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SUBMISSION TO THE COMMISSION ON TAXATION

Terms of Reference; *ECONOMIC ACTIVITY & THE ENVIRONMENT*

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ABSTRACT: *This submission to the Commission on Taxation attempts to illustrate how our tax code can best support economic activity and prosperity by recognising that data processing centres are the modern factories of tomorrow. These new “factories” are more environmental friendly and will in turn reduce our carbon footprint. The phasing out of “manufacturing” relief, notwithstanding our competitive 12.5% corporation tax rate will possibly make Ireland a less attractive location for data processing centres. Consequently, this paper sets out why and how the modern data processing “factory” should be treated as a factory by our tax code notwithstanding that manufacturing relief will no longer be available.*

1. INTRODUCTION

Under section 268 Taxes Consolidated Act, 1997 (TCA 1997) an industrial building or structure is a building or structure in use for the purpose of a specific trade. In the present case we are concerned with “a trade carried in a mill, factory or other similar premises.” Once the building comes within the section then capital allowances in respect of capital expenditure incurred on the construction or refurbishment of the “industrial building” are available. The

period over which the capital allowances are granted (the tax-life) for an industrial building used for a trade carried on in a mill, factory or other similar premises is 25 years (i.e. usually 4% per annum). If the building is sold or otherwise ceases altogether to be used as an industrial building during the tax-life of the building the owner may have a balancing charge or a balancing allowance. However, temporary disuse of an industrial building will not trigger a balancing charge or allowance, nor will a disposal of the building or a cessation of the trade after the expiry of the tax-life.

2. DEFINITION OF INDUSTRIAL BUILDING

Section 268(1)(a) TCA 1997 states that an industrial building or structure means a building or structure in use;

“(a) for the purposes of a trade carried on in –

(i) a mill, factory or other similar premises”

As the act does not define what that trade is we must refer to case law. In Vibroplant Ltd. v. Holland (1982) 1 All ER the English Court of Appeal held that the purpose for which industrial building allowances are given was to encourage manufacturing, processing, producing, importing and allied trades. The court refused Vibroplant Ltd. industrial buildings allowance against its income from its plant hire income. As Lord Templeman stated at page 669;

“In the present case the taxpayers carried on the trade of plant

hire operators and for the purposes of that trade cleaned, serviced and repaired hire articles in buildings constructed for that purpose. But neither the trade of plant hire operator nor the purpose for which the buildings are employed falls within the (Act), because neither the trade nor the activities carried out in the building have anything to do with manufacturing or processing" (emphasis added)

In Ellerker v. Union Cold Storage Co. Ltd 22 TC 195 in which the phrase under consideration was "mills, factories or other similar premises", Macnaghten J. at page 208 stated;

"Since the words "mills" and "factories" are ordinary English words, they must be construed in their ordinary and natural sense,I take it that a factory is a building used for the manufacture of goods and equipped with machinery, and the word is generally understood in that sense. It is a building where goods are made."

3. MANUFACTURING OR PROCESSING

From 1981 the schemes of export sales relief and Shannon relief were replaced by a new incentive scheme based on a low rate of corporation tax applicable to Irish manufacturing industry generally. Part 14 of the TCA 1997 sets out the

legislation governing this relief and is commonly referred to as “manufacturing relief” or the “10% rate of corporation tax”. Section 45 of the Finance Act, 1984 extended the meaning of manufacturing to “computer services”. This provision is contained in section 443(10) TCA 1997 which provides *inter alia*;

“(10) (a) In this subsection “computer services” means one or more of the following-

- (i) data processing services,*
- (ii) software development services, and*
- (iii) technical or consultancy services relating to either or both services specified in subparagraphs (i) and (ii),”*

the work on the rendering of which is carried out in the state in the course of a service undertaking in respect of which -

- (I) (A) an employment grant was made by the Industrial Development Authority under section 25 of the Industrial Development Act, 1986, or*
(B) an employment grant was made by the Industrial Development Agency (Ireland) or Forbairt, as may be appropriate, under section 12(2) of the Industrial Development Act, 1993,
- (II) a grant under section 3, or financial assistance under section 4, of the Shannon Free Airport Development Company Limited (Amendment) Act, 1970, was made*

*available by the Shannon Free Airport Development
Company Limited*

*“(b) For the purposes of relief under this Part, in relation to a
company carrying on a trade which consists of or includes
the rendering of computer services-*

- (i) the rendering of the computer services shall be regarded as
the manufacture in the State of goods, and*
- (ii) any amount receivable in payment for the rendering of the
computer services shall be regarded as an amount receivable
from the sale of goods.”*

According to the Revenue Commissioners *Notes for Guidance on the TCA 1997* the effect of this provision is to;

*“extend to cases of on-line transmission of computer-based
data processed in the State the same treatment as is provided
for cases where there is a sale of a tape or disc on which information
or programmes had been recorded.”*

Section 74 Finance Act 1999, which amended Section 442 TCA 1997, introduced a phased withdrawal of manufacturing relief. Certain companies continue to qualify for manufacturing relief until 31/12/2010.

4. DATA PROCESSING AND INDUSTRIAL BUILDINGS ALLOWANCE

From the above it can be seen that if an undertaking is carrying on “computer services” within the meaning of Section 443(10) TCA 1997 then it is “manufacturing”. Once it is manufacturing it meets both Lord Templeman’s test in the Vibroplant Ltd v. Holland case and Lord Macnaghten’s test in the Ellerker v. Union Cold Storage Co Ltd. case as to entitlement to industrial buildings allowance.

“Data processing services” are not defined in the TCA 1997 however, the *Data Protection Act, 1988* defines in section 1 “data” as;

“means information in a form in which it can be processed.”

This act’s preamble states, *inter alia*;

“An Act to give effect to the Convention for the protection of individuals with regard to automatic processing of personal data done at Strasbourg on the 28th day, January 1981.”

Article 2 of the Strasbourg Convention of the 28th Day, January 1981 defines

“automatic processing” as;

“includes the following operations if carried out in whole or in part by automated means; storage of data, carrying out of logical and/or arithmetical operations on those data, their alteration, erasure, retrieval or dissemination.”

Halsbury's “Laws of England” (4th Ed) Vol 36 defines “data processing” at page 615 as;

“Data processing includes the storage and retrieval of information.”

The Taxes Acts 2004 (Lexis Nexis), edited by Philip Brennan reproduces a number of Revenue Commissioners precedents on “manufacturing”, of interest is the following on page 902;

“ Issue; Whether a service provided for a parent or unconnected company would be regarded as data processing where the operations are grant aided by the IDA, or other appropriate agencies, as a computer service. Types of activities include

(i) Telephone calls for hotel reservations

or airplane tickets are taken, data processed and that data

passed on to another company (no sale of hotel rooms or airline tickets takes place)

(ii) *Technical support for computers services is provided over the phone.*

(ii) *Invoices, accounts and other data are processed for third parties*

Decision; (i), (ii) and (iii) ALLOWED."

Therefore if an undertaking is providing "computer services", be it by way of data processing services and/or technical or consultancy services relating to such services then it is "manufacturing". If it is "manufacturing" then it is in occupation of an "industrial Building".

5. OFFICES AND INDUSTRIAL BUILDINGS

Where part only of a building or structure is an industrial building, and the capital expenditure on the non-industrial portion does not exceed one-tenth of the total capital expenditure incurred on the whole building, then the whole building will be treated as an industrial building. However, where the cost of offices in a building exceed 10% of the total expenditure, the full cost of the office is disallowed and not just the excess over the 10%. If data processing centres are deemed to be offices then the 10% restriction would be fatal.

Of importance in this regard is the case of Girobank plc v. Clark (Inspector of Taxes) 1996 STC 540. In this case Girobank plc sought industrial buildings in respect of a document and data-processing centre in which large numbers of documents were processed at high speed using machinery.

The case concerned the UK *Capital Allowances Act 1990 (CCA 1990)*. Section 18 (1) CCA 1990 provides *inter alia*;

*"Subject to the provisions of this section, in this Part
"industrial building or structure means a building or
structure in use-*

(a) for the purposes of a trade carried on in a mill, factory or

other similar premises”

Section 18 (1) (e) provides that a building or structure in use;
“for the purpose of a trade which consists in the manufacture of goods or materials or the subjection of goods or materials to any process.”

is an industrial building.

Section 18 (4) provides, *inter alia*,
“Notwithstanding anything in subsection (1) to (3) above ... “industrial building or structure does not include any building or structure in use as, or part of, a office”

Lindsay J. held that as the documents were subject to a process the building was an “industrial building” under the second test of Section 18 (1) (e). In other words they were subject to a process but were not manufactured.

However, Lindsay J. then goes on to examine the issue of “office” in section 18 (4). He refers to *IRC v. Lambhill Ironworks Ltd* (1950) 31 TC 393 decided by the Scottish Court of Session where the three judges held unanimously that a drawing office for the preparation of drawings from which articles were manufactured in a factory was an industrial building or structure within the meaning of that Act. He quotes the Lord President;

“A drawing office of this type is no more an “office” within the meaning of the Act than a machine shop is a “shop”.”

Lindsay J. then states that;

“He indicated that one must look at the building as a whole and have regard to its predominant purposes or use.”

He distinguished the *Girobank* case from the *Lambhill Ironworks* case thereby reversing the Special Commissioners on the grounds *inter alia* that in the *Girobank* case nothing at the processing centre was sold and that it was in effect an administrative back office of the bank. Consequently, he disallowed the industrial buildings on the grounds that it was an office. At page 19 Lindsay J. states;

“In my judgement, the deputy Special Commissioner’s conclusion cannot stand as a matter of law...He finds there to be a data-processing centre where the speedy processing of paperwork to add information to it and

derive information from it takes place. Papers are sorted into bundles; clips and staples are removed and the machines present are all of a kind found in buildings clearly to be regarded as offices. Many of the employees sit at keyboards. It seems to me that the machines, under the guidance of their operators, perform functions which, as far as the aims to be achieved are concerned, are tasks that in the past would have been performed manually by clerks working in the offices of banks. The centre is far larger than one might normally think of as an office and less subdivided and more mechanised. For those reasons, no doubt it is noisier than one would normally expect an office to be... ..It was in use as a document and data-processing centre. Nothing at the centre was either sold or prepared for sale. All the operations were of a kind one would expect to be carried on in or by a bank in its back office." (emphasis added)

In the High Court Girobank sought to advance a new argument that the building was a "mill or similar premises". Lindsay J. was of the opinion that it would be undesirable to allow the issue of the "mill" be raised as it had not been raised before the Special Commissioners. However, by way of *obiter dicta* he did deal with the definition of "mill" and suggested that mills alter the physical nature of the materials to which they are applied. In coming to this *dictum* he approves the following passage of Macnaghten J. in Ellerker (Inspector of Taxes) v. Union Cold Storage Co Ltd. (1938) 22 TC 195;

"In my view, since the words "mills" and "factories" are ordinary English words, they must be construed in their ordinary and natural sense, I take it that a factory is a building used for the manufacture of goods and equipped with machinery, and that the word is generally understood in that sense."(emphasis added)

6. IRISH CASE LAW AND "OFFICES"

In O'Conaill (Inspector of Taxes) v. Waterford Glass Ltd 3 ITR 65 McWilliam J. held in the High Court that a building housing computer facilities was an industrial building. The computer facilities were used primarily to monitor the functioning of the factory machinery and the quality of the goods produced, and consequently the building was primarily industrial in character and not ancillary to the company's offices. McWilliam J. quoted with approval CIR v. Lambhill and at page 71 he states;

“It appears from the observations of the Lord President at page 399 and of Lord Keith at page 400 of the report that they considered that the character of the building or structure should be determined by reference to its predominant purposes or use. In some cases this may be difficult to determine, but the facts set out at para 4(x), of the present case make it clear that the computer is a most important part of the equipment for the manufacture of the product and that its use for the purposes of the general office is only a minor part of its total use.”(emphasis added)

7. “FACTORIES”

Judge in “Income Tax” (2006) states at page 882;

“A number of activities established as manufacturing by these cases have been excluded from the benefit of the 10 per cent corporation tax rate by subsequent legislation (see TCA 1997, s 443). This does not affect the question as to whether such activities constitute manufacturing for the purposes of industrial building allowances. Conversely, a number of activities which do not constitute manufacturing in its ordinary meaning are deemed to be so for the purposes of the 10 per cent rate; a building or structure housing these activities should not usually qualify as an industrial building.”(emphasis added)

With respect to Judge I have a difficulty with the last phrase. Indeed the next paragraph on page 882 seems to be at variance with the phrase;

“The Revenue Commissioners have stated that in general it can be taken that industrial buildings allowances will be available in respect of a building where the duplication of software is carried out subject to the normal legislative conditions. However, where a building is being used for software development which qualifies for manufacturing relief under TCA 1997, s 443(10), the matter would need to be considered on a case-by-case basis, which would involve a close examination of the nature of the trade being

carried on. The Revenue's interpretation of the word "factory" in the context of industrial buildings allowance does in fact take recent technological advances into account." (emphasis added)

It must be remembered that text of Section 268 (1) TCA 1997 reads as follows;

*"In this Part "industrial building or structure" means a building or structure in use
(a) for the purposes of a trade carried on in –
(i) a mill, factory or other similar premises"
(emphasis added)*

As was pointed out by Kennedy CJ in Revenue Commissioners v. Doorley (1933) IR 759 at 765 that;

*"The duty of the court, as it appears to me, is to reject an a priori line of reasoning and to examine the text of the taxing Act in question and determine whether the tax in question is thereby imposed expressly and in clear and unambiguous terms, on the alleged subject of taxation, for no person or property is to be subjected to taxation unless brought within the letter of the taxing statute, i.e. within the letter of the statute as interpreted with the assistance of the ordinary canons of interpretation applicable to Acts of Parliament so far as they can be applied without violating the proper character of Taxing acts to which I have referred.
I have been discussing taxing legislation from the point of view of the imposition of a tax. Now the exemption from tax, with which we are immediately concerned is governed by the same considerations."*

Consequently, in interpreting the Act we must look to the express wording or as McCarthy J. stated in the Supreme Court in Texaco (Ireland) Ltd v Murphy (Inspector of Taxes) (1992) ILRM 304 at 311 when allowing Texaco an allowance for scientific research;

"As I have sought to illustrate, the legal principal appears clearly to be that if the claim for allowances falls within the express wording of the permitting section, it must be upheld."

Henchy J. in the Supreme Court in Inspector of Taxes v. Kiernan (1981) IR 117 enunciated three basic rules of statutory interpretation which should inform the approach to the construction of a taxation statute. The first rule is that;

“If the statutory provision is one directed to the public at large, rather than a particular class who may be expected to use the word or expression in question in either a narrowed or an extended connotation, or as a term of art, in the absence of internal evidence suggesting the contrary, the word or expression should be given its ordinary colloquial meaning.”

There is nothing in Section 268 TCA 1997 to suggest that “factory” or “factory or similar premises” is to be treated as a term of art or to have any special connotation. The ordinary canons of construction should apply and the words and phrase in issue have to be given their plain meaning. Macnaghten J. held as much in the Ellerker (Inspector of Taxes) v. Union Cold Storage Co Ltd case in relation to a factory under similar UK legislation.

From the express wording of Section 443(10) income from “computer services” as defined, is clearly “*income from the sale of goods manufactured*” in the State, (see paragraph (3) above).

8. CONCLUSIONS & PROPOSALS FOR CHANGE

The question is not “is the building a factory or other similar premises?”, but rather “is it in use for a trade that is carried on in a factory or similar premises?” In answering this question we must examine the plain text of the taxing Act and ascertain if the claim for the allowance falls within the express wording of the permitting section i.e. Section 268 TCA 1997. The term “factory” and the phrase “similar premises” must be given their ordinary colloquial meaning.

As already pointed out Macnaghten J. in Ellerker (Inspector of Taxes) v Union Cold Storage Co Ltd and approved by Lindsay J. in Girobank v. Clarke (Inspector of Taxes) has stated that a factory is;

“A building used for the manufacture of goods and equipped with machinery, and that the word is generally understood in that sense. It is a building where goods are made.”

If an undertaking is manufacturing and selling goods within the meaning of Section 443(10) TCA 1997 then as the predominant purpose and/or use of the data-processing centre is that of manufacturing and generating manufacturing income, in my opinion the building is not a general administrative office as was found in the *Girobank* case. Lindsay J. in the latter case held that the bank documents were subject to a process but not a manufacturing process.

Consequently, even though manufacturing relief is being phased out the definition of manufacturing contained in Section 443(10) TCA 1997 should not be repealed unless data processing is specifically deemed to be a use that is carried on in a factory or similar structure. The mega-data centre is after all crucial for the development of the modern “knowledge economy”, and consequently, it is imperative that our tax code provides for such centres to continue to obtain industrial buildings allowance.

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