# TAX STRATEGY GROUP

## Capital Taxes Issues

## 1. Introduction and context

### 1.1 **Scope of this paper**
This paper covers a range of Capital Taxes, including Capital Gains Tax (CGT), Capital Acquisitions Tax (CAT), certain Stamp Duties and taxes on savings. It sets out the current position for each of the main areas and examines issues that have been raised or are likely to arise in the context of the Budget/Finance Bill 2010, including recommendations reported by the Commission on Taxation.

Stamp Duties on property are covered in an associated paper on the Taxation of Property (TSG 09/07).

### 1.2 **Programme for Government**
*An Agreed Programme for Government 2007 – 2012* sets out guiding principles for economic and fiscal policy for the lifetime of the Government, including a key commitment, detailed in Appendix I, which has underpinned policy development in relation to Capital Taxation.

In general terms, the commitment to secure "A Fair Tax System" by keeping low income earners out of the standard rate band and average earners out of the higher band has informed the development of base-broadening measures in recent Budgets to shift the burden of tax from labour and consumption to wealth and sources of wealth.

### 1.3 **Commission on Taxation**
The Commission on Taxation recommended a number of options in regard to capital and savings taxes which are contained in Appendix II. The most significant are as follows:

- Capital Gains Tax
- – Gains attributable to inflation should be excluded
- – Rollover relief should apply to the gains on disposal of farm land pursuant to a compulsory purchase order where the proceeds are re-invested in farm land
- – Continue the exemption on the disposal of a principal private residence.
- – Discontinue the exemptions (also Stamp Duty) on the disposal of site to a child.
- – Relief for disposal of a business or a farm on retirement should continue.
- – The tax treatment of venture fund managers should be modified such that in the case of an individual who is a venture capital fund manager:
    - – Where the investment return on a carried interest represents income, it should be taxed at the appropriate marginal rate, and

– Where the investment return on a carried interest is a capital gain, it should be subject to capital gains tax at the normal rate (25%).

– The remittance basis of taxation for income tax and capital gains tax should be discontinued.

- Capital Acquisitions Tax
– For business relief for CAT, a reduction of no more than 75% of the value of the business should be allowed before tax is calculated. The reduction should be subject to an overall monetary limit of €3 million.
– For agricultural relief for CAT, a reduction of no more than 75% of the value of the business should be allowed before tax is calculated. The reduction should be subject to an overall monetary limit of €3 million. A condition of the relief should be that a farm asset is owned and operated as a farm for a period of six years after the transfer.
– The annual exemptions for interest and dividends on special term accounts and special term share accounts should be continued.

- Stamp Duty on financial transactions
– Stamp duty on ATM, credit and debit cards should be phased out in the interest of promoting the move towards a cash-free society

- Stamp Duty on shares
- Stamp duty on all share transactions should be reduced to zero.

## 2. Capital Gains Tax

2.1 **Introduction**

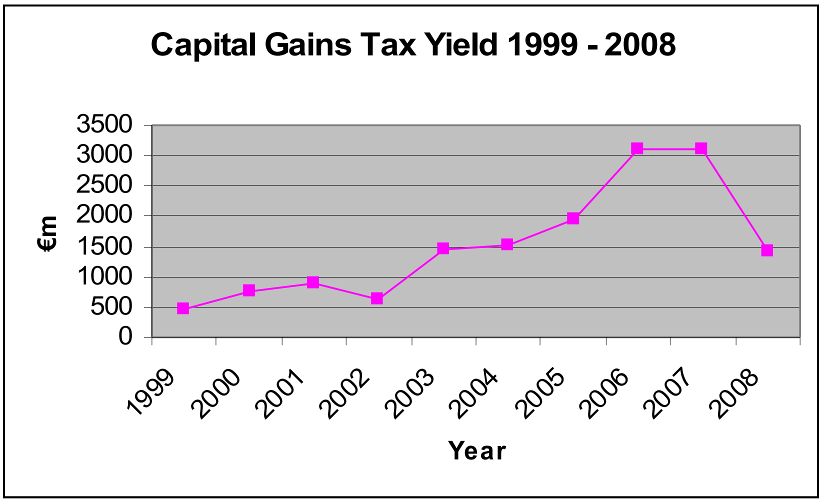
Capital Gains Tax (CGT) was introduced in the Capital Gains Tax Act 1975 in respect of disposals made during the tax year 1974/75. The tax is charged on the value of the capital gain of an asset, when the asset is disposed of by an individual. All classes of assets are covered by CGT but the majority of the yield relates to property.

2.2 **Evolution of CGT**

- 1975 – Capital Gains Tax at a rate of 26% was introduced
- 1978 - 1990 – indexation relief introduced and rates periodically reformed.
- 1991 – CGT application of self-assessment introduced to CGT.
- 1992 – multiple rate system (based on how long the asset was held) changed to a single rate of 40%.
- 1998 – single 20% rate introduced.
- 2003 – abolition of indexation relief, change in the CGT payment date to current year, and the abolition of roll-over relief.
- 2008 – Budget 2009 rate increase to 22%, from 20%
- 2009 – Supplementary Budget 2009 rate increase to 25%, from 22%

## 2.3 **CGT Yield**

The amount of Capital Gains Tax (CGT) received for each year over the past ten years is set out below.




The recent drop in the CGT yield is due to declining asset values and a reduction in the number of property and share transactions. The 2009 Supplementary Budget saw an increase in the CGT rate to 25% which is in line with CAT and DIRT rates, this followed on from a 2% increase in the CGT rate (from 20%) in Budget 2009.

## 2.4 **CGT Exemptions and Reliefs**

The main exemptions and reliefs from CGT are as follows:

<u>Annual exemption</u>
There is an annual CGT exemption of €1,270 applying to all assets disposed of in a calendar year.

<u>Principal Private Residence Relief</u>
An individual's principal private residence is exempt from CGT. Where the individual resides in the property for part of the duration of ownership, the relief is apportioned accordingly.

<u>Retirement Relief</u>
Retirement relief provides that business or farming assets are relieved from CGT where the person disposing of the assets is aged 55 or over and had owned and used the asset for the ten years prior to disposal. The relief applies to assets valued up to €750,000. However, where the disposal is made to a child or favourite niece/nephew, there is no monetary limit to the relief.

<u>Remittance basis</u>

Individuals who are resident or ordinarily resident, but not domiciled in Ireland (that is, for whom Ireland is not their permanent home), are liable to tax on foreign capital gains only to the extent that the proceeds are remitted or brought into Ireland.

2.4 **Capital Gains Tax issues**

*Re-introduce indexation (inflation) relief*
The Commission on Taxation has recommended the re-introduction of indexation relief – this seeks to limit CGT to 'real' gains in asset values by excluding the impact of inflation as measured by the Consumer Price Index (CPI). Indexation (excluding gains attributable to inflation) was brought in a number of years after the introduction of Capital Gains Tax in 1975 to take account of high levels of inflation when CGT rates were relatively high. With a marked decline in inflation, it was abolished in 2003 when CGT rates were reduced from 40% to 20%.

Any consideration of the case for the re-introduction of indexation would have to consider the current negative rates of inflation and the fact that other jurisdictions do not exclude inflation from capital gains. In addition, the cost associated with introducing indexation relief would adversely affect the CGT yield.

*Re-introduce "roll-over relief" for farm CPOs*
"Roll-over relief" (under which the CGT payable on the proceeds of a gain was deferred if the proceeds were reinvested with the result that the tax liability is not realised until the assets are eventually sold) was abolished in 2003 for all disposals, including disposals as a result of a compulsory purchase order.

The Commission on Taxation has recommended that it be re-instated for the purchase of farmland using an award made under a Compulsory Purchase Order. The rationale appears to be that it would enable farmers to consolidate their holdings and re-invest the proceeds from a CPO into productive economic activities rather than simply investing in a financial institution.

However, if conceded, this change may lead to added pressure for the general re-introduction of roll-over relief for the business and agricultural sectors in the context of transfers of assets. This was not recommended by the Commission and it would be extremely expensive.

## 3. Capital Acquisitions Tax (CAT)

3.1 **Introduction**
The Capital Acquisitions Tax (CAT) code includes gift tax, inheritance tax and discretionary trust tax. It was first introduced in 1976 and replaced estate duty taxation.

The tax is charged on the amount gifted to, or inherited by, the donee (the person receiving the gift/inheritance). There is a tax-free threshold (referred to as a 'group threshold'), depending on the relationship between the disponer (the person making the gift/leaving the inheritance) and the donee. Previous gifts/inheritances since 1991 from other disponers in the relevant group are counted when calculating the taxable amount over the threshold. The balance of the gift/inheritance above the threshold is taxable, currently at a single rate of 25%. The tax-free thresholds are linked to the Consumer Price Index (CPI). The group thresholds are set out below.

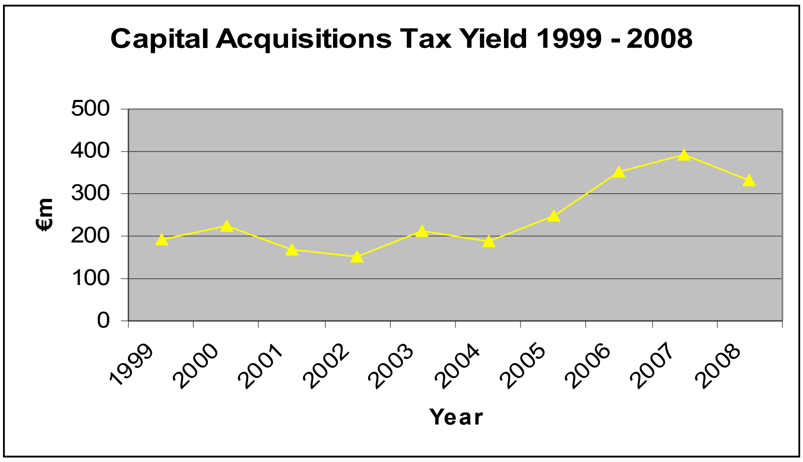
**CATGroup tax-free thresholds 2008 and 2009**

| Group | Relationship to Disponer | Group Thresholds | | |
|---|---|---|---|---|
| | | 2008 | 1 January to 7 April 2009 | From 8 April 2009 |
| **A** | Son/Daughter | €521,208 | €542,544 | €434,000 |
| **B** | Parent*/Brother/Sister/ Niece/Nephew/Grandchild | €52,121 | €54,254 | €43,400 |
| **C** | Relationship other than Group A or B | €27,127 | €27,127 | €21,700 |

* In certain circumstances, a parent taking an inheritance from a child can qualify for Group A threshold.

Finance Act 2009 saw, for the first time, a reduction of approximately 20% in the tax-free threshold amounts for all groups reflecting a general fall in asset values. This measure was coupled with an increase in the rate to 25% (from 22%, which was raised in Budget 2009 from 20%). The CAT yield for January to June 2009 has fallen by over 30% compared to the yield for the same period in 2008. As the CAT yield arises mainly from inheritances /gifts, any reduction in the yield can be mainly attributable to decreasing asset values, particularly the decline in property values.

The CAT yield for each year over the past ten years is as follows:




3.2 **Evolution of CAT**

- 1994 - CATpayable at 20% on first IR£10,000 above tax-free threshold, 30% on next IR£30,000 and 40% on the balance.
- 1996 - Agricultural relief and business property relief increased to 75% of the taxable value of the relevant assets.

- 1997 – Agricultural relief and business property relief increased to 90% of the taxable value of the relevant assets.
- 1999 - CAT tax-free thresholds increased to Group A - IR£300,000 (€380,921); Group B - IR£30,000 (€38,092); and Group C IR£15,000 (€19,046). [NB – the thresholds are linked to the Consumer Price Index and therefore have increased accordingly.]
  Introduction of single CAT rate of 20% on all amounts above tax-free threshold.
- 2008 – Finance (No. 2) Act 2008 increased the rate to 22% on all amounts above the relevant tax-free threshold.
- 2009 - Supplementary Budget 2009 increased the rate to 25% on all amounts above the relevant tax-free thresholds.
  CAT tax-free thresholds reduced by 20%: Group A - €434,000; Group B - €43,400 and Group C - €21,700.

## 3.3 **CAT Reliefs/Exemptions**

The main CAT reliefs and exemptions are as follows:

<u>Small Gifts Exemption</u>
The CAT code contains an exemption on the first €3,000 of taxable gifts (not inheritances) received in a tax year. This is in addition to the group thresholds which relates to gifts and inheritances received from 1991 to date.

<u>Dwelling House Exemption</u>
In addition to the group thresholds, Finance Act 2000 introduced an exemption from CAT for certain dwelling houses. The purpose of the exemption is to benefit individuals who have been living in a house prior to receiving it as a gift or inheritance. The main condition is that the beneficiary has to occupy the dwelling house as his or her only or main residence for three years prior to the gift/inheritance and continue to reside in it for six years after the gift/inheritance. It is a full exemption without a ceiling or a requirement that the beneficiary has to be related to the disponer.

<u>CAT Agricultural/Business Relief</u>
Qualifying farmers and business owners can avail of CAT agricultural/business relief which reduces liability to CAT by 90%. In order to qualify for these reliefs, 80% of the individual's/farmer's assets, after having received the gift/inheritance, must consist of qualifying agricultural/business assets.

## 3.4 **CAT issues for consideration**

*Remove or reduce agricultural and business property relief*
The Commission on Taxation has recommended reducing these two reliefs from 90% to 75% of the taxable value of the relevant assets; this would increase the yield from CAT. While the yield from such a reduction might not be significant, it could be a useful measure in terms of base-broadening and ensuring equity for different classes

of taxpayers. However, when combined with the Commission's recommended cap of €3m, it could have a negative impact on the development and growth of family businesses. The Commission has also recommended that the two reliefs be amalgamated by aligning the conditions for availing of the reliefs.

## 4. Stamp Duty

4.1 **Introduction**

Stamp Duty is generally a tax on documents or transactions which has been in existence since the late-seventeenth century. There are a variety of Stamp Duties; some are fixed (e.g., Stamp Duty on credit and debit cards - which is a fixed amount irrespective of how much the card is used), while others are proportional (e.g., stamp duty at 1% on the value of shares sold).

The main (non-property) Stamp Duties are:

- Financial Cards (including credit, ATM & Debit cards) and cheques
- Insurance Levies
  - Non-Life
  - Life
  - Health Insurance
- Shares

### 4.2 Stamp Duty on financial cards (Credit, ATM and Debit cards) and cheques

4.2.1 **Introduction**

The Stamp Duty on cheques, bills of exchange and promissory notes is long-established. When electronic means of money transfer (credit cards, ATM cards and debit cards) were subsequently introduced, Stamp Duty was gradually extended to those products to ensure that receipts from paper transactions were not eroded. The current Stamp Duty on cheques and paper transactions is 50c, increased from 30c in Budget 2009.

The Stamp Duty on credit cards is charged on accounts open at any stage during the year and is payable on 1st April of each year in arrears, or on the date the account is closed. The Stamp Duty on ATM and debit cards is charged on relevant accounts at 31st December each year.

Current stamp duty charges are as follows:

| Description | Stamp Duty | Payable |
|---|---|---|
| ATM cards | €2.50 | 31 December each year |
| Debit cards | €2.50 | |
| Combined ATM/Debit cards | €5 | |
| Credit cards/ Charge cards | €30 | 1 April in arrears |
| Cheques | 50c | Per cheque |

4.2.2. **Yield from financial cards and bills of exchange**

The following table details the yield from stamp duty on financial cards and bills of exchange over recent years:

| Year | Yield (€m) |
|---|---|
| 2002 | 48 |
| 2003 | 100 |
| 2004 | 112 |
| 2005 | 118 |
| 2006 | 136 |
| 2007 | 133 |
| 2008 | 176 |

4.2.3 **Stamp Duty on financial cards and cheques – issues for consideration**

Although the Stamp Duty yield from financial cards and cheques has risen in all, but one of the last seven years as shown by the figures above, this is likely to change in 2009. For a variety of factors, the yield for January to June 2009 appears to less than half of the yield for the same period in 2008.

The Stamp Duty rate for bills of exchange and cheques increased from 30c to 50c from 15 October 2008, while the rate applicable to ATM, debit and combined cards was halved. This measure was introduced to encourage the movement away from these forms of payment towards electronic means of payment.

Consideration may be given to reducing/eliminating Stamp Duty on ATM/debit/combined cards, in line with the Commission on Taxation's recommendations. If considered, this could be balanced by increasing the charge on cheques and Bills of Exchange.

## 4.3 Insurance Levies

### 4.3.1 Non-Life Insurance Levy

A 2% stamp duty on certain non-life insurance products (for example, house and motor insurance) was introduced in 1982 and it is charged on most non-life insurance premiums. The exceptions are re-insurance, voluntary health insurance, marine, aviation and transit insurance and export credit insurance.

Finance Act 2009 increased the rate to 3% for premiums received by an insurer on, or after, 1 June 2009.

### 4.3.2. Life Insurance Levy

Finance Act 2009 introduced a new levy on life assurance policies at a rate of 1%. To allow lead in time for the industry, this levy applies to premiums received by an insurer on or after 1 August 2009. An earlier life assurance levy was in place from 1982 to 1993.

#### 4.3.3 Health insurance levy

A levy on health insurance premiums was introduced in Health Insurance (Miscellaneous Provisions) Act 2009. This levy was not designed to be a revenue-raising measure because it was introduced to facilitate community rating on health insurance following the judgment in *BUPA Ireland Ltd and another* v *Health Insurance Authority and others* [2008] IESC 42. It is accompanied by a tax relief at source for health insurance policy holders aged 50 and over – this is paid by Revenue to the health insurance companies. The levy is set at €160 for adults and €53 for children covered by the policy.

#### 4.3.4 Insurance levies – issues for consideration

The re-introduction of the life insurance levy led to concerns that the pension products linked to life insurance policies were treated less fairly than non-life pensions. It is accepted that as currently structured, it can have a distortionary effect. The Department is looking at alternative means of taxing pension products that overcomes the problem and ensures tax neutrality.

## 4.4 Stamp Duty on share transfers

4 .4.1 **Introduction**

Under rules laid down by the Department of Enterprise, Trade and Employment, the only approved operator that can transfer legal title in Irish quoted companies is 'CREST' and all dematerialised shares must be transferred in CREST. Share transfers outside of CREST require a share transfer certificate and this must be stamped by Revenue. Share transfers incur a 1% stamp duty charge and there are exemptions for intermediaries.

4.4.2. **Yield from Stamp Duty on Share Transfers**

The following table details the yield from stamp duty on share transfers over recent years:

| **Year** | **Yield (€m)** |
|---|---|
| 2002 | 303 |
| 2003 | 256 |
| 2004 | 261 |
| 2005 | 324 |
| 2006 | 456 |
| 2007 | 609 |
| 2008 | 419 |

4.4.3. **Stamp Duty on Share transfers – issue for consideration**

Consideration might be given to reducing/eliminating Stamp Duty on share sales, as recommended by the Commission on Taxation. This change would also be in line with EU intentions on this issue which aim to eliminate all Government charges on shares as a means of encouraging the free flow of capital and investments between Member States. However, the cost would be considerable at €420m, based on 20008 yields.

## 5. Deposit Interest Retention Tax (DIRT)

### 5.1 **Introduction**

Deposit Interest Retention Tax (DIRT) is deducted by banks from the accounts of Irish residents. The basic rate is 25% where interest is paid or credited at least once annually (bank accounts) and 28% where it is paid less frequently (life assurance and funds products). DIRT satisfies the individual's full liability to Income Tax in respect of deposit interest, although the individual may still be liable to PRSI and/or the health contribution. Deposit interest subject to DIRT is not subject to the Income Levy. Subject to certain statutory exceptions, financial institutions are required to deduct the tax from interest paid or credited in respect of the income on deposit. Up to Budget 2009, the rate of DIRT was equal to the standard rate of Income Tax.

### 5.2 **Evolution of DIRT**

- 1986 – DIRT introduced at 35% (pegged to the standard rate of income tax)
- 1994 - DIRT becomes a final liability tax.
- 2007 - Finance Act 2007 introduced a new scheme to allow the operation of DIRT free savings accounts for persons subject to two conditions: (a) the account holder must be aged over 65 years of age and (b) their total income must not exceed the relevant exemption threshold. (€20,000 (for an individual) or €40,000 (for a married couple) in 2009). Permanently incapacitated persons can seek a refund of DIRT in certain circumstances.
- 2009 - Rate of DIRT increased from 20% to 23% for all payments, including deemed payments made on or after 1 January 2009.
  Rate of tax increased from 23% to 25% for all payments, including deemed payments made on or after 8 April 2009.

### 5.3 **Net Yield from DIRT**

The following table sets out the net yield from DIRT collected from 2002 to 2008:

| **Year** | **Net Yield (€m)** |
|---|---|
| 2002 | 207 |
| 2003 | 153 |
| 2004 | 144 |
| 2005 | 167 |
| 2006 | 254 |
| 2007 | 472 |
| 2008 | 654 |

### 5.4 **DIRT issues for consideration**

The sharp increase in the DIRT in 2007 and 2008 may have been related to an increase in deposit interest rates and rising savings levels in the economy as investors move away from more-risky investments such as property and shares. Such rates have fallen in 2009 and there may be an associated decline in yield for this year as a result.

**Capital and Savings Taxation Policy**
**September, 2009**

## APPENDIX I

PROGRAMME FOR GOVERNMENT – UPDATE SEPTEMBER 2009

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**A Fair Tax System**

*Subject to the controlling economic and fiscal framework, the Government will implement the following specific approach to tax:*

- *Our first priority remains low and middle income earners – therefore our first task will be to use tax credits and bands to keep low income earners out of the standard rate band and average earners out of the higher band.*

Finance (No 2) Act 2008 and Finance Act 2009 increased both the Capital Gains Tax (CGT) rate and Capital Acquisitions Tax (CAT) rate from 20% to 22% (2008) and then to 25% (2009). CAT thresholds were also reduced in the Supplementary Budget. Taxation on savings income were also increased – DIRT increased in two stages from 20% to 25% and exit taxes on investment products were increased by a similar amount. These base-broadening measures help to shift the burden of tax from labour and consumption to wealth and sources of wealth.

## APPENDIX II COMMISSION ON TAXATION RECOMMENDATIONS ON CAPITAL TAXES

**Taxation of Capital**

**Recommendation 5.25**
**Gains attributable to inflation should be excluded from the charge to capital gains tax.**

**Recommendation 5.26**
**Capital gains tax rollover relief should apply to the gains on disposal of farm land pursuant to a compulsory purchase order where the proceeds are re-invested in farm land.**

**Stamp Duty - Cards**

**Recommendation 5.29**
**Stamp duty on ATM, credit and debit cards should be phased out in the interest of promoting the move towards a cash-free society.**

**Stamp Duty - Shares**

**Recommendation 7.8**
**Stamp duty on all share transactions should be reduced to zero.**

**Remittance treatment of Capital Taxes**

**Recommendation 5.32**
**The remittance basis of taxation for income tax and capital gains tax should be discontinued.**

**Capital Taxes and Housing**

**Recommendation 8.17**
**The capital gains tax exemption on the disposal of a principal private residence should be continued.**

**Recommendation 8.20**
**The capital gains tax and stamp duty exemptions on the disposal of site to a child should be discontinued.**

**Capital Taxes and Philanthropy**

**Recommendation 8.35**
**The capital gains tax exemption on works of art loaned for public display should be retained but the exemption should only apply to the gain accruing in the period for which the work of art has been so loaned.**

**Recommendation 8.38**
**The CAT exemption of heritage property and heritage property of companies should be retained.**

**Capital Taxes – Fishing Industry**

**Recommendation 8.64**
**The tax treatment of the decommissioning of fishing vessels should continue.**

**Capital Taxes – Venture Capital Investments**

**Recommendation 8.66**
**The tax treatment of venture fund managers should be modified such that in the case of an individual who is a venture capital fund manager:**

- **Where the investment return on a carried interest represents income, it should be taxed at the appropriate marginal rate, and**
- **Where the investment return on a carried interest is a capital gain, it should be subject to capital gains tax at the normal rate (25%).**

**Capital Taxes – Remittance basis of taxation**

**Recommendation 5.32**
**The remittance basis of taxation for income tax and capital gains tax should be discontinued.**

**Business and Agricultural CGT and CAT Relief**

**Recommendation 8.69**
**Capital gains tax relief for disposal of a business or a farm on retirement should continue.**

**Recommendation 8.70**
**For business relief for CAT, a reduction of no more than 75% of the value of the business should be allowed before tax is calculated. The reduction should be subject to an overall monetary limit of €3 million.**

**Recommendation 8.71**
**For agricultural relief for CAT, a reduction of no more than 75% of the value of the property should be allowed before tax is calculated. The reduction should be subject to an overall monetary limit of €3 million. A condition of the relief should be that a farm asset is owned and operated as a farm for a period of six years after the transfer.**

**Recommendation 8.72**
**Business relief and agricultural relief should be amalgamated into a single relief.**

**Taxation of savings and investments**

**Recommendation 8.103**
**Tax exemption for the income of credit unions should be continued.**

**Recommendation 8.104**
**The annual exemptions for interest and dividends on special term accounts and special term share accounts should be continued.**