not applied to net profits but is applied to the gross figure. However, as I have determined that the foreign withholding taxes on royalty income are in the nature of a tax on income, I consider *Dowdall* an authority in favour of the Respondent.

52. The Appellant also relied on the case of *Ashton Gas Company v the Attorney-General [1906] AC 10* as authority for the proposition that income tax is a charge on the profits of a trade; however, the case also contains the following dicta of the Earl of Halsbury, at page 12: *'The income tax is a charge upon the profits; the thing which is taxed is the profit that is made, and you must ascertain what is the profit that is made before you deduct the tax - you have no right to deduct the income tax before you ascertain what the profit is. <u>I cannot understand how you can make the income tax part of the expenditure.</u> I share Buckley J.'s difficulty in understanding how so plain a matter has been discussed in all the Courts at such extravagant length.'* [emphasis added]

53. In *Allen v Farquharson Bros & Co.* 17 TC 59, Finlay J. considered the nature of an expense incurred in a trade as compared with a loss, stating;

TAX APPEALS COMMISSION

'Here the point before me is narrow but, as I indicated at the beginning, not free from difficulty. The question is whether this deduction, the £100, is allowable, … either under Rule 3 (a) or Rule 3 (e). Rule 3 (a) is this: in computing the amount of "the profits or gains to be charged, no sum shall be deducted in" respect of - (a) any disbursements or expenses, not being money "wholly and exclusively laid out or expended for the purposes of the trade, profession, employment, or vocation;" and Rule 3 (e) is: "Any loss not connected with or arising but of the trade, profession, employment or vocation." Now these two Rules have been discussed in a great many cases (in one very well-known case, Strong v Woodifield, in the House of Lords, in particular) together and no doubt they do run rather close to each other, but I cannot help thinking that there is a distinction between (a) and (e). Now a case might be put in which it was not very easy to say whether a thing was a disbursement or expense or was a loss. it is conceivable - such things sometimes happen - that there may be cases in which a thing might fall alternately - it might be either within (a) or within (e), but, none the less, I do think that there is a distinction to be drawn between the two. (a) relates to disbursements; that means something or other which the trader pays out; I think some sort of volition is indicated. He chooses to pay out some disbursement; it is an expense; it is something which comes out of his pocket. A loss is something different. That is not a thing which he expends or disburses. That is a thing which, so to speak, comes upon him ab extra. it is not very easy to formulate the thing, but it is easy enough to put illustrations falling on one side or the other of the line which may show what is, I think, the distinction, and the real distinction, between these things. Take the case of money being stolen from a till: I should say that that, quite plainly, was not a disbursement or an expense and, equally plainly, I should say it was a loss'.

54. There is no volition involved in the payment of the foreign withholding tax in the within appeal. The amount of withholding tax is levied on the gross and is withheld by the payor when paying the amount to the Appellant and indeed this is a point emphasised by the Appellant. The Appellant's submission on the aspect of volition (there being no volition) is that the unavoidable nature of the withholding tax renders it a cost of doing business in the foreign territory which is deductible as an expense in accordance with s.81(2)(a) TCA 1997 as supported by the *Harrods (Buenos Aires) Limited v Taylor — Gooby (HM Inspector of Taxes)* [1963] 41 TC 450. However, based on the dicta of Finlay J in *Allen v Farquharson Bros & Co*, the unavoidable nature of the withholding tax renders it less likely to comprise a deductible expense due to the absence of the element of volition.

(5) Whether the foreign withholding tax comprises a loss in accordance with section 81(e) TCA 1997

55. On the issue of whether the excess foreign withholding tax might constitute a loss in accordance with s.81(2)(e) TCA 1997, Senior Counsel for the Respondent submitted that a tax incurred on income abroad cannot comprise a loss arising out of a transaction because if that were the case then all foreign income taxes would be deductible losses and that that cannot be a correct statement of the law. I accept this submission.

56. In addition, the purpose of double taxation relief is to specifically address the matter of tax relief for double taxation and the contention that the foreign tax could comprise a loss in this context is contrary to the nature of the DTA legislative scheme.

57. As a result, I determine that the excess foreign withholding tax does not constitute a loss in accordance with s.81(e) TCA 1997.

Conclusion

- **i.** I determine that foreign withholding taxes levied by a source State on the Appellant's software licence royalty income, are in the nature of a tax on income.
- **ii.** I determine that the fact that the foreign withholding taxes are calculated on gross income or gross receipts does not deprive them of their nature as taxes on income.
- **iii.** I determine that the excess foreign withholding tax deducted from royalty income does not comprise a deductible expense pursuant to s.81(2)(a) TCA 1997.
- **iv.** I determine that the excess foreign withholding tax deducted does not constitute a loss in accordance with s.81(2)(e) TCA 1997.
- **v.** I determine that the amended assessments to corporation tax in the sum of €188,196 relating to accounting periods ended 31 December 2004 and 31 December 2005, shall stand.
- **vi.** This appeal is hereby determined in accordance with s.949AK TCA 1997.

APPEAL COMMISSIONER
February 2018

The Tax Appeals Commission was requested to state and sign a case for the opinion of the High Court in respect of this determination, pursuant to the provisions of Chapter 6 of Part 40A of the Taxes Consolidation Act 1997 as amended.

The request for a case stated was withdrawn prior to the expiration of the three-month time limit contained in section 949AQ TCA 1997.