



6 December 2011

INTRODUCTION

Budget 2012 is the first Budget of the new Fine Gael/Labour government. It has the difficult task of taking €3.8 billion out of the economy in 2012, whilst at the same time supporting the creation of jobs and growing the economy. This will be achieved through €2.2 billion in cuts in public spending and raising €1.6 billion in extra taxes. The government has indicated that this is the first budget in a four year path to Ireland's recovery.

As expected and on a positive note, the 12.5% corporation tax rate remains untouched and the Irish government remain fully committed to the rate. The well publicised increase in VAT from 21% to 23% will take effect from 1 January 2012. However, the government have committed to no further increases in VAT during their term. Some positive business measures include the introduction of a special assignee relief and foreign earnings deduction programme, which should be of assistance to the multi-national and export sector. The Minister for Finance has also indicated that he intends to introduce measures in the Finance Bill to support the financial services, insurance and aircraft leasing industries.

The SME and Agri/Food sector were not ignored with the continuation of the corporation tax start up exemption and improvements to the R&D regime. Well flagged changes to capital taxes include an increase in the capital acquisitions tax and capital gains tax rates from 25% to 30%. The controversial proposed abolition of property tax reliefs by the previous government has been replaced by a new 5% surcharge and the end of unused accelerated capital allowance reliefs after 1 January 2015 in certain cases.

We have focussed in this briefing on the taxation measures introduced and hope that you will find it useful. Should you have any queries, please do not hesitate to contact us.

HIGHLIGHTS

- The Minister for Finance confirmed yet again the government's continued commitment to the 12.5% corporate tax rate.
- New special assignee relief programme and foreign earnings deduction to be introduced to assist the multinational and export sector. Details to be included in the Finance Bill.
- Improvements to the R&D tax credit regime.
- Extension of the three year corporation tax relief for start up companies to commence for new trades in 2012, 2013 or 2014.
- No changes to income tax.
- Capital acquisitions tax and capital gains tax to increase on 7 December 2011 from 25% to 30%.
- Stamp duty on the transfer of non residential property reduced from 6% to 2% from 7 December 2011.

- New 5% levy proposed on income sheltered by property reliefs in a given year for individuals with gross income over €100,000. Changes proposed on the use of accelerated capital allowances after 1 January 2015.
- VAT rate to increase from 21% to 23% from 1 January 2012.
- Deposit interest retention tax and exit taxes on life assurance policies and investment funds to increase to 30% for payments made annually or more frequently and 33% for payments made less frequently than annually. These changes will apply to payments including deemed payments made on or after 1 January 2012.

PERSONAL

Personal Tax

- *Rates, bands and credits* – There will be no change in the income tax rates, no narrowing of tax bands and no reduction in personal tax credits.
- *Universal Social Charge (USC)* - The exemption threshold from USC will be raised from €4,004 to €10,036 from 1 January 2012. The USC will be collected by the Revenue Commissioners on a cumulative basis from 1 January 2012 which should assist in dealing with issues regarding under and overpayment of USC by taxpayers in 2011.
- *Illness Benefit* – The existing tax exemption has been removed for the first 36 days of Illness Benefit and Occupational Injury Benefit to combat absenteeism.
- *Mortgage Interest Relief* - Mortgage interest relief will be increased to 30% for first time buyers who took their mortgage out during the years 2004 to 2008. The relief will not be available to those who purchased after the end of 2012 and will be fully abolished from 2018. However, first time buyers who purchase property in 2012 will get mortgage interest relief at 25% and non first time buyers will benefit from relief at 15%. Separately, a further announcement is expected on future steps to be taken to help people in difficulty with mortgage arrears.
- *Special Assignee Relief Programme* - A Special Assignee Relief Programme is to be introduced to attract key people to Ireland to help expand established multinational and indigenous companies. Further detail will be published in the Finance Bill.
- *Foreign Earnings Deduction* - A Foreign Earnings Deduction (FED) will be available to individuals who spend 60 days or more in a year aiding Irish market development in Brazil, Russia, India, China and South Africa (BRICS countries). A FED has not been available for a number of years and previously was not limited to specific countries. Further detail on the FED will be available in the Finance Bill.
- *Household Charge* – An interim charge of €100 will be introduced for each household in Ireland in 2012 pending implementation of a full property tax in 2014.
- *Deposit Interest Retention Tax (DIRT)* - DIRT is to be increased from 27% to 30% on ordinary deposit accounts and from 30% to 33% on long term deposit accounts. The increased rates will apply from 1 January 2012.
- *Life Assurance Policies and Investment Funds* - Taxes on life assurance policies and investment funds are to increase by 3% to 30% for payments made annually or more frequently and to 33% for payments made less frequently than annually. The increased rates will apply to payments, including deemed payments, from 1 January 2012.
- *PRSI* – The Minister flagged that the collection base for PRSI will be broadened in 2013 to include income sources including rental and investment income.

Pensions and post retirement funds

- The existing employer PRSI relief of 50% on the amount of employee contributions to pension schemes is to be removed from 1 January 2012. The relief was reduced from 100% to 50% from 1 January 2011.
- The annual imputed distribution which applies to the value of assets in an Approved Retirement Fund (ARF) will be increased from 5% to 6% in respect of ARFs with asset values in excess of €2 million or in cases where an individual owns more than one ARF, if the aggregate value of the assets in that individual's ARFs exceeds €2 million. This rate is to be charged on the asset values as at 31 December 2012 and future years.
- The annual imputed distribution provisions which apply to ARFs will be extended to apply to "vested" Personal Retirement Savings Accounts (PRSAs) with assets in excess of €2 million. A "vested" PRSA is a PRSA from which retirement benefits (usually in the form of a "tax-free" lump sum) have commenced to be taken. Where an individual holds more than one PRSA, the deemed distribution will apply to the aggregate of the assets in all of that individual's PRSAs once any one of them is vested. These changes will affect those who have drawn down a tax-free lump sum from one or more PRSAs but who have not yet either purchased an annuity or transferred their remaining pension funds to an ARF. The rules will apply in respect of vested PRSA asset values at 31 December 2012.
- Under current rules, the transfer of ARF assets on the death of the ARF owner to a child of the owner who is aged over 21 is subject to a total liability equal to the standard rate of income tax (currently 20%). It is proposed to apply a higher tax rate of 30% to such transfers and this will be addressed in the Finance Bill.

Capital Gains Tax

From 7 December 2011 the rate of Capital Gains Tax will increase from 25% to 30%.

A tax incentive is being introduced in relation to property purchased between 7 December 2011 and 31 December 2013. If the property is held for a period of 7 years any capital gain accrued in that period will be exempt from Capital Gains Tax. No mention was made of where a capital loss arises.

Retirement relief provides a full exemption from Capital Gains Tax for individuals aged 55 or over in respect of an intra-family transfer of qualifying business assets regardless as to value of the assets transferring. A cap of €3 million has been introduced where the individual is 66 or over and is transferring farming business assets. There will be a 2 year transitional period for individuals aged 66 or who reach 66 before 31 December 2013 during which the cap will not apply. The upper limit of €750,000 in respect of non intra-family, or third party, transfers of farming business assets has been reduced to €500,000 for individuals aged 66 or over and the 2 year transitional period will apply. The purpose of this change is to incentivise the early transfer of farming businesses.

Domicile Levy

A domicile levy of €200,000 was introduced in 2010 subject to specified criteria on asset values and income. The levy applies to persons domiciled in Ireland who are also citizens of Ireland. The citizenship requirement is to be removed.

Proposed modifications to the current regime applying to non-residents will be published in 2012 followed by a public consultation process before changes are introduced in 2013.

Capital Acquisitions Tax

From 7 December 2011, the current rate of Capital Acquisitions Tax (gift / inheritance tax) will increase from 25% to 30%.

From 7 December 2011 the current Group A tax free threshold below which Capital Acquisitions Tax (gift / inheritance tax) is not payable will be reduced from €332,084 to €250,000. The Group A tax free

threshold applies to gifts or inheritances taken by a child from a parent. The current Group B and Group C tax free thresholds of €33,208 and €16,604 respectively remain unchanged.

Excise Taxes

From 7 December the excise duty on a standard packet of 20 cigarettes will increase by 25 cents (including VAT) with a pro-rata increase on other tobacco products. No increase in excise duty has been applied to alcohol.

Motor Tax and VRT

Motor Tax rates will increase across all categories with effect from 1 January 2012. A consultation process with the motor industry and other interested parties will commence in 2012 to review options for improvements in VRT and Motor Tax revenues in the future. An export refund scheme is proposed which would allow for a refund of VRT on the permanent export of the vehicle to another EU state.

BUSINESS

Corporation Tax Rate

In line with the Programme for government, the Minister for Finance has restated the government's continued commitment to the 12.5% corporation tax rate and that there will be no change in Ireland's 12.5% corporation tax rate.

VAT

With effect from 1 January 2012, the standard rate of VAT on goods and services will be increased from 21% to 23%.

District or communal heating is a concept which is relatively unknown in Ireland. By an EU Council Directive, Member States were authorised to apply a reduced rate of VAT to supplies of natural gas, electricity and district heating services provided no risk of distortion of competition exists. A Member State intending to apply such a reduced rate must inform the EU Commission before doing so. The Minister proposes that following consultation with the EU Commission, the rate of VAT on district heating services will be at the rate of 13.5%. No commencement date has been given.

With effect from 1 January 2012, the rate of VAT on admission to open farms will at the rate of 9%.

A farmer may claim a refund of VAT incurred on a wind turbine purchased on or after 1 January 2012.

R&D Tax Credit

There have been a number of changes proposed to the R&D tax credit scheme as follows:

- The first €100,000 qualifying R&D expenditure will be allowed on a volume basis for the purposes of the R&D tax credit. The R&D tax credit on incremental expenditure over €100,000 will be treated as per the current scheme and comparable with the expenditure in the base year 2003;
- The outsourcing limits for R&D activities to subcontractors or to third level institutions are being increased to the greater of 5% or 10% as appropriate or €100,000; and
- Companies in receipt of the R&D credit can use a portion of the credit to reward key employees involved in the development of the R&D.

Three Year Tax Exemption for Start Up Companies

The Corporation tax exemption for start up companies has been extended for the next three years to cover companies commencing new trades in 2012, 2013 or 2014.

Foreign Earnings Deduction

A foreign earnings deduction will be introduced to aid export companies seeking to expand into emerging markets from Ireland. The deduction will apply where an individual spends 60 days a year developing markets for Ireland in Brazil, Russia, India, China and South Africa. Further details and measures will be provided in the Finance Bill.

Special Assignee Relief Programme

A Special Assignee Relief Programme is to be introduced to attract key people to Ireland to help expand established multinational and indigenous companies. Further details on this programme will be published in the Finance Bill.

Capital Allowances on Renewable Energy Generation

The qualifying period for tax relief for corporate investment in certain renewable energy projects is to be extended to 31 December 2014. The scheme is to encourage investment in the renewable energy generation sector. A project must be approved by the Minister of Communication, Energy and Natural Resources and fall within the Solar, Wind, Hydro and Biomass technology sectors.

International Financial Services

The Minister for Finance announced that a package of measures to support and promote the international financial services industry, the corporate treasury sector, the international insurance industry and aircraft leasing industry will be outlined in the Finance Bill. This is to be welcomed.

Deposit Interest Retention Tax (DIRT)

DIRT is to be increased from 27% to 30% on ordinary deposit accounts and from 30% to 33% on long term deposit accounts. The increased rates will apply from 1 January 2012.

Life Assurance Policies and Investment Funds

Taxes on life assurance policies and investment funds are to increase by 3% to 30% for payments made annually or more frequently and to 33% for payments made less frequently than annually. The increased rates will apply to payments, including deemed payments, from 1 January 2012.

Carbon Taxes

Carbon tax on fossil fuels will increase from €15 per tonne to €20 per tonne. This increase is effective for auto-diesel and petrol from 7 December 2011, but will only become effective for other fossil fuels such as oil and gas from 1 May 2012. There will be no increase to carbon tax on solid fuels such as peat or coal.

Betting Duty

As noted in Budget 2011, betting duty of 1% will be extended to remote betting (by telephone or internet) under the Betting (Amendment) Bill, the final draft of which is expected in early 2012. The Bill will also introduce a betting intermediaries' duty (gross profits tax of 15%) to cover betting exchanges. The new measures are subject to EU notification and are expected to be effective from the second quarter of 2012.

PROPERTY

Stamp Duty

With effect from 7 December 2011, stamp duty on the transfer of non residential property applies at a flat rate of 2%. This has been reduced from a top rate of 6%. Non residential property includes immovable property which is not residential property and intangible property such as debts and

goodwill. The exemption from stamp duty for non residential property for consideration of €10,000 or less has been removed.

There is no change in the rates of stamp duty for residential property, stocks or marketable securities or a policy of insurance.

The Minister indicated in his speech that consanguinity relief for non residential property will continue only until 31 December 2014. However, the financial resolution appears to unwittingly abolish the relief entirely.

With effect from 7 December 2011 the rate of stamp duty on a premium in a lease of non residential property is 2%. There is no change on the rate of stamp duty applicable on the premium in a lease of residential property.

Property Based Legacy Reliefs

The Minister for Finance has announced that the previous government's proposals to guillotine all unclaimed and unused capital allowances arising will not proceed. However, a new 5% surcharge will apply from 1 January 2012 to individuals with annual gross incomes in excess of €100,000 on income sheltered by property based reliefs in any tax year. This is irrespective of whether the reliefs availed of include section 23 type reliefs or accelerated capital allowance schemes.

Section 23 type reliefs will not be terminated or otherwise restricted for investors with annual gross incomes under €100,000 and residential owner occupier relief remains unchanged. However, investors in accelerated capital allowances schemes:

- with a tax life ending after 1 January 2015 - will not be able to use capital allowances arising under that scheme beyond the end of the tax life of the scheme;
- with a tax life ending before 1 January 2015 – will not be able to carry forward capital allowances arising under that scheme into 2015.

This is a smart proposal by the government and addresses some of the constitutional issues with the previous administration's position. Obviously the economic impact assessment carried out aided the government in designing this proposal. However, the high earners restriction is still the real issue as it may stop taxpayers being able to utilise the allowances fully during the relevant tax life and thereby effectively lose them.