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FINANCE BILL 2012 – HIGHLIGHTS

Overview

Given the backdrop of a very difficult fiscal environment together with an overall objective of raising income rather than distributing benefits, the Finance Bill contained more positives than negatives.

In terms of Ireland's attractiveness on the world stage, they were a number of positive measures introduced, most notably, the introduction of the Special Assignee Relief Programme and the Foreign Earnings Deduction. Both of these should serve to boost Ireland's attractiveness as a location for inward investment. On the domestic front, the enhanced R&D credit regime and the extension of the startup exemption are both positive measures in terms of job creation and its incentivisation of key staff.

From a property perspective, the reduction in stamp duty, the CGT exemption and the provision of clarity around legacy property reliefs are all welcome.

Investors and high earners have had a mixed fortunes with tax increases on unearned income and the introduction of a 5% surcharge by reference to utilisation of property allowances increasing overall effective tax rates.

For family business, whilst the CGT and CAT rates have increased, of greater significance is the fact that various reliefs such as business property relief and agricultural relief remain largely untouched. The restriction of retirement relief for transfers post age 66 is regrettable in that it could perhaps result in too much weight being given to tax considerations to the detriment of other commercial / personal objectives. Given the significant contribution by the pensions sector to revenues over the past number of years, it is regrettable that the measures introduced in the Bill further erode pension funds.

Given the Minister's commitment to further reform of the pension sector, it is hoped that a more equitable approach can be arrived at in continuing to make it attractive for individuals to provide for pensions over the longer term.

Individuals

The Bill provides for a number of measures already announced in the Budget relating to the Universal Social Charge, most notably the increase in the exemption threshold for USC from €4,004 to €10,036 for the tax year 2012 onwards. It also clarifies the position that foreign based employees who are the subject of PAYE exclusion orders are not liable to the USC in respect of their employment income.

The Bill provides for enhanced mortgage interest relief for certain categories of owners as announced by the Minister on Budget day. A 30% rate of mortgage interest relief applies in respect of interest paid by those who took out their first loan to purchase their principal private residence in the period from 1 January 2004 to 31 December 2008. In addition, in order to encourage first time buyers to purchase their own home, it confirms that for those who take out loans in 2012, mortgage interest relief will be at 25%.

The Bill introduces changes to the age related income tax credit for medical insurance premiums. It provides for graduated credits

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based on age brackets. In broad terms, there is no additional relief available for those aged under 60, with full relief available for those aged 85 and over.

Capital Taxes

As announced in the Budget, the rate of Capital Gains Tax and Capital Acquisitions Tax was increased from 25% to 30% (effective from 7 December 2011).

Retirement Relief

In the Budget, the Minister has announced changes to retirement relief effectively allowing more generous reliefs for people who transferred / disposed of their businesses between the ages of 55 and 66. The provisions are as follows:-

- Disposals of qualifying assets to a child by an individual aged 55 to 65 are fully exempt from CGT.
- Disposal of assets to a child by an individual who is 66 years or over, will be fully exempt for the first €3m with any amounts above this being fully taxable.
- For individuals aged 55 to 65 disposing of assets to a third party, there is a full exemption where the disposal proceeds do not exceed €750k. In a case where the proceeds exceed €750k, marginal relief applies.
- For individuals aged over 66 years, a full exemption applies where the proceeds do not exceed €500k with marginal relief being available in cases where the proceeds exceed €500k.

These measures are to be effective in relation to disposals made on or after 1 January 2014. Clearly the purpose of the measures is to encourage timely transition of family businesses and farms. Arguably, however, given the backdrop of increasing requirements together with increased age limits to qualify for the State Pension, these measures may not be in tandem with the financial obligations / objectives of many business owners. However, given the fact that they do not become effective until 1 January 2014, it does provide some time for individuals to arrange their affairs so as to qualify for the various reliefs.

Compensation for Turf Cutters

The Bill provides for an exemption in respect of compensation paid to turf cutters for giving up rights to cut turf in special areas as in accordance EU Conservation Rules.

Property Relief

As announced in the Budget, the Bill provides for an exemption from CGT in respect of property purchased between the 7 December 2011 and the end of 2013. Where properties bought during that period are held for at least 7 years, any future gain arising on the disposal of the property will be relieved from CGT. Where a property is held beyond the 7 year period, any gains arising are time apportioned. Therefore, if for example a property was retained for 12 years, then seven-twelfths of the gain would be free from CGT.

Interestingly the exemption applies to any EEA property (EU countries plus Iceland, Liechtenstein and Norway). Clearly consideration would need to be given to the tax implications of any property acquisitions in a foreign jurisdiction. In the case of the UK for example, a non-UK resident individual purchasing property is not liable to any Capital Gains Tax arising on the disposal of that property. Therefore, in tandem with the current relief, any gain arising on UK property

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would be free of Irish and UK tax as the legislation currently stands.

Employers

The Bill provides clarity in relation to a number of issues concerning share based remuneration. In broad terms, they can be summarised as follows:-

- Confirmation that any gains on the exercise release or assignment of a share option are charged to USC at a top rate of 7% (and not 10%).
- Guidance previously provided by Revenue which sets out that in the case of share option gains, the tax payable within 30 days of the date of exercise must include the relevant amount of USC is now included in the legislation. This is in line with the tax briefing issued by Revenue in 2011.
- The Bill introduces a number of other provisions which prevent a double charge to USC in relation to share awards.
- It also provides that the employer will be committed to sell sufficient shares to cover USC due on share remuneration where there is insufficient funds to collect it from the employee via the PAYE system and / or the employee has not made available the relevant amount to the employer.

Overall, the changes introduced in Finance Act 2011 and the current Bill have reduced the attractiveness of share based remuneration for employees. However, notwithstanding this, share based remuneration can prove more attractive than cash bonuses. In addition, it can provide an incentive to employees to focus on the longer term growth of their employer company. Therefore the combined tax and non-tax benefits mean they are still an attractive mechanism by which to reward employees in certain circumstances.

Illness Benefits

As announced in the Budget, the Bill provides that where an individual is receiving illness benefit from the Department of Social Protection, the first 36 days payment is no longer exempt from tax. This applies for the 2012 tax year onwards. Therefore employers need to be aware of this in cases where sick pay is adjusted to take account of Social Welfare benefits.

Relief for Employees engaged in R&D activities

The Bill provides for a new reward mechanism for key employees involved in R&D activity. It effectively allows such employees to receive part of their remuneration on a tax-free basis.

In broad terms, the relief applies as follows:-

- The key employees must perform 75% of their activities engaged in R&D activities. R&D activities are defined along similar lines to the entitlement for companies to the R&D credit regime.
- The relief is not available to directors and / or individuals holding more than 5% of interest in the employer company or a connected company.

In broad terms, the relief is provided by means of the employer company surrendering some of its entitlement to R&D credit relief. Overall, the employee must continue to pay an effective tax rate of 23%.

The relief does provide a mechanism for companies to incentivise key employees involved in R&D activity. It is however

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somewhat limited in its application in that the employer company must be in a position to avail of R&D credit relief, i.e. it must have a liability to Corporation Tax. Overall, however, the relief together with the relaxation of the rules for companies in relation to the availability of R&D credits is to be welcomed.

Pensions

The Bill introduces a number of changes to the whole area of pensions, some of which were already highlighted in the Budget as follows:-

- The annual deemed distribution from ARFs has been increased from 5% to 6% for ARFs with asset values exceeding €2m. In addition, the deemed drawdown applies to "vested" PRSAs (again, where asset values exceed €2m).
- The Bill provides some guidance around the practicalities of the drawdown in cases where an individual holds multiple PRSAs / ARFs.
- The increased drawdown applies for the 2012 tax year onwards.
- Employer PRSI relief for employee pension contributions has been abolished with effect from 1 January 2012.
- The Bill introduced some changes around the practical cashflow issues arising from those who hold dual public and private sector pensions. In some cases, the existing rules would result in a significant tax liability arising as at the date of retirement. The Bill provides for a deferred payment mechanism so as to avoid the payment of a significant liability all on date of retirement.
- In line with Budget announcements, the transfer of an ARF on death to a child who is over 21 years of age has been increased to 30%. This had previously been the standard income tax rate of 20%. Therefore, these changes align the tax payable to the current CAT rates.

Overall the pensions area has undergone significant changes over the past number of years. A number of measures including the removal of the employer PRSI exemption for pension contributions, the reduction in the standard fund threshold to €2.3m and the inability to use pension payment contributions to shelter USC and PRSI have made pensions less attractive.

On a positive note, the continuation of tax relief at the 41% marginal rate is to be welcomed. The Minister has however in commentary recognised that the overall pension regime will need to be reformed to make the system "more sustainable and equitable over the longer term". Clearly, given the demographic profile of the Irish population, one would hope that the Minister will work to retain an incentive for individuals to provide for pensions into the future.

Domestic Business

R&D Tax Credits

As announced in the Budget, the Bill provides for R&D credit relief to be claimed in respect of the first €100,000 of expenditure without reference to a base year which had previously been the case. This therefore broadens the availability of the regime to a larger number of companies. This together with the R&D employee incentive is a welcome measure in an area which is likely to be a key driver of economic growth going forward.

In addition, changes were introduced so that expenditure on outsourcing activities can be

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taken into account for the purposes of the credit. This is of particular advantage to the SME sector who are more likely to have to rely on outsourcing of certain R&D activity.

Corporation Tax exemption for Start Up

The Corporation Tax exemption for new startup companies is to be extended for a further 3 years to the end of 2014.

Employment & Investment Scheme

The Employment and Investment Incentive Scheme (EIIS) (which will replace the old BES scheme) which received Revenue approval and is operational since 25 November 2011 is included in the Bill. Again this is a welcome development as a means of sourcing startup capital or indeed additional capital for existing businesses.

International Tax Developments

Special Assignee Relief Programme

The Finance Bill sets out the detailed provisions in relation to the new Special Assignee Relief Programme (SARP) that was announced on Budget day.

Briefly, this new relief will operate by allowing for a tax deduction in the calculation of the individual's taxable income. The relief will apply in respect of income in excess of €75,000 up to a maximum of €500,000 and a deduction of 30% of the employment income in that range will be available. Therefore, the maximum deduction possible under this new relief will be €127,500 (i.e. €425,000 @ 30%). The relief will apply to employees assigned to work in Ireland for a minimum of 12 months and the relief can be availed of for a maximum period of 5 years. The relief will apply in respect of assignees arriving in Ireland in 2012, 2013 or 2014.

There are certain conditions attaching to the relief. In particular, it should be noted that new employees are not eligible, the employee in question must have been a full-time employee of a company resident in a country with which Ireland has concluded a double taxation treaty and the employee in question must have exercised the duties of their employment outside Ireland for the 12 months prior to arriving in the country. Furthermore, the individual must not have been tax resident in Ireland for the 5 tax years preceding the year of arrival. Therefore, Irish domiciled individuals or citizens are not excluded from claiming the relief.

Foreign Earnings Deduction

A new foreign earnings deduction relief is being introduced targeted at companies seeking to expand into the so called BRICS (ie Brazil, Russia, India, China or South Africa). Where the relief applies, a portion of the individuals employment income, up to a maximum of €35,000 is exempted from Irish tax. In order to qualify for the relief, the individual must have spent at least 60 days in the BRICS region and in order for a day to be taken into account in determining whether the 60 day test has been satisfied, that day must be one of at least 10 consecutive days during which the individual is present in the BRICS region, in the performance of the duties of his / her employment. Similar to the SARP, this relief will operate for the tax years 2012, 2013 and 2014.

Property Related Changes

USC surcharge on use of property incentives

A new surcharge, at 5%, has been introduced with effect from 1 January 2012. The surcharge applies to individuals with annual gross income over €100,000 and have availed

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of specified property reliefs (eg Section 23 / Section 50 type relief, accelerated capital allowances, etc). Where an individual in question falls within the scope of the USC surcharge, then the 5% charge will apply on the amount of income sheltered by specified property reliefs in a given year. So, by way of example, if an individual has gross income of €120,000 comprising €70,000 of Irish rental income and €50,000 of salary and the entire €70,000 of rental income is sheltered by availing of the specified property reliefs, then a USC surcharge of €3,500 (ie €70,000 @ 5%) will apply.

Restriction on property based Capital Allowances

As a welcome development, the Bill has repealed the legislation that had been introduced in Finance Act 2011 (although it had never become effective) in relation to the utilisation of Section 23 / Section 50 type allowances. Essentially, Section 23 / Section 50 type reliefs continue to be available but are subject to the High Earners Restriction. However, and importantly, the time period during which these allowances may be utilised remains open ended.

The Bill, however, modifies the restrictions in respect of passive investors in accelerated capital allowance projects (eg hospitals, nursing homes, hotels, etc). Under the new measures, where the tax life of the property ends after 31 December 2014, investors will not be in a position to carry forward any unutilised allowances into periods after the end of the tax life of the property. Where the tax life of the property has already ended or will end on or before 31 December 2014, no carry forward of unutilised allowances into 2015 or subsequent years is permitted.

Stamp Duty

The Bill gives effect to the Budget day announcement in relation to the reduction of the rate of stamp duty on the transfers of commercial property from 6% to 2%. This change is effective in respect of transfers of property on or after 7 December 2011.

Close family relief (which gave a 50% stamp duty reduction on transfers between certain family members) will be abolished with effect from 1 January 2015. This relief had already been removed in respect of transfers of residential property in Finance Act 2011.

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