Ref: 08TACD2019

NAME REDACTED

Appellant

V

REVENUE COMMISSIONERS

Respondent

DETERMINATION

Introduction

1. This appeal is concerned with the refusal by the Respondent to grant to **Name Redacted**, the Appellant, a corporation tax deduction pursuant to Taxes Consolidation Act 1997 (TCA) section 81 in respect of foreign withholding tax incurred in respect of the dividends received.

2. The deductions taken by the Appellant which were refused by the Respondent amounted to **Sums Redacted**

Background

3. The Appellant together with its affiliated and related companies, comprise one of the largest independent, proprietary trading firms in the world. It is internationally recognised for its expertise in trading derivative products. Its team of skilled traders utilise leading-edge technology and analytical tools to trade equity derivatives, equity options, equity index options, convertible bonds, warrants, fixed income derivatives and underlying securities. It has offices in **Cities Redacted** and has in excess of 1,850 employees worldwide.

4. The Appellant established its Irish operations in **Time & Location Redacted** and has built up a specialised business in Ireland, **Activities Redacted**.

5. **Activities Redacted**.

6. Its business is that of market making and providing liquidity in complex financial products. The Securities and Exchange Commission defines a 'market maker' as a firm that stands ready to buy and sell a particular stock on a regular and continuous basis at a publicly quoted price.

7. Therefore, in its capacity as a market maker in equity options on multiple European exchanges, the Appellant is obliged by these exchanges to provide liquidity to the market by buying or selling options. If the Appellant fails to enter into these trades, it will be excluded as a market maker on the exchange.

8. The Appellant does not take directional positions based on any view as to whether the market or particular instruments is rising or falling. Trading decisions are predicated on an assessment of fair value of the instrument traded relative to current market price and the firm generally aims to be delta neutral in other words the Appellant seeks to hedge its risk by means of offsetting positions in correlated positions. Therefore, positions in options or ETFs, where the Appellant has a market making obligation and legal requirement to be continually present in the market, may be hedged by offsetting stock positions.

9. Throughout the year in the normal course of trading, the Appellant would have sold options, short position and bought stock, long position and would regularly hold stock positions over dividend record dates and as a consequence be in receipt of dividends. This is an unavoidable consequence of the above trading activities. The tax suffered on the dividend was based on the gross dividend paid and not on its Irish entities' income or profits from the individual transaction, the overall holding or the general profits of the business.

10. The sequence of a typical trading event would involve the sale of an option on a particular share and the acquisition of correlating stock to hedge the option exposure. Thereafter it would receive a dividend and suffer dividend withholding tax. That dividend may relate to a company's earnings and would not be pro-rated for the period that the Appellant's holds that stock. The option would subsequently expire or be exercised. Thereafter the Appellant would calculate the profit or loss on the composite transaction.

11. The tax suffered on the dividend is based on the gross dividend paid and not on the its income or profits from the individual transaction, the overall holding or the general profits of the business.

12. To the extent that withholding tax is suffered on a dividend and cannot be reclaimed under a relevant double tax treaty represented a final cost for the Appellant of entering the trade.

Issue

13. The issue in this appeal is whether the tax withheld on foreign dividends derived by the Appellant in the course of its trade is a deductible expense for the purposes of

calculating profits assessable to corporation tax in accordance with TCA, section 81 to the extent that the withholding tax cannot be offset as a credit against the Appellant's tax liability. In this regard, at the hearing neither party placed any significant reliance on TCA, Part 35 and Schedule 24 which sets out the specific provisions for relief from double taxation.

14. As highlighted by the Appellant, the dividend withholding tax on which it is seeking to claim a deduction under TCA, section 81 was specifically excluded from relief from corporation tax and double taxation relief pursuant to TCA, section 21B(4)(c) and TCA, Schedule 24 respectively. As such, the Appellant was taxed on dividend income without a corresponding entitlement to a credit or deduction for the foreign tax withheld on that income.

15. Therefore, further clarification was sought from the Appellant to clarify why relief was not been claimed under the provisions of TCA, section 21B(4) in respect of dividend income derived from stock in companies in which it held less than 5% of the share capital or voting rights. In this regard a further case management conference was conducted on 6th December 2018 where the Appellant confirmed that the other provisions of the Taxes Consolidation Act denied the exemption from corporation tax on the income and indeed double taxation relief for the dividend withholding tax.

16. Furthermore, it was necessary to remind the Appellant that my responsibility exceeded the basis of submissions before me and to look into whether the assessments should be reduced, increased or indeed stand pursuant to TCA, section 949AK. This obligation requires that I satisfy myself that if the Appellant was entitled to the deduction for the withholding tax, that entitlement must be in accordance with the law and not solely with reference to the parties' submissions. As such because there was reference in the Appellant's submissions to TCA, section 21B and the Respondents submissions asserting that the most appropriate way of claiming the foreign withholding tax was by way double tax relief, it was incumbent on me to conduct a further case management conference to establish the exact position.

Legislation

Taxes Consolidation Act

17. For the purposes of calculating its taxable income, the Appellant is seeking a deduction for the foreign withholding tax and has relied on TCA, section 81(2) which provides:

> *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;*

18. TCA, section 81(2)(a) is therefore structured in the negative and with positive inversion provision is made for a deduction in respect of any disbursement or expense that is wholly and exclusively laid out or expended for the purposes of the trade or profession.

Evidence

Dr Budimer, expert witness for the Appellant

19. Dr Budimer is employed by Deutsche Borse in the Eurex Group and was called by the Appellant to give evidence. He explained the operation of the financial markets and elaborated on the different financial products such as stocks and derivatives (including futures and options). He gave evidence that market makers such as the Appellant facilitate investors by buying and selling when investors want to trade. He stated that market makers operated in a symbiotic relationship with exchanges by filling order books.

20. Dr Budimer explained that the Appellant as a market maker facilitates investors to trade. When investors want to buy, market makers will sell to them and if an investor wants to sell then market makers will buy from them. Therefore, the position of a market maker is to fill the order book with buy and sell orders that are available for instant trading.

21. He stated that the principal component to market maker's income was the difference between the bid price and ask price known as the bid ask spread. He discussed the ways that market makers manage risk including hedging and investment in correlated products.

Appellant's Employee Witness Name Redacted - Head of Trading Operations

22. **Name Redacted** the Appellant's head of trading operations since **Year Redacted**. He gave evidence of the Appellant's proprietary trading position in particular that it was a company trading on its own account. He stated that most of the trading was carried out in exchanges.

23. **Name Redacted** stated that dividends were not a separate source of income but were inextricably linked with its trading activities. He pointed out that in some instances, for example, where there were incidents of dividend slippage, dividends could give rise to a cost. **Name Redacted** said that dividend slippage was the difference between

what was received in respect of dividends and what was paid out in dividends. He stated that dividends were received relatively infrequently. He confirmed that the principal component of the Appellant's income was derived from the bid ask spread.

24. **Name Redacted** confirmed that the Appellant had developed statistical models to predict stock returns on horizons of minutes, hours or days. He outlined the typical interactions between the Appellant and its prime brokers. **Name Redacted** described a prime broker as a large entity such as Bank of America, Merrill Lynch, Barclays that provide a range of services including brokering services, but also financing and in certain circumstances stock lending. He gave evidence that the prime brokers used its positions in equities and ETF's as collateral to borrow money themselves. He explained how the Appellant borrowed securities and paid manufactured dividends to the lenders to make them equal. **Name Redacted** explained the concept of a 'manufactured dividend' as a process arising when a security is loaned, the title of the security transfers to the borrower. The borrower receives dividend payments but it required to pay the dividend to the lender.

25. He gave evidence that the stock price drops by the dividend price on an ex- dividend stock and thus the receipt of dividends is not related to making a profit. He stated that 80% of the Appellant's trade derives from market making. He outlined that the general *modus operandi* is to balance trades at the end of the day and to be delta neutral in so far as possible. He explained that 'delta neutral' meant the aspiration to hedge its risk by means of offsetting positions in correlated positions.

26. **Name Redacted** stated that ETFs are to some extent inherently illiquid and hence the Appellant has to carry a large portfolio of ETFs. Therefore, he said it is inevitable some positions straddle dividend payment dates. He pointed out that consequential dividends do not determine whether there is an overall profit or loss on the trade.

27. **Name Redacted** stated that the Appellant weighs up various factors from a commercial perspective including the cost of dividend slippage when deciding which type of instrument, they use to hedge.

28. **Name Redacted** explained the accounting treatment of shares it beneficially owns and the shares from which a 'manufactured dividend' is derived is exactly the same. In both cases, the gross value of the dividend as income is reflected in the accounts with the withholding tax treated as an expense within the income expense account.

Appellant's Employee Witness Name Redacted *- Chief Financial Officer*

29. **Name Redacted**, Chief Financial Officer of **Name Redacted**, gave evidence that there was no difference in the accounting treatment of dividends and manufactured dividends and stated that all dividends were recorded gross with an expense claimed in respect of withholding tax.

Dr George Oldfield-Principal Brattel Group, expert witness for the Respondent

30. Dr Oldfield as expert witness for the Respondent outlined his background working for the US SEC in the securities industry as an academic writer and lecturer. He confirmed he had prepared a report for the Respondent entitled *"Market Making Operations"*

31. Dr. Oldfield gave evidence as to the nature of a market maker and confirmed that typically market makers have four incomes streams in the forms of the bid ask spreads, commissions, carry and dividend income. He agreed that the bid ask spread was the most important component of income for market makers.

32. He stated that market makers seek to be in a net zero position each day but that due to human error and commercial constraints that this was not always possible and hence the need to hedge. He explained that the inevitable consequence of this was that shares were sometimes held over dividend record dates giving rise to withholding tax costs.

33. On cross examination Dr. Oldfield confirmed he was not involved in the raising of assessments by the Respondent and that his role was confined to the preparation of his report.

34. Dr Oldfied stated he was not asked to give an opinion on tax and stated he was not qualified in the field of taxation. He confirmed that he was of the view that dividends were revenue and hence the withholding tax was a cost or expense. He stated that commercial traders would be cognisant of the tax consequences of holding stock over a dividend date.

35. On re-examination Dr. Oldfield confirmed he would expect a trader to consider the tax effect when deciding whether to hold stock over a dividend record date. He stated the various hedging strategies would be considered and the overall most commercially attractive option to be taken after factoring in the tax effect.

Mr Robert Almanas, expert witness for the Respondent

36. Mr. Almanas worked in the financial services industry for more than 30 years, both in the US and in Europe for companies such as SIS, State Street Corporation and Harvard Management Company. Mr Almanas was called as an expert witness on behalf of the Respondent.

37. He confirmed he had prepared a high-level report on the operation of prime brokers for the Respondent to answer some of the questions on prime brokerage and, as part of his assignment on how tax reclaims work. During the course of cross examination

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Mr Almanas confirmed that he did not have any substantive disagreement with the evidence of **Name Redacted** of Head of Operations or the evidence of Dr. Budimir.

Submissions

Appellant

38. The Appellant outlined the provisions of TCA, section 81 governing the deductions permitted when computing taxable sums for companies classified in Cases I and II of Schedule D. In this regard, TCA, section 81(2)(a) contains the rule relevant in this appeal: *"in computing the amount of the profits or gains to be charged ... no sum shall be deducted in respect of any disbursement or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade or profession"*.

39. The Appellant submitted that this test is framed by TCA, section 81(2)(a) in double negative terms and has been given a positive reformulation in the case law which permits the deduction of an expense if incurred *"for the purpose of enabling a person to carry on and earn profits in the trade"*. Therefore, taxes are not covered by the test and cannot therefore be deducted in the calculation of profit where those taxes are measured and applied after a company has made a profit. However, by application of well-established general principles, it was submitted, there are certain circumstances when a tax may be a deductible expense. The foreign dividend withholding tax suffered by the Appellant is one such tax.

40. The starting point for the Appellant was the decision in *Strong & Co of Romsey Ltd v Woodifield* [1906] AC 448, wherein Lord Davey expressed the relevant principles in terms that have been repeatedly adopted by the courts at p. 453:

    "I think that the payment of these damages [to a customer of an inn owned by the brewery company who was injured by the fall of a chimney] was not money expended "for the purpose of the trade." These words are used in other rules, and 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. It must be made for the purpose of earning the profits.

41. The Appellant submitted that that passage made clear why taxes are generally not deductible as they are not generally paid *"for the purpose of earning ... profits"* but as a result of a profit having been earned. However, the Appellant noted that there are instances where a charge in the nature of a tax is not the product of a profit, but an essential precondition to making that profit and relied on *Smith v Lion Brewery Co Ltd*, [1911] AC 150. In that case contributions paid by a company by way of

compensation fund charges levied under the Licensing Act 1904 were held to be deductible. Inland Revenue had argued that the levy was paid by the taxpayer not in its capacity as brewers but in its capacity as landowners. This argument was rejected by the House of Lords which held that the charge was one incurred for the purpose of setting up the system of trading which enabled the making of profits.

42. Thus, while taxes are generally not deductible on the grounds of having been incurred wholly and exclusively for the purposes of trade, in certain circumstances a charge by way of tax may be so deductible. The essential difference between the tax which is not deductible and the tax that is, is that the tax that is not deductible is a charge determined after the profits of the business have been ascertained, while a tax that is deductible is itself a necessary precondition to trading and therefore in making of the profits.

43. The Appellant submitted that the most detailed and relevant consideration of the dividing line between deductible and non-deductible taxes is found in the decision in *Harrods (Buenos Aires) v Taylor-Gooby* 41 TC 450, Court of Appeal of England and Wales, 1 January 1964. The taxpayer company, which was incorporated and resident in the United Kingdom, had a large retail store in Buenos Aires. In consequence, it was liable in Argentina to a tax known as the substitute tax, which was levied on joint stock companies incorporated in Argentina, and on companies incorporated outside Argentina carrying on business in the jurisdiction through an *"empresa estable"*. The substitute tax was charged annually at the rate of one per cent on 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 substitute tax. In deciding whether or not the outlay in the form of the substitute tax was incurred so as to earn profits, and was thus deductible as an expense, the High Court and the Court of Appeal emphasised a number of features.

44. The Appellant opened the following passage of the judgement of Buckley J. where at p.461 it was observed:

> *"[Counsel for the Company] is justified in saying that incurring liability for this tax was a pre-condition of the Company's earning profits in the Argentine, for without incurring liability for this tax the Company could not carry on business in the Argentine at all ... 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 just as in the Lion Brewery case 5 TC 568 the liability of the landlord to make compensation fund contributions was a liability which it subjected itself to by assuming the character of landlord for the purposes of its trade as brewer."

45. Wilmer LJ in the Court of Appeal commented at p.462:

"I content myself with mentioning certain features of the tax which seem to me directly relevant for the purposes of this appeal. (1) Substitute tax is payable by all joint stock companies incorporated outside the Argentine which have in that country a commercial, industrial, agricultural, mining or other establishment organised in the form of an "empresa estable" ... (2) The amount payable annually by way of substitute tax is a percentage of the capital of the company calculated in a certain way and subject to certain deductions. (3) Substitute tax is not payable until after the termination of the financial year in respect of which it is levied. (4) The tax is payable regardless of whether profits are earned, and is in no way related to the earning of profits. (5) Sanctions are provided under Argentine law against failure to pay the tax, and the imposition of such sanctions would render it virtually impracticable, if not wholly impossible, for the company to continue trading."

46. Wilmer LJ further observed at 466:

"It remains to consider one further point which was taken on behalf of the Crown. Some reliance was placed on the fact that the substitute tax is not payable until after the conclusion of the financial year in respect of which it is levied. This was advanced as a reason for saying that payment of the tax cannot be regarded as being made for the purposes of the trade but only as a consequence thereof. It seems to me that there are two answers to this argument. (1) Liability to pay the tax was incurred as soon as the Company established its "empresa estable" and quite regardless of whether the trade thereof resulted in a profit. (2) The tax paid in respect of any given year is a payment necessarily made in order to ensure that trading will be allowed to continue during the next and succeeding years. In this respect the payment of the tax is clearly made for the purpose of earning profits from the continuance of trading."

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47. In his judgment, Danckwerts LJ stated at p.468:

"In my opinion, the present case fails within the principle of Smith v Lion Brewery. 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."

48. Diplock LJ also delivered a judgment in similar terms:

"I agree. The only thing which has caused me doubts as to the correctness of Buckley J's judgment is that I have had none. Can a tax question really be as simple as I think this is? But the … question here is: was the money paid by the Company in settlement of its liability for Argentine substitute tax, money wholly and exclusively expended for the purposes of the trade which it carried on in the Argentine? In order to engage lawfully in its trading activities in the Argentine at all, whether or not it made a profit by doing so, it had to pay the substitute tax. That was the purpose for which the money was expended by the Company. None other is suggested. Why, then, is it not deductible?"

49. Diplock LJ continued at p.469:

"The statutory expression "the purposes of the trade" is not a metaphor which personifies the trade, to which it ascribes human aims and objects. It is concerned with the actual purposes for which the actual person who carries on a trade expends money and "of the trade" is an adjectival phrase limiting "the purposes" for which the expenditure of money is a permissible deduction in computing the profits of his trade for Income Tax purposes. The phrase is elliptical; it has to be construed in its context, viz., the computation of profits under Schedule D, which deals with the earning of profits by carrying on a trade and the taxation of those profits after they have been earned and computed. It was to this purely mercenary context in which the expression appears and to the dichotomy between the earning and mild computation of profits on the one hand and the taxation of those profits after they had been earned and computed on the other, to which Lord Davey drew attention in is dicta in Strong and Co.'s case, when he said, at 5 TC 215, 220, "'for the purpose of the trade' … mean for the purpose of enabling a person to carry on and earn profits in the trade" and added "It is not enough that the disbursement … is made out of the profits of the trade." It is for this reason that payment by a trader of United Kingdom or foreign fixes on profits after they have been earned is not a deductible disbursement. This seems to me to be the ratio decidendi of the Dowdall O'Mahoney case, the Rushden Heel Co. case and the Smith's Potato Estates case. But the

Argentine substitute tax is not paid out of profits. Liability to the tax does not depend upon whether profits are made or not. It is a payment which the company is compelled to make if it has a business establishment in the Argentine at all, and it must have a business establishment if it is to carry on its trade. I can see no relevant difference between this tax and rates upon its business premises."

50. As noted by the Appellant, the relevant general principles deriving from the case law are summarised in *Simon's Taxes* at B2.472 as follows :

"Where tax is charged on a transaction which is to be taken into account in ascertaining the results of the trading activity, the tax is deductible in arriving at those results. Thus, stamp duty incurred on the purchase of land or shares by a dealer in either of those commodities is deductible in his trading income computation. Where a trader acquires business premises, however, and pays stamp duty on the purchase, the tax is a capital item and is only deductible in his chargeable gains computation on the disposal of the premises ... If, however, the tax is an annual or regular levy which enables the trader to continue in business or to maintain business premises or equipment the expenditure will be revenue in nature and deductible."

51. The Appellant also referred to *MacAonghusa v Ringmahon Company* [2001] 2 IR 507, a case in which the Supreme Court addressed the issue of deductible expenses and applied the general principles as set out in the English authorities. In that case the respondent company had taken out a term loan in 1991, which was applied to redeem preference share capital. It sought to deduct the interest payable in respect of the loan as an expense incurred wholly and exclusively for the purposes of its trade. The appellant took the view that the loan was raised for the purpose of a share restructuring, which was capital in nature, rather than for the company's trade and refused to allow the deduction. The Supreme Court (Denham, Murray and Geoghegan JJ) held, in dismissing the appeal, that the interest was a deductible expense because it was laid out to retain the benefits of the borrowed money which enabled the respondent to carry on its trade thus expenditure incurred wholly and exclusively for the purposes of the respondent's trade. Geoghegan J explained at p. 516:

"In Strong & Co Ltd v Woodifield [1906] AC 448, a brewing company which also owned licensed houses in which they carried on the business of innkeepers incurred damages and costs to the amount of £1,490 on account of injuries caused to a visitor staying at one of their houses by the falling in of a chimney. The House of Lords held that these once off payments were not deductible, that because although there may have been a connection with the trade they were not made for the purpose of enabling the carrying on and earning of profits in the trade. That case is also clearly distinguishable. The remaining cases, in so far as they are really relevant at all, were decided on their own facts and by that I mean, there was a finding of fact as to the

purpose of the payment and in the light of that finding of fact it was reasonably clear whether as a matter of law the payment was deductible or not. If, for instance, the purpose of the payment was the financing of the business rather than the earning of profits, the payment could not be deductible (see Montreal Coke and Manufacturing Co v Minister of National Revenue [1944] AC 126, a decision of the Privy Council). I have no doubt that, in this case, the learned Circuit Court Judge took the view that the ongoing interest payments were necessarily part and parcel of the trading of the company and were clearly deductible. In my opinion the learned High Court Judge was correct in upholding that view."

52. The Appellant submitted that the relevant principles, as set out are well-established and beyond doubt and as noted by Geoghegan J. in *MacAonghusa*, it is a question of making "*a finding of fact as to the purpose of the payment and in the light of that finding of fact it [will be] reasonably clear whether as a matter of law the payment [is] deductible or not.*" This exercise, it was argued, lead to the inescapable conclusion that the dividend withholding taxes incurred by the Appellant were a prerequisite to the making of any profit and are therefore deductible.

53. It was submitted that the relevant test required an enquiry as to whether the relevant expenditure is incurred *"for the purpose of enabling a person to carry on and earn profits in the trade"*. It cannot be denied that a tax, in broad terms, has the potential to be a deductible expense. There is no separate rule applicable to taxes, or indeed to any particular category of taxes. There can, for example, be no blanket prohibition on the possible deductibility of a tax on revenue. It is not possible to distinguish the specific taxes that have arisen in the case law – such as rates or annual taxes on capital – and say that they are a particular type of tax that is deductible. As regards deductibility, all taxes are governed by the same general principles. A profits tax like income tax or corporation tax, for example, is non-deductible not because it falls into the broad category of taxes to be labelled "profits taxes", but because it fails Lord Davey's *Strong* test.

54. The Appellant argued that the foreign dividend withholding tax that it had incurred in the course of its trading activity fell within the type of expenditure deductible under the general principle set out in TCA, section 81(2)(a). It was an expense incurred *"for the purposes of the trade"*, in accordance with how that phrase has been interpreted and applied in the case law. It was submitted that any attempt to define *"the purposes of the trade"* more narrowly than Lord Davey's *"for the purpose of enabling a person to carry on and earn profits in the trade"* so as to exclude the dividend withholding tax in question is impermissible. Furthermore, any attempt to argue that the dividend withholding tax was merely incidental constituted an argument along the lines of the *"but only as a consequence [of the trade]"* argument emphatically rejected in *Harrods (Buenos Aires)*.

55. The Appellant distinguished the facts of this appeal with a previous determination of this Commission, 02TACD2018. The Appellant submitted that dividend withholding tax is different to royalty withholding tax and that the factual situation in this appeal is very different to the usual withholding tax situation. The Appellant contended that royalty income withholding tax is different to dividend withholding tax due to the fact that royalty income arises from a licensing right and is income which is earned whereas dividend income is not earned as the entitlement to the dividend simply arises from being the holder of record on the record-date of the stock. In contrast to the historic business model of an asset manager where stock positions may be held for a long period with a view to capital appreciation and /or dividend flow, the Appellant's business strategy is such that it does not passively hold stock positions with a view to earning dividend income.

56. It was argued that the withholding tax suffered by the Appellant was on dividend and not royalty income. Furthermore, the circumstances in which the withholding tax arises can be distinguished from the current case. In the royalty case appeal, it was noted that the business of the taxpayer was the licencing of software in return for a royalty with the entitlement to earn royalty income corresponding to the full period over which the licence relates. In contrast, the Appellant did not 'earn' dividends as part of their trade but instead the dividends merely flowed from the trade of buying and selling securities. The receipt of a dividend was not by reference to holding the securities for the full period to which the dividends related. Instead the Appellant held stock positions over dividend record dates and was in receipt of dividends as a result. Hence the dividend withholding tax was suffered in making the overall trade, rather than earning dividend income.

57. Another distinction was that the Appellant was not claiming double taxation relief in relation to the dividend withholding tax suffered on the dividends and therefore is not claiming that the dividend withholding tax was a tax on income for the purposes of obtaining such relief. It was argued that the issue in this appeal is whether the dividend withholding tax incurred by the Appellant in relation to stock held over a dividend date as a hedge to positions arising from liquidity provision is a deductible expense for the purposes of TCA, section 81.

58. In terms of deductibility, the Appellant argued that there is no separate rule applicable to taxes to the extent that all taxes are governed by the same general principles. The reason a tax on income is generally not deductible is because taxes are usually measured and applied after a company has made a profit and as a consequence fails Lord Davey's *Strong* test.

59. The Appellant noted that while the determination 02TACD2018 concluded that *"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", there was no discussion the fact that the Venezuelan tax in that case was not based on gross receipts, but on 90% of contract value.

60. The Appellant submitted that the gross dividend amount and related dividend withholding tax was completely divorced from the overall return earned by the Appellant on its trading activity and may not result in the making of profits on such positions or in their overall business in the relevant year.

61. The Appellant noted that while some market participants such as asset managers may hold stock positions over an extended period in order to earn dividend income, this is not the situation for the Appellant. As a result, the withholding tax suffered was not similar to a tax on income as it was suffered even if no profit was derived for the holding of the stock.

62. It was submitted that this case falls to be decided by a straightforward application of well-established principles governing the deductibility of expenses for Case I, Schedule D companies. The general principle at issue is contained in TCA, section 81(2)(a) and provides that only expenses laid out *"wholly and exclusively ... for the purposes of the trade"* are deductible. A line of English authority stretching back over 100 years has consistently interpreted the phrase *"for the purposes of the trade"* to mean *"for the purpose of enabling a person to carry on and earn profits in the trade"*. That judicial interpretation, it was submitted, unambiguously captures the dividend withholding tax at issue in this appeal. Any attempt by the Respondents to exclude the possibility that taxes can, in principle, constitute deductible expenses must be resisted as inconsistent with authority. Simply put, far from being a tax calculated by reference to and imposed on its profits, dividend withholding taxes are paid by the Appellant *"for the purpose of enabling [it] to carry on and earn profits in [its] trade"*.

63. As such, it was submitted that it was manifest that dividend withholding taxes must be paid by the Appellant for the purposes of earning profits, if any. The disconnection between the payment of dividend withholding tax and the making of profits starkly illustrated the nature of the expense. The business of trading in marketable securities inevitably involves holding shares over a dividend record date, which inevitably meant that dividend withholding taxes were suffered. The Appellant argued that it was fair and accurate in these circumstances to describe the dividend withholding taxes as a charge imposed for undertaking the business. It was the price of carrying out the business which the Appellant conducts. It was not possible to conduct the trade of buying and selling marketable securities without paying dividend withholding taxes.

Respondent

64. The Respondent fundamentally disagreed with the proposition that foreign withholding tax deducted in the source State from dividend income is an expense laid out wholly and exclusively for the purposes of the trade on the following grounds:

    a) foreign withholding taxes on dividends are by their nature taxes on income;

    b) the fact that foreign withholding tax on dividends may be calculated as a percentage of the gross dividend does not mean that the tax is not in the nature of a tax on income profits; and

    c) that withholding tax deducted from dividends is not an expense '*made for the purpose of earning the profits*' and so is not deductible in accordance with TCA, section 81.

65. The Respondent argued that the treatment for which the Appellant contended was at odds with the scheme of double taxation relief provided for in TCA, sections 826-826A and Schedule 24.

66. The Respondent submitted that all dividends received by the Appellant, and from which withholding tax has been deducted in some cases, are in the nature of income, and are charged to corporation tax on the basis that they are trading income. Furthermore, withholding taxes deducted from those dividends in the source State, whether that source State is a double tax treaty country or a non-double tax treaty country, are taxes on income.

67. The Respondent argued that dividends are a form of investment income which is recognised in Article 10 (Dividends), paragraph 3 of the Commentary on the *OECD Model Tax Convention on Income and on Capital*, which states:

    "From the shareholders' standpoint, dividends are income from the capital which they have made available to the company as its shareholders."

68. The Respondent submitted that, in order for the Appellant to succeed in this appeal, it must establish that foreign withholding tax deducted from dividend income is not in the nature of a tax on income. The Respondent submitted that this is not a tenable position. However later in its written submissions, the Respondent argued that no entitlement existed under TCA, section 81 in respect of 'a tax on income profits'. However, in its oral submissions, the Respondent clarified its position by confirming that its primary submission was that the foreign dividend withholding tax

was a ‘tax on income’ and therefore not an expense deductible under TCA, section 81.

69. In the Respondent’s submission, foreign withholding taxes deducted from dividends are taxes on income and any suggestion to the contrary is inconsistent with the entire scheme that exists, both in Irish tax law and under international double tax treaties, for relieving double taxation. The very basis on which double tax relief is available under Ireland’s double tax treaties and under TCA, Schedule 24 for foreign withholding tax suffered on dividends is that the withholding taxes are taxes on income. Furthermore, any argument which the Appellant may make to the contrary is inconsistent with claims made by them for double tax relief in respect of withholding tax suffered on dividends received from treaty countries.

70. The Respondent also argued 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 in particular to fully regulate the collection of taxes from that non-resident. To circumvent issues regarding the collection of taxes from non-residents, an obligation is placed on the payer of an income stream within the source State to withhold tax from the income payment, in this case, the dividend payment. While the base on which the withholding tax percentage is applied may be wide, i.e. the gross dividend, the withholding tax rate may be less than the tax rate that might apply to tax resident entities who will be able to take account of expenses in computing their taxable income in the relevant State. Withholding tax may be likened to a crude mechanism for approximating the liability due on the dividend income, and the withholding tax will usually satisfy an underlying tax liability in the source State.

71. If, as the Respondent submitted, all dividends are in the nature of income receipts and all withholding taxes deducted from dividends by a source State are in the nature of taxes on income profits, this position is unaltered by the fact that the withholding tax rate is a percentage of the gross dividend. That being the case, foreign withholding taxes on dividends are taxes on the income from the trade and are not expenses laid out wholly and exclusively for purposes of earning profits of the trade. Therefore, they are not deductible under TCA, section 81. When one comes to consider the relevant persuasive case law none of which can be regarded as binding on the Irish courts, it was submitted that these basic principles still hold good.

72. The Respondent opened *IRC v Dowdall O’Mahony & Co. Limited* [1952] 33 TC 259, a case in which the UK House of Lords held that Irish income tax was not allowable as a deduction for the purpose of calculating the UK profits of an English company. Lord Oaksey held at 274:

"Taxes such as those are not paid for the purpose of earning the profits of the trade: they are the application of those profits when made and not the less so that they are exacted by a dominion or foreign government.

73. In that case both Lord Reid and Lord Radcliffe refer to the Judgment of Lord Davey in *Strong & Co. v Woodifeld* [1906] AC 448; 5 TC 215. 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 arising out of, or is connected with, the trade, or is made out of the profits of the trade. It must be made for the purpose of earning the profits."

74. Lord Reid went on at p.281 to comment as follows:-

"This explanation has always been regarded as authoritative and it is difficult to reconcile with the Respondents' contention."

75. Further reference to *Strong v Woodifield* was made in the speeches of Lord Reid and Lord Radcliffe. The Respondent argued that there was no reason to believe this case would not be followed in the Irish courts. While it might be possible to argue that the withholding tax in this case 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 it is paid *"for the purpose of earning the profits"*. Here, the withholding tax was not suffered, or at a stretch, '*laid out'* for the purpose of earning the dividends that contributed to the profits of the trade, but rather was deducted as tax from income received "*during the course of the trade*."

76. Withholding tax which is required to be deducted by a payer of a dividend in a source State does not bear the hallmarks of an expense that is deductible in accordance with section 81(2)(a) TCA 1997. Finlay J in *Allen v Farquharson Bros & Co* 17 T.C. 59 considered that an expense of the trade:

"…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…."

77. Furthermore, the paying out of the expense must be for the purpose of earning profits of the trade.

78. The Respondent proceeded to distinguish *Harrods (Buenos Aires) Limited v Taylor – Gooby (HM Inspector of Taxes)* [1963] 41 TC 450 to the extent that the tax in issue in

that case was not charged on the basis of profits, or 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 tax could result in different sanctions under Argentine law, one of which could result in the company being precluded from trading at all. Buckley J. stated, in relation to the tax that: -

"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…"

79. Later he stated that:-

"Failure to pay the tax would bring into play under Argentine law two possible forms of sanction … the fiscal authority could request the cancellation of a form of registration of the company in the Argentine without which it would not continue to carry on its business in that country at all."

80. Dankwerts LJ 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 its business in Argentina it could not earn profits. Consequently it was an expense necessarily incurred by it in order to carry on its trade and was wholly and exclusively laid out for the purpose of the trade of the company."*

81. The Respondent submitted that there was no such sanction in the facts to this appeal. If a payer of a dividend to a non-resident fails to operate withholding tax in the source State, typically, the payer in that source State will be assessed for the withholding tax not deducted. It is not the case that the entity that is entitled to receive dividends would be precluded from trading or from receiving dividends in the future. Any sanction would be on the defaulting payer. Further, suffering a deduction by way of withholding tax could not logically be seen as a pre-condition to doing business, as in the *Harrods* case. An obligation for the payer of the dividends only arises where a dividend income payment is made. It was submitted that this decision provides no persuasive authority and no logical basis whatever for the proposition that a withholding tax levied by a foreign country on income received by a trader constitutes an expense of carrying on the trade or business; and it was submitted that reliance on this case as such an authority is misplaced.

82. The Respondent submitted that *Yates (Inspector of Taxes) v CGA International Limited [1991] STC 157*, a decision of the Chancery division of the UK High Court had persuasive authority. While that case did not relate to TCA, section 81 or its UK equivalent, it considered whether a turnover tax levied under Venezuelan law was

entitled to relief under the UK provisions relating to double tax relief. In this regard, it was argued that the decision was of potential significance, in that the issue that had to be determined under UK law was whether the Venezuelan tax corresponded to UK income or corporation tax. The relevant provisions of the UK law concerned appear to be Section 498 (1) of the Income and Corporation Taxes Act, 1970 which provides in part as follows: -

"…relief from income tax and corporation tax 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 …"

83. Also relevant is subsection 6 of the same section which provides 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 …"

84. Accordingly, the issue in that case was whether the Venezuelan tax did or did not *"correspond to income tax or corporation tax in the United Kingdom"*. While the decision is not strictly relevant in that it concerned the UK double tax relieving provisions, it is highly significant insofar as the issue was whether a turnover tax could correspond to UK income tax or corporation tax. Scott J. held that it could and did, in part. Having quoted article 54 of the Venezuelan tax code, Scott J. said at 168 G-H:

"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 open 'net profits' to use the expression employed in the article."

85. Scott J. went on to say, in a passage that seems very relevant to the circumstances of this case at 168 J – 169 A:

"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."

86. The Respondent submitted that *Yates* is an important recognition that a withholding tax may correspond to tax on income profits, even in circumstances where the authorities in the withholding country do not go about attempting to calculate the actual profits of the recipient. The above quotations strongly support the proposition advanced in this case on behalf of the Respondent and give a wise and correct analysis of the nature of withholding tax.

87. Part 35 and Schedule 24 TCA contain specific provisions for relief from double taxation. The Respondent submitted that the scheme of relief from double taxation under the TCA is comprehensively set out in these provisions, and that the legislature did not intend to provide an alternative basis for such relief under TCA, section 81.

88. The Respondent submitted that this approach is consistent with standard principles of statutory construction. Dodd on *Statutory Interpretation in Ireland* (Tottel, Dublin, 2008), 89-90, paragraph 4.77 states that, in accordance with the principle of *generalia specialibus non derogant*,

"Where a provision deals with a particular situation in special or specific terms, and the language of a more general provision could be taken to apply to the same particular situation, the general provision will not be held to undermine, amend or abrogate the effect of the special words used to deal with the particular situation."

89. In the present case, the 'specific provisions' are those of Part 35 and Schedule 24, and the general provision is section 81.

90. Relief available for foreign withholding tax suffered on dividends that are charged to corporation tax as trading income under Schedule D, Case I, may be by way of credit relief or relief by reduction 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.

91. As the issue in this appeal is whether or not irrecoverable foreign tax is deductible under TCA, section 81, the Respondent did not consider it necessary to address the complex rules in TCA, Schedule 24 for the calculation of double taxation relief.

92. In summary the Respondent's submissions are as follows: -

    a) Foreign taxes paid by reference to dividend income received during the course of a trade are not monies *"laid out or expended for the purposes of the trade"*;

    b) Taxes deducted abroad in relation to sums received by way of dividends are in the nature of taxes on income profits and therefore are not monies laid out or expended for the purposes of the trade;

    c) There is no authoritative support for the proposition that taxes calculated as a percentage of a gross dividend are or are necessarily expenses of carrying on a trade; and

    d) In no circumstances can foreign withholding tax on dividends be deducted as an expense for the purpose of Case 1 under TCA, section 81.

ANALYSIS

Issue

93. The issue in this appeal is whether the tax withheld on foreign dividends derived by the Appellant in the course of its trade is a deductible expense for the purposes of calculating profits assessable to corporation tax in accordance with TCA, section 81 to the extent that the withholding tax cannot be offset as a credit against the Appellant's tax liability.

94. In this regard, at the hearing neither party placed any significant reliance on TCA, Part 35 and Schedule 24 which sets out the specific provisions for relief from double taxation.

95. As such, the Appellant is seeking a deduction for the foreign withholding tax and has relied on TCA, section 81(2) which provides:

> *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;*

96. Therefore, and as noted by the Appellant, that provision is structured in the negative and with positive inversion provides for a deduction in respect of any disbursement or expense that is wholly and exclusively laid out or expended for the purposes of the trade or profession.

No entitlement to exemption from tax or credit for withholding taxes

97. The Respondent argued that in accordance with Irish and international tax law foreign withholding taxes deducted from dividends are taxes on income. As a consequence, the Appellant should be denied a deduction for such taxes. However, as consistently argued by the Appellant, the dividend withholding tax on which it is seeking to claim a deduction under TCA, section 81 was specifically excluded from relief from corporation tax and double taxation relief pursuant to TCA, section 21B(4)(c) and TCA, Schedule 24 respectively. As such, the Appellant was taxed on dividend income without a corresponding entitlement to a credit or deduction for the foreign tax withheld on that income.

Tax on income

98. As highlighted above, foreign withholding taxes deducted from dividends are taxes on income, a view not ostensibly expressed by the Appellant. As such the Respondent argued that in order for the Appellant to succeed in this appeal, it must be established that foreign withholding tax deducted from dividend income is not in the nature of a tax on income.

99. However, while it is clear that dividend withholding tax is a tax on income, such an acknowledgement is not fundamentally fatal to the Appellant's appeal as there is no general principle of law that specifically denies a deduction for taxes in accordance with the prescribed rules as set out under TCA, section 81, where those taxes are not calculated after the ascertainment of profit.

Not for the purpose of the trade

100. There was agreement between the parties that the dividends derived by the Appellant did not constitute a separate source of income but part of its total income to be taken into consideration for the purposes of calculating its trading profits.

101. The Respondent argued that a compulsory deduction by a source state similar to that imposed on the dividends derived by the Appellant does not have the characteristics of an expenditure laid out for the purpose of the trade and relied on the following passage of Finlay J. in *Allen v Farquharson* 17 TC 59 at page 64:

"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 nonetheless, I do not think 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."

102. However, it is necessary to highlight the context of that passage and the extent to which a comparison was made between a disbursement and a loss. Secondly, if there was a requirement for volition in a disbursement, the deductions claimed in *Harrods (Buenos Aires)* and *Inland Revenue Board of Review Decisions (Hong Kong) Case No. D43/91* [1991] would have been denied.

103. Furthermore, and as noted by the Appellant's expert witness, Dr Budimir "*that market makers do not necessarily look at what exactly is the asset but they look at the statistical figures and if for some reason they find that for instance wheat and a share are correlated, then they might also end up hedging the other product*". Therefore, the failure of the Respondent to permit a deduction under TCA, section 81 could have prompted the Appellant to devise algorithms, strategies or policies that avoids the acquisition of stock with imminent dividend payment dates or alternatively factor such a cost into its business model. However, where the Appellant chose to hedge its position with a stock with an imminent dividend entitlement, there was no opportunity to avoid such a compulsory deduction.

104. Therefore, the dividend withholding taxes were incurred in the Appellant's capacity as a market maker. It chose to hedge certain products traded with stock in the knowledge that dividend withholding tax would be suffered if the stock position was held over dividend record date. The cost of hedging the derivative leg of the trade involved buying stock and dividend withholding tax was suffered on such stock. This position was also supported by evidence of the Respondent's expert witness Dr Oldfield when forming the view that *"traders have to be aware of the tax consequences of their decisions."*

105. Notwithstanding the above, there are many compulsory deductions imposed by a Sovereign Government that are permissible as a deduction pursuant to TCA, section 81 such as Irish and foreign stamp duty, Irish and foreign irrecoverable VAT, foreign Financial Transaction Tax, and employer's PRSI. The following extract from Simon's Taxes is also relevant where it states at B2.472:

"Where tax is charged on a transaction which is to be taken into account in ascertaining the results of the trading activity, the tax is deductible in arriving at

those results. Thus, stamp duty incurred on the purchase of land or shares by a dealer in either of those commodities is deductible in his trading income computation. Where a trader acquires business premises, however, and pays stamp duty on the purchase, the tax is a capital item and is only deductible in his chargeable gains computation on the disposal of the premises ... If, however, the tax is an annual or regular levy which enables the trader to continue in business or to maintain business premises or equipment the expenditure will be revenue in nature and deductible"

106. It is also significant that the Respondent's historic position of denying a deduction for dividend withholding tax since 2011 has not prevented the Appellant from hedging its positions with stock having imminent dividend entitlements.

107. However, in light of the above, the absence of a volition to incur expenditure does not deny the entitlement to claim a deduction under TCA, section 81.

108. The Respondent also argued that the dividend withholding tax was incurred in the course of the trade and not for the purpose of earning the dividends or for the purpose of earning the profit of which the dividend formed part. As such, the withholding tax was a consequence of the receipt of the dividend and it was not an expense laid out to earn the dividend or to earn the profit that may result from the dividend. The Respondent derived support for that assertion from the following passage of the decision of Lord Davey in *Strong & Co v Woodfield* [1906] A.C. 448 when stating at page 3:

"These words I used in other rules and appear to me to mean for the purpose of enabling a person to carry on and earn profits in the trade. I think the disbursements permitted are such as are made for that purpose - and this is the important part - 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, it must be made for the purpose of earning the profits."

109. The Respondent also argued that *Yates* was an important recognition that a withholding tax may correspond to tax on income profits, even in circumstances where the authorities in the withholding country do not go about attempting to calculate the actual profits of the recipient.

110. In light of the Respondent's submission, I have considered the evidence and submissions in context of the activities of the Appellant and I am satisfied that such activities involved the taking of trading and pricing decisions notably when market making in single stock options predicated on various considerations, including whether a stock position could be held over a dividend record date and thus be in receipt of a dividend payment. To the extent that withholding tax was suffered on the dividend and could not be reclaimed under a relevant double tax treaty, impacted on the final net profit or loss realised on the overall trade, as a final cost of entering the

trade. Thus, the withholding tax was required to be incurred by the Appellant for the purposes of earning profits, if any. As such the dividend withholding taxes were a prerequisite to the making of a trade.

111. Therefore, I disagree with the Respondent with regard to the interpretation of *Yates* as the issue considered in that case was whether the Venezuelan tax had the same function as UK income or corporation taxes. It was held by Scott J. that although the Venezuelan tax was computed on the basis that only 10% of the gross income was deductible, it was intended to be a tax on profits rather than on turnover as confirmed at p.169

> *"The intention of each of these articles, evidenced from the language used therein, is to charge 'net profits'. That expression is used in each of the Chapter IV articles. To the extent that art 54 and the other articles seek to charge net profits to income tax, they are, in my judgment, serving the same function as income tax and corporation tax serve in the United Kingdom in relation to the profits of a business carried on by an individual or by a company, as the case may be. That was the conclusion to which the Special Commissioner came. I agree with it, and would dismiss the Crown's appeal against that part of his decision."* [Emphasis added]

112. Accordingly, the Court held that the Venezuelan tax corresponded to income or corporation tax and was therefore creditable. In this regard I agree with the Appellant that *Yates* is irrelevant for the purposes of determining this appeal.

113. The deductibility of taxes was also considered in *IRC v Dowdall, O'Mahoney & Co* [1952] A.C. 401 where it was held that taxes calculated after the ascertainment of profit were not wholly and exclusively laid out for the purposes of the company's trade in the UK as confirmed by Lord Oaksey at p.409:

> *"that taxes such as those now in question, namely, income tax, corporation profits tax and excess profits tax, are not according to the authorities wholly and exclusively laid out for the purposes of the company's trade in the United Kingdom. Taxes such as these are not paid for the purpose of earning the profits of the trade: they are the application of those profits when made and not the less so that they are exacted by a dominion or foreign government. No clear distinction in point of principle was suggested to your Lordships between such taxes imposed by the United Kingdom government and those imposed by dominion or foreign governments."*

114. Correspondingly in *Ashton Gas Company v the Attorney-General* [1906] AC 10, the Earl of Halsbury confirmed at page 12:

> *"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. But if you confound what is the necessary*

expenditure to earn that profit with the income tax, which is a part of the profit itself, one can understand how you get into the confusion which has induced the learned counsel at such very considerable length to point out that this is not a charge upon the profits at all. The answer is that it is. 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. I cannot understand how you can make the income tax part of the expenditure. I share Buckley J.'s difficulty in understanding how so plain a matter has been discussed in all the Courts at such extravagant length."

115. However, *Dowdall, O'Mahoney & Co*. and *Ashton Gas Company* can be distinguished as both judgements considered the deductibility of taxes after the profit was ascertained. In this appeal, a consideration is required of whether taxes imposed on gross receipts prior to the deduction of expenses and the ascertainment of profit. Furthermore, and as argued by the Appellant, the imposition of a flat rate of withholding tax on the foreign dividends derived by the Appellant bore no relationship in determining whether profits had been earned from trading activities.

116. In this regard, based on evidence adduced and submissions made, I have found that the dividend withholding taxes were incurred at the volition of the Appellant as a result of the acquisition of stock with imminent dividend entitlement on the basis that it chose to be a market maker. It chose to hedge certain products traded with stock in the knowledge that dividend withholding tax would be suffered if the stock position was held over dividend record date. The cost of hedging the derivative leg of the trade involved buying stock and dividend withholding tax was suffered as a consequence. Furthermore, and as confirmed by the Respondent's expert witness, Dr Oldfield, the acquisition of a share with an imminent dividend entitlement would have had the income built into the acquisition cost of that share. Correspondingly Dr Oldfield also confirmed that the withholding tax is a cost in respect of the particular carrying of the share over the dividend date and that one cannot regard one as a revenue without regarding the other as a cost in earning that revenue. On this basis, I have found that such taxes were disbursements of the business laid out wholly and exclusively for the purpose of the trade.

Taxes allowed as a deduction

117. The Appellant placed significant reliance on the decision of the Court of Appeal of England and Wales in *Harrods (Buenos Aires) v Taylor-Gooby* 41 TC 450 a case in which the dividing line between deductible and non-deductible taxes was considered.

118. In that case, the taxpayer company, which was incorporated and resident in the United Kingdom, had a large retail store in Buenos Aires and as a consequence it was

liable in Argentina to a tax known as the substitute tax, which was levied on joint stock companies incorporated in Argentina, and on companies incorporated outside Argentina carrying on business in the jurisdiction through an *"empresa estable"*. The substitute tax was charged annually at the rate of one per cent on capital and was payable whether or not there were profits liable to Argentine income tax. Under Argentine law there were sanctions to prevent non-payment of the substitute tax. In deciding whether or not the outlay in the form of the substitute tax was incurred so as to earn profits, and was thus deductible as an expense, the Court held that "*it was an expense necessarily incurred by it in order to carry on its trade and was wholly and exclusively laid out for the purpose of the trade of the company."*

119. The Respondent distinguished *Harrods* based on the factual circumstances specifically on the grounds that the Argentinian tax was not charged on the basis of profits, or 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 tax could result in the company being precluded from trading. However, in the Appellant's case, no such restriction or sanction could be imposed for failing to pay the dividend withholding tax. On the contrary it is the payer of a dividend to a non-resident that has to account for the withholding tax.

120. The Respondent also argued that it was not the case that the entity entitled to receive dividends would be precluded from trading or from receiving dividends in the future. Any sanction would be on the defaulting payer. Furthermore, suffering a deduction by way of withholding tax could not logically be seen as a pre-condition to doing business, as in the *Harrods* case. An obligation for the payer of the dividends only arose where a dividend income payment is made. In this regard, it was submitted by the Respondent that the decision in *Harrods* provided no persuasive authority and no logical basis for the proposition that a withholding tax levied by a foreign country on income received by a trader constitutes an expense of carrying on the trade or business and reliance *Harrods* as an authority was misplaced.

121. I accept the Respondent's submission that the Appellant was not subjected to a sanction for the failure to pay the dividend withholding tax as that obligations fell on the payor of the dividend in the source country. Furthermore, and contrary to the Appellant's assertion of its obligation to be present in the market and inevitably suffer withholding tax, such an impediment has not prevented that Appellant operating in the market and conducting trades notwithstanding the Respondent's historic position of denying a deduction for dividend withholding tax since 2011.

122. However, the decision in *Harrods* is significant for the Appellant. Similar to the factual circumstances ventilated in *Harrods*, the Appellant incurred the dividend withholding tax irrespective of whether the company generated any profits, either on a particular position or overall in the relevant year.

123. In this regard and contrary to the Respondent's submissions, I am of the view that the significance of the references to the factual background in the *Harrods'* case, specifically the impediments to trade and the imposition of sanctions, were for the purposes of highlighting the contextual background to enable the courts consider whether the expenditure was incurred "*for the purposes of the trade*".

124. Furthermore, the dividend withholding tax as with the substitute tax is, in the words of Buckley J. in *Harrods* at p. 461:

> *"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 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."*

125. As is evident from the *Harrods* case, there is a distinction to be made between taxes calculated before and after profits have been ascertained. As such, the dividend withholding tax was incurred irrespective of whether the Appellant generated any profits, either on a particular position or overall in the relevant year. Therefore, such taxes represented a cost of doing business as opposed to a consequence of the receipt of the dividend as the primary objective of the Appellant was to derive a profit from the aggregated trade of its share acquisition and hedging strategy.

126. *Hong Kong Inland Board of Review Decisions Case No. D43/91* also considered whether a company could claim a deduction for the taxes paid against its profits under legislation not too dissimilar to TCA, section 81. The Appellant was a Hong Kong Incorporated Shipping Company liable to corporation tax in Hong Kong on all of its worldwide profits and sought to deduct taxes paid in Australia, the Philippines and Taiwan in respect of gross receipts derived in those territories.

127. In the course of its deliberations, the Board referred to the UK statutory provisions analogous to the Irish statute and a significant number of the UK cases that considered "*for the purposes of the trade*" in determining whether there was an entitlement to the deduction for expenses against profits calculated for taxation purposes.

128. At paragraph 6, based on evidence adduced, the Board found:

> *"that in each case the foreign tax was an impost on the gross receipts relevant to the territory concerned whether or not profits are earned…. However on the clear evidence of all the three experts that the taxes were in each case a tax on turnover as opposed to net income, we are of the view that the 'taxable income' treatment in*

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Taiwan and Australia is but a mechanism, a device to subject to tax the amount representing the fixed proportion of the gross receipts, and does not change the fact that the tax is imposed on the gross receipts before any deduction is made in respect of outgoings or expenses."

129. Similar to the factual circumstances in *Harrods*, the Board noted that failure to pay the taxes in Australia, the Philippines and Taiwan would invoke sanctions that would have ensured that:

"the Taxpayer could not have gone on earning income without paying the foreign taxes. Directly or indirectly, the imposition of the sanctions available to the authorities would have forced the Taxpayer to cease its operations."

130. However as considered in my analysis of *Harrods*, the significance of the reference to a sanction was for the purposes of placing context and the rationale as to why such expenditure was for the purposes of the trade as opposed to a specifically prescribed condition for claiming the expenses as a deduction.

131. Recourse was thereafter made to a review of the UK jurisprudence where at paragraph 10 it was observed that in:

"the Ashton case, the question was whether in calculating the rate of dividend, income tax payable on the profits should be included in the profits. At 624 Buckley, J had this to say:

> *' The profits are not arrived at after deducting income tax. The income tax is part of the profits – namely, such part as the Revenue is entitled to take out of the profits. A sum which is an expense which must be borne whether profits are earned or not, may no doubt be deducted before arriving at profit. But a proportionate part of the profits payable to the Revenue is not a deduction before arriving at, but a part of, the profits themselves.'*

The two principles establish respectively (1) the unavailability of income tax as a deduction and (2) the deductibility of expenses which must be borne whether or not profits are earned. They are approved in the Court of Appeal at 627, 629 and 630 and in the House of Lords in [1906] AC 10 at 12, 13 and 14. Mr Kotewall also referred to Willoughby's Hong Kong Revenue Law, vol 2, section 16, 2-259 where it says:

> *'However, as a matter of general principle a foreign tax is also deductible if it is a charge on earnings and is payable whether or not a profit is made. This may be particularly relevant in the case of shipping companies assessed on a proportion of their total world profits under section 23B or 23C. In an unreported Board of Review case it is understood that Indian freight tax and Canton Government tax were held deductible in ascertaining the chargeable*

profits of a shipping company. The general principle was stated by Buckley, J in AG v Ashton [1904] 2 Ch D 621 at 624 in these words:

" A sum which is an expense which must be borne whether profits are earned or not, may no doubt be deducted before arriving at profit."'

132. At paragraph 16, the Board proceeded to consider the *Harrods* case and commented thus:

"We are not aware of any United Kingdom case which decided or considered a question of foreign tax on gross receipts in relation to the phrase 'for the purposes of the trade'. The nearest case appears to be Harrods…"

133. Later in the same paragraph, the Board distinguishes *Yates* by observing that:

"Mr Kotewall submitted that the facts, the law and the issues in that case were all different from those in the present case, and that no assistance could be obtained from it. We agree. Superficially the words used in the passage quoted from page 169 of Yates v GCA International Ltd above bear some resemblance to some of the arguments advanced by Mr Wu, but Mr Wu did not rely on that passage, nor did he refer to that case in his submission. We think Mr Wu was right not to rely on that case. It turned on the peculiar wording of the Venezuelan tax law which in effect says that net profits are x% of gross receipts. In deciding whether the Venezuelan tax corresponded to the United Kingdom income tax or corporation tax, the judge took into account the intention of the Venezuelan law to charge net profits and the Venezuelan tax serving the same function as income tax or corporation tax, whereas in the present case we are concerned with the ascertainment of total profits in accordance with the provisions of sections 16(1) and 17(1)(b) of the Ordinance; those provisions permit the taxpayer to make all proper deductions against the gross receipts and to take the balance thus arrived at as his taxable profit or loss as the case may be;"

134. In determining that the taxes paid in Australia, the Philippines and Taiwan were deductible, the Board concluded at paragraph 17:

"In the present case, we are satisfied that the Taxpayer could not have gone on earning income without paying the foreign taxes and that the foreign taxes must be paid whether or not profits were earned, and we conclude that the taxes were paid with a view to producing profits and were outgoings incurred in the production of profits within the meaning of section 16(1) of the Ordinance and that the payment of the taxes was not prohibited by section 17(1)(b) of the Ordinance. "

135. In this regard, I am satisfied that in accordance with the Appellant’s hedging strategy, the acquisition price of a share with an imminent dividend entitlement together with the underlying tax was factored into the price of that share and in effect the total cost represented the Appellant’s stock in trade and reflected as such in its statutory accounts, it would be contrary to commercial and indeed tax provisions to artificially remove the element of that cost on the basis that part of that cost represented income tax. As mentioned above, there is no principle of tax law that excludes taxation as a deduction against profits where that taxation is not based on the underlying profits.

Accounting treatment

136. As a market maker on exchanges, the Appellant has a legal requirement to be ‘present in the market’ offering two way prices. It is obliged by the exchanges in which it operates to provide liquidity to the market by buying or selling options and prudent risk management dictates that they hedge with associated securities. Therefore, in the normal course of trading, stock positions may be held over dividend record dates resulting in the receipt of dividends. This is an unavoidable consequence of these trading activities.

137. Therefore, a profit can arise on the option leg of the trade and a loss on the stock leg of the trade or *vice versa* resulting in a net trading profit or loss. As such, the Appellant’s business model needs to be viewed in totality rather than looking at a single leg of a trading strategy. The dividend withholding tax was suffered before earning the profits of each relevant financial trade, and can thus be considered as an expense incurred in earning the receipts of the trade.

138. The withholding tax that was suffered on dividends could not be reclaimed under a relevant double tax treaty and constituted the final cost for the Appellant of entering the trade, similar to a ‘cost of sale’ in accounting terms, and impacted on the final net profit or loss realised on the overall trade.

139. As such, dividends were not ‘earned’ as part of their trade but instead flowed from the trade of buying and selling securities and any dividend withholding tax suffered was an unavoidable consequence of that particular part of its trading activities.

140. In his evidence, **Name Redacted**, the Appellant’s chief financial officer said “*we reflect the gross value of the dividend as income within the income and expense account and we reflect the withholding tax as an expense within the income expense account.”*

141. The relationship between accounting principles and taxable profits was considered in *M. Cronin v Cork and County Property Company Limited* [1986] IR 559 were at p.569 Griffin J. noted that the:

"method of computation of the balance of profits and gains for tax purposes has been considered in a number of cases. The passage most frequently cited is that of Lord President Clyde in Whimster and Co v The Commissioners of Inland Revenue (1925) 12 TC 813, at p 823: -

> *"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."*

142. In this regard, I accept that the Appellant was engaged in the trading of marketable securities for the purposes of earning profit and all of its resources were directed to the earning of profit. Where it carried out trades that involved stock being held over dividend payment dates, it did so for the purposes of earning profit. It may not have succeeded in earning profit, but I was satisfied that was its purpose. As such, the grossed up dividends were included in the Appellant's total receipts and that expenditure was laid out to include the costs of trading, brokerage fees, stamp duties and the dividend withholding tax.

143. Therefore, the endorsement of the accounting principles for the purposes of calculating tax profits as espoused in *M. Cronin v Cork and County Property Company Limited* supports the Appellant's entitlement for a deduction for the dividend withholding taxes claimed against its taxable profits pursuant to TCA, section 81.

Tax Appeal Commission Determination 02TACD2018

144. I agree with the Appellant that the determination of this Commission, 02TACD2018 can be distinguished as in that case there was a consideration of withholding tax with reference to royalty income. As noted by the Appellant, royalty income withholding tax is different to dividend income withholding tax due to the fact that royalty income arises from a licensing right and is income which is earned whereas dividend income is not earned as the entitlement to the dividend simply arises from being the holder of a stock on the record date.

145. Furthermore, in determination 02TACD2018, it was noted that the business of the taxpayer was the licencing of software in return for a royalty with the entitlement to earn royalty income corresponding to the full period over which the licence relates. In contrast to this appeal, the Appellant did not ‘earn’ dividends as part of their trade but instead the dividends merely flowed from the trade of buying and selling securities. The receipt of a dividend was not by reference to holding the securities for the full period to which the dividends related. Instead the Appellant held stock positions over dividend record dates and was in receipt of dividends as a result. Hence the dividend withholding tax was suffered in making the overall trade, rather than earning dividend income.

146. It is also relevant that in this appeal the Appellant is not claiming double taxation relief in relation to the dividend withholding tax suffered on the dividends and therefore is not claiming that the dividend withholding tax was a tax on income for the purposes of obtaining such relief. The sole issue in this appeal is whether the dividend withholding tax incurred was a deductible expense for the purposes of TCA, section 81. Therefore, withholding tax represented a final cost for the Appellant of entering the trade, similar to a ‘cost of sale’ in accounting terms, and impacted on the final net profit or loss realised on the overall trade.

TAX APPEALS COMMISSION

Conclusion

147. It is significant that the dividend withholding tax on which the Appellant is seeking to claim a deduction under TCA, section 81 was specifically excluded from relief from corporation tax and double taxation relief pursuant to TCA, section 21B(4)(c) and TCA, Schedule 24 respectively. As such, the Appellant was taxed on dividend income without a corresponding entitlement to a credit or deduction for the foreign tax withheld on that income.

148. While it is clear that dividend withholding tax is a tax on income, such an acknowledgement is not fundamentally fatal to the Appellant's appeal as there is no general principle of law that specifically denies a deduction for taxes in accordance with the prescribed rules as set out under TCA, section 81 where those taxes are not calculated after the ascertainment of profit.

149. Furthermore, there are many compulsory deductions imposed by a Sovereign Government that are permissible as a deduction pursuant to TCA, section 81 such as Irish and foreign stamp duty, Irish and foreign irrecoverable VAT, foreign Financial Transaction Tax, and employer's PRSI.

150. Based on the evidence adduced, I have found that the business of trading in marketable securities by the Appellant involved holding shares over a dividend record date, which inevitably meant that dividend withholding taxes were suffered. As such the dividend withholding taxes could be described as a charge imposed for undertaking the business. It was the price of carrying out the business which the Appellant conducts. To the extent that withholding tax was suffered on the dividend and could not be reclaimed under a relevant double tax treaty, impacted on the final net profit or loss realised on the overall trade, as a final cost of entering the trade. Thus, the withholding tax was required to be incurred by the Appellant for the purposes of earning profits, if any. As such, the dividend withholding taxes were a prerequisite to the making of a trade and were disbursements of the business laid out wholly and exclusively for the purpose of the trade.

151. As is evident from the *Harrods* and the *Hong Kong* cases, there is a distinction to be made between taxes calculated before and after profits have been ascertained. As such, the dividend withholding tax was incurred irrespective of whether the Appellant generated any profits, either on a particular position or overall in the relevant year. Therefore, such taxes represented a cost of doing business as opposed to a consequence of the receipt of the dividend as the primary objective of the Appellant was to derive a profit from the aggregated trade of its share acquisition and hedging strategy.

152. I am satisfied that in accordance with the Appellant's hedging strategy, the acquisition price of a share with an imminent dividend entitlement together with the underlying tax was factored into the price of that share and in effect the total cost represented the Appellant's stock in trade and reflected as such in its statutory accounts. As such, it would be contrary to commercial and indeed tax provisions to artificially remove the element of that cost on the basis that part of that cost represented income tax. As mentioned above, there is no principle of tax law that excludes taxation as a deduction against profits where that taxation is not based on the underlying profits.

153. Finally, the endorsement of the accounting principles for the purposes of calculating taxable profits as espoused in *M. Cronin v Cork and County Property Company Limited* supports the Appellant's entitlement for a deduction for the dividend withholding taxes claimed against its profits pursuant to TCA, section 81.

154. Therefore based on a consideration of the evidence and submissions together with a review of the facts and documentation, I have determined that the Appellant is entitled to claim a deduction pursuant to TCA, section 81 in respect of the withholding tax on dividend income on which it was precluded from claiming exemption from corporation tax and also denied a credit for such taxes under the double tax relief provisions of TCA, Part 35 and Schedule 24 . The deductions to be allowed are in accordance with those set out at paragraph 2 of this determination.

155. This appeal is therefore determined in accordance with TCA, section 949AK.

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Conor Kennedy
Appeal Commissioner
11th January 2019

The Tax Appeals Commission has been 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.