

## BUDGET 2014 - HIGHLIGHTS

### OVERVIEW

Before the Minister rose to deliver his Budget speech this afternoon, we already knew that a total budgetary adjustment of €2.5bn was the target for 2014. Tax adjustments accounted for €1.2bn. Of this €1.2bn, €500m was set to arise by way of carry-over of measures announced last year (i.e. full year impact of Local Property Tax), therefore new tax revenues of €700m needed to be sourced.

The Minister had signalled his intention that this was to be a 'pro-business' budget and it had also been well-flagged that there were to be no changes to personal tax rates, levies, or bands. It is to be welcomed that no further burdens have been placed on individual tax payers in this respect. It is also to be welcomed that the Minister reaffirmed our commitment to the 12.5% corporate tax rate and took the opportunity of today's Budget announcement to publish a new International Tax Strategy for Ireland. The Minister reaffirmed Ireland's commitment 'to play fair' and also 'to win' in what is an increasingly competitive

international market for mobile foreign direct investment.

On the domestic front, it is positive that the Minister announced no further increases to capital tax rates (CGT, gift tax, and inheritance tax). Furthermore, certain key capital tax reliefs (Retirement Relief and Business Property Relief) remain intact. These are critical reliefs in the context of the inter-generational transfer/sale of businesses in a tax-neutral manner.

In terms of the elusive €700m, the Minister targeted four groups, with the banks set to contribute €150m; pension savers and investors €275m; those with private medical insurance, €127m; and finally, alcohol and tobacco consumers €160m.

Overall, the Budget achieved the stated objectives of fostering business and enterprise while protecting those least able to contribute any further. However, it did target savers and investors by eliminating any tax advantage associated with these activities, thereby further reducing returns in an already low-return environment. However, this may just be the catalyst to encourage the application of

non-productive cash to more productive uses, providing further stimulus for the economy.

The key areas of change announced today are discussed in further detail below.

### INCENTIVES FOR EXISTING BUSINESSES

A stated objective of Government has been to foster an environment that would be attractive to MNCs in terms of locating high-end research and development activities in Ireland. The R & D tax credit (originally introduced in 2003) has been a key element of this strategy. Today's Budget has made three welcome changes to our R & D regime. Firstly, the basic R & D limit (i.e. expenditure calculated without reference to the base year) as introduced in Finance Act 2012 and extended in Finance Act 2013, has been further increased by €100k to €300k.

Secondly, the amount of R & D work which a claimant company can outsource to a third party has been increased from 10% to 15%

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and, finally, the rules which allow a company to pass the benefit of the R & D credit to certain key employees have been relaxed, which it is hoped will remove some of the barriers to uptake of this particular aspect of the relief. All of these changes further enhance an already valuable relief.

Some years ago, the BES (Business Expansion Scheme) was replaced by a more broadly-based scheme known as the EIS (Employment Investment and Incentive Scheme). The maximum permitted investment in any one year by an individual in an EIS structure was €150k. Up until now, the high earner's restriction meant an individual could generally only claim €80k relief in year 1, and €70k of relief in year 2. This was somewhat of an anomaly in the legislation which has been removed. In consequence, an individual investing €150k in an EIS will be able to claim full relief for the investment (at 31%) in year 1, with a further 10% relief claimable (subject to conditions) at the end of the three-year investment term.

In an effort to boost activity on the Irish Stock Exchange, companies listed on the Enterprise Securities Market (ESM), which has been specifically designed to meet the funding needs of companies at earlier stages in their development, will be able to avail of stamp duty-free share transfers. This section will be enacted by way of Commencement Order by the Minister for Finance.

Finally, in relation to VAT, the annual VAT cash receipts' basis threshold for small to medium size businesses, is being increased from €1.25m to €2m with effect from 1 May 2014. This change will assist such businesses in the critical area of cash flow management and will also reduce administration.

## NEW INVESTMENT & INNOVATION

The Minister noted that Ireland was at the lower end of the EU and OECD scale in terms of citizens with the aspiration to set up a new business. The Minister announced two measures to promote investment and innovation, one aimed at what he termed 'serial' entrepreneurs, and the other aimed at new entrepreneurs.

The Minister announced a new CGT incentive to encourage reinvestment in assets used in trading activities. The new incentive will apply where an individual, who has paid CGT on the disposal of assets, makes investments in a new business in the period from 1 January 2014 to 31 December 2018, and subsequently disposes of this investment no earlier than three years after the date of the initial investment. The CGT payable on the disposal of the new investment will be reduced by the lower of:-

- (i) the CGT paid on a previous disposal of assets in the period from 1 January 2010, and
- (ii) 50% of the CGT due on the disposal of the new investment.

The commencement of this relief is subject to clearance under EU State Aid rules. While the introduction of this relief is to be welcomed, it will still result in an effective CGT rate of c. 16.5%, which compares unfavourably with a similar relief in the UK which delivers a 10% rate. Nevertheless, the introduction of this relief is a step in the right direction.

In the context of new entrepreneurs, an exemption from income tax for a period of two years and up to a maximum of €40k per annum is to be introduced for individuals who set up non-incorporated businesses (i.e. sole traders). In order to qualify, the individual claiming the relief must have been unemployed for a period of at least fifteen months prior to establishing the business. Once again, this is a welcome relief and it is positive to see a relief introduced for start-ups in an income tax situation, especially when a corresponding relief has existed for new corporates for a number of years. In due course, it is to be hoped that the scope of the relief will be extended and, in particular, that the tax-free period of the relief would be extended beyond two years.

## INVESTORS

As mentioned at the outset, investors and pension savers are significant contributors to the €700m of new tax measures for 2014. A number of changes have been introduced. In the first instance, the rate of deposit interest retention tax (DIRT) will be increased to 41% from 33%, with effect from 1 January 2014. Additionally, the rates of exit tax that

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apply to life assurance policies and investment funds is being increased to a similar level. These products were previously taxed at either 33%, or 36%, depending on the frequency of distributions.

Last year, the Minister announced changes to the scheme of tax relief for investment in film production (Section 481 relief). The impact of the change announced a year ago was that individual investors would no longer be able to avail of Section 481 relief, and that it was to be replaced by a credit relief mechanism available to the film production company. It had been anticipated that this change would become effective on 1 January 2016. However, the Minister has announced his intention to bring forward this change to 1 January 2015. Section 481 relief was one of the few means available to an individual to reduce (in net terms) his/her tax liability. It is unfortunate, in an environment where the marginal tax rate for the self-employed is 55%, that the timescale for the abolition of this relief is being shortened.

## PROPERTY

The property sector has always been a key element of our economy. During the 'boom' years, the property sector represented a disproportionately high portion of the economy but now, the proportion of the economy attributable to the construction sector is well below the long-term average.

Against this backdrop, the Minister believes that the sector is in need

of some level of stimulus and announced some welcome changes.

In 2011, a capital gains tax relief was introduced. This relief was set to expire on 31 December 2013. It provided that property acquired up to 31 December 2013, and held for a period of seven years from acquisition, could be sold largely CGT-free after that date. The qualifying period for the availability of this relief has been extended by twelve months to 31 December 2014.

A Home Renovation Incentive is to be introduced in respect of renovation and improvement works on a principal private residence carried out in 2014 and 2015. The incentive will be applied by way of an income tax credit to the home owner, payable over the two years following the year in which the work is carried out. Credit will be available for an amount equal to 13.5% of the qualifying expenditure. Qualifying expenditure includes extensions and renovations, window-fitting, plumbing, tiling and plastering. In order to qualify for relief, expenditure must fall in the range of €5k to €30k.

In his 2013 Budget, the Minister announced a relief in respect of work done to Georgian properties in certain areas of certain cities. Today, the Minister announced the extension of this incentive to include all residential properties constructed prior to 1915 and announced the geographical extension of this relief to the cities of Cork, Galway, Kilkenny and Dublin. The extension of the relief to

property built up to 1915 broadens the scope of the relief far beyond Georgian property.

## PENSIONS

The government has always sought to incentivise those employed in the private sector to save for retirement with the intention of ultimately reducing long-term burdens on the State. Generous reliefs were put in place which, at one point, allowed individuals to accumulate effectively limitless pension benefits. A cap was put on pension investment (at one time at €5.4m) falling to €2.3m in 2010.

Last year, the Minister announced that there would be further changes to the pension regime in Budget 2014. However, in a statement of intent, he signalled that his objective was to provide a tax-efficient mechanism for pension investment up to a level that would allow for an annual pension benefit of €60k. Today, the Minister announced that with effect from 1 January 2014, the maximum tax-efficient value of a pension fund is to be reduced to €2m. There are provisions in place to protect individuals who have already accumulated benefits over and above this amount.

The Minister announced that he would follow through on his commitment to abolish the pension levy on 31 December 2014. However, he announced that a new pension levy was to be introduced with effect from 1 January 2014. The old pension levy is charged at a rate of 0.6%, while the new

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pension levy will be charged at a rate of 0.15%. The net impact of the foregoing is that for calendar year 2014, two pension levies will apply! This will increase the charge on pension funds to 0.75% in 2014, falling to 0.15% per annum thereafter.

Finally, on a positive note, the Minister did not reduce the €115k ceiling under which age-related contributions to pension funds may be made. Additionally, pension contributions continue to attract tax relief at 41% and it appears that the ability to take a tax-free lump sum on retirement of €200k remains.

## INDIVIDUALS

The most significant change (at least in terms of a revenue-raising measure) has been the restriction of tax relief for medical insurance premiums with effect from 16 October 2013. The restriction will apply in respect of premiums in excess of €1k per adult and in excess of €500 per child. This change represents yet another change in a long history of amendments to medical insurance relief. In the context of a two-adult and two-children family, the maximum tax saving on medical insurance premiums is now restricted to €600 per annum.

In keeping with the withdrawal of relief in respect of interest incurred by an individual to invest in a trading company, the Minister has announced the phased withdrawal (over a four-year period) of relief for loans taken out from 15 October 2013 and used to acquire an interest in a partnership. Where an individual is currently

claiming this relief, a degree of relief would continue to be available on a reducing basis until 1 January 2017.

Finally, a relief known as 'top slicing relief', has been a feature of our tax code for many years. Briefly, this relief allowed for a reduced rate of tax to apply to the taxable element of all ex gratia lump sum payments. The scope of top slicing relief was restricted in Finance Act 2013 and today, the Minister announced that this relief is to be abolished altogether.

## TOURISM & AGRICULTURE

The Minister acknowledged the significant contribution of the tourism sector to the economy over the last two years, through the creation of over 15,000 new jobs. This increase in employment was attributed in no small part to the availability of a 9% VAT rate, due to expire on 31 December 2013. The Minister has announced the continuation of the 9% rate on an indefinite basis.

Air travel tax is to be reduced to zero with effect from 1 April 2014. It is expected that this reduction will be utilised by the airlines to develop new routes and build traffic volumes, thereby boosting domestic tourism.

An extension to the capital gains tax retirement relief regime has been announced in respect of the disposal of long-term leased farmholds, in certain circumstances. The objective of this change is to encourage older farmers to lease out

their farmland on long-term leases (greater than five years) to younger farmers, in circumstances where the older farmer does not have children who are willing to take up farming.

The eligibility requirement for Young Trained Farmers relief is to be extended by adding three more qualifying courses to the list of relevant qualifications required. This relief allows for qualifying Young Trained Farmers to avail of a 100% rate of stock relief, and also to avail of a targeted stamp duty relief for the acquisition of agricultural assets.

The Minister announced that the farmers' flat rate addition is being increased from 4.8% to 5% with effect from 1 January 2014.

Finally, on a cautionary note, the Minister did acknowledge the importance of the agrifood and fisheries' sector to the economy. However, he indicated that both sectors received significant tax reliefs and incentives over the years, but that an information gap existed in terms of the cost-to-benefit effectiveness of these reliefs. A review group is to be established with the intention of introducing changes in Budget 2015.

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