Section 1 of Finance Act 2010

Report on Tax Expenditures

PRN A10/0776 July 2010

Section 1 of Finance Act 2010

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Introduction

Section 1 of the Finance Act, 2010 requires that:

'The Minister shall within three months from the passing of this Act prepare and lay before Dáil Eireann a report on a cost-benefit analysis of tax expenditures provided for by this Act, setting out the costs of tax forgone, and the benefits in terms of job creation or otherwise".

The Finance Act, 2010 was signed into law by the President on 3 April 2010, thereby requiring this Report be laid before Dáil Eireann not later than 3 July 2010.

18 out of a total of 165 sections of the Finance Act were identified as falling within the OECD definition of tax expenditures and an analysis of each of the 18 is contained in the report.

Appendix A sets out a list of each of the sections and whether the measure constitutes a tax expenditure.

Certain tax expenditures (such as section 31 and section 39) are included even though there is no Exchequer cost as they may be regarded as meriting examination.

This report was prepared within the Department of Finance by the Budget, Taxation and Economic Division, with the assistance of the Department's Central Evaluation Unit, which regularly carry out cost benefit analysis exercises, and the Office of the Revenue Commissioners.

Although there is no single universally accepted definition of a tax expenditure, the OECD definition is widely used internationally and this is the definition used in this Report.

Cost benefit analysis is an evaluation tool which is typically used to assess the net economic impact of public expenditure proposals.

There is an underlying principle of proportionality in cost benefit analysis which states that the level of resources invested in carrying out the analysis should be commensurate with the scale of the expenditure involved.

In most cases in this report, the annual cost of individual tax expenditures has been calculated using the "initial revenue loss" method, that is the amount by which tax revenue is reduced as a consequence of the introduction of a tax expenditure, based upon the assumption of unchanged behaviour and unchanged revenues from other taxes.

Given the relatively modest level of expenditure involved with most of the tax expenditures considered in this report, a qualitative approach has been adopted.

In all cases, the level of detail in the analysis has been influenced by the extent of available and timely data on individual costs and benefits.

To assist the reader of the report, a consistent method of presentation has been used in outlining the individual assessments.

Details regarding each tax expenditure are set out in a separate chapter of the report and are examined under a uniform set of criteria.

CHAPTER 1

Defining Tax Expenditures

Introduction

1.1 Tax expenditures are provisions of tax law or regulation that reduce or postpone tax revenue due from a relatively narrow population of taxpayers (relative to a benchmark level of taxation).[1] Tax expenditures are tools of government policy that substitute for direct expenditures. They may take many forms, including incentives and reliefs. Because of the variation that exists among tax expenditures it is necessary to first establish a definition of what constitutes a tax expenditure for the purpose of this report.

Definition of a Tax Expenditure

1.2 Although there is no single accepted definition of a tax expenditure, the OECD definition is widely used:[2]
"a transfer of public resources that is achieved by reducing tax obligations with respect to a benchmark tax, rather than by direct expenditure".

1.3 The OECD lists several categories of tax expenditures covered by this definition:[3]

- Allowances: amounts deducted from the benchmark to arrive at the tax base;
- Exemptions: amounts excluded from the tax base;
- Rate relief: a reduced rate of tax applied to a class of taxpayer or taxable transactions;
- Tax deferral: a delay in paying tax;
- Credits: amounts deducted from tax liability.

1.4 The OECD definition is adopted in this report to identify the tax expenditures that are subject to a cost benefit analysis in the Finance Act 2010. This is in line with the best practice internationally. The Commission on Taxation, in its review of tax expenditures in Ireland, also adopted the OECD definition above.[4]

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[1] Anderson (2008), *Tax Expenditures in OECD Countries*, presentation to the Annual Meeting of OECD-Asia SBO, January 2008.
[2] OECD (2010), *Tax Expenditures in OECD Countries*, report published by the OECD.
[3] OECD (2010).
[4] Commission on Taxation (2009), *Report of the Commission on Taxation 2009*.

The Benchmark Tax System

1.5 Having defined a tax expenditure as involving a departure from a benchmark, it is then necessary to define the benchmark tax system itself. The choice of a benchmark is important.[5] Choosing a very narrow benchmark would result in many provisions of tax law being classified as tax expenditures, while a broader, more comprehensive, benchmark would mean fewer provisions being classified as tax expenditures.

1.6 Studies by the World Bank and the OECD identify the tax benchmark as including the rate structure, accounting conventions, deductibility of compulsory payments, provisions to facilitate tax administration and international fiscal obligations.[6] These may include measures that reduce the tax base but should still be regarded as part of the benchmark as they are part of the structure of the tax system or play a role in making the tax system function more efficiently.[7] This report follows the OECD approach to the benchmark system. Measures that are part of the benchmark tax system should not be considered as tax expenditures and this approach is adopted in identifying the tax expenditures assessed in this report.

Measurement Issues

1.7 For measuring the costs and benefits associated with a tax expenditure, the OECD classifies the available methods into three categories:[8]

- Initial revenue loss (also known as the revenue forgone method): the amount by which tax revenue is reduced as a consequence of the introduction of a tax expenditure, based upon the assumption of unchanged behaviour and unchanged revenues from other taxes;

- Final revenue loss: the amount by which tax revenue is reduced as a consequence of the introduction of a tax expenditure, taking into account the change in behaviour and impacts on revenues from other taxes as a consequence of the introduction;

- Outlay equivalence: the direct expenditure that would be required in pre-tax terms to achieve the same after-tax effect on taxpayers' incomes as

[5] OECD (2010).
[6] World Bank (2004), *Tax Expenditures – Shedding Light on Government Spending Through the Tax System*, edited by Brixi, Valenduc and Swift; OECD (2010).
[7] Commission on Taxation (2009).
[8] Anderson (2008).

the tax expenditure if the direct expenditure is accorded the tax treatment appropriate to that type of subsidy or transfer in the hands of the recipient.

1.8 In practice, very few countries use the outlay equivalence method to measure tax expenditures. The initial revenue loss method is limited by not taking into account the dynamic effects of a tax expenditure. It follows the assumption that, to measure the effect of a tax expenditure, everything else (other than the tax expenditure) remains unchanged. However, in practice introducing a tax expenditure will result in a change in behaviour of taxpayers in many cases and therefore the initial revenue loss method does not always accurately measure the effect of a tax expenditure.[9]

1.9 The final revenue loss method is the most appealing from a theoretical perspective but it is also the most impractical. The final revenue loss method relies on predicting changes in taxpayer behaviour and understanding the interactions between a tax expenditure and other government programmes. The OECD argues that governments cannot generate such estimates over a feasible production cycle and this is illustrated by the fact that every government that measures tax expenditures chooses the initial revenue loss method despite its flaws. [10]

1.10 The OECD notes that an important implication of the use of the initial revenue loss method is that estimates of multiple tax expenditures cannot be added together to provide a valid total measure of the tax expenditures (because the effects of interactions between tax expenditures are not measured).

1.11 As a consequence of the issues surrounding measurement methods and the variations in the definition of a tax expenditure (and the benchmark tax system) making comparisons across countries is difficult. While qualitative conclusions may be drawn, any quantitative analysis or comparative data across countries are likely to be flawed due to the differences in definitions.[11]

[9] OECD (2010).
[10] OECD (2010).
[11] World Bank (2004).

CHAPTER 2

Methodology

2.1 This section outlines the methodology for reporting on the costs and benefits of the tax expenditures under review.

Overview

2.2 Cost benefit analysis (CBA) is an evaluation tool which is typically used to assess the net economic impact of public expenditure proposals. It is most often used as a tool to evaluate investment decisions but can also be used to assess tax expenditure decisions. It involves an assessment of whether or not the economic and social benefits of a project are greater than the economic and social costs over the life of a project. Cost and benefits are monetised where possible and adjusted for the time value of money i.e. net present value analysis (NPV).

2.3 There is an underlying principle of proportionality in CBA analysis that states that the level of resources invested in carrying out the analysis should be commensurate with the scale of the expenditure involved. Accordingly, detailed NPV analysis has not been presented in this report due to the relatively low levels of tax expenditure involved. This approach is in line with the 2005 Capital Appraisal Guidelines which recommends full CBA analysis for projects exceeding €30m. For most tax expenditures outlined in this document, a more qualitative approach has been taken, and in order to provide a consistent and coherent report on costs and benefits of individual tax expenditures, a similar structure of presentation has been used in outlining the individual assessments.

2.4 Carrying out a cost benefit analysis usually involves the following stages:

- Identification of objectives;
- Consideration of options;
- Identification of costs and benefits;
- Quantification of costs and benefits;
- Selection of preferred option.

2.5 This approach has been followed for the report.

Objectives

2.6 It is important to specify the objectives of the project. This allows possible alternatives to be identified and facilitates the assessment of costs and benefits. It also makes it easier to identify the potential beneficiaries of the tax expenditures. Accordingly, this report sets out the main objectives, for each tax expenditure, to provide the context for further analysis.

Options

2.7 The report highlights the other main realistic actions that could be taken to achieve the identified objectives. This list generally includes the option of doing nothing or doing the minimum.

Identification and quantification of costs and benefits

2.8 In each case, the analysis focuses on the costs and benefits which are estimated to arise as a direct consequence of the tax expenditure. These include tangible costs and benefits some of which may be capable of monetisation e.g. tax forgone, job creation, carbon emissions savings. There are also other intangible costs and benefits which cannot be reliably monetised but which nonetheless are important qualitative considerations for the analysis e.g. cultural benefits etc.

2.9 Market prices have been used to value costs and benefits where available.

Costs

2.10 In most cases, the annual cost of individual tax expenditures has been calculated as the initial revenue loss. This is the amount by which tax revenue is reduced as a consequence of the introduction of tax expenditure, based upon the assumptions of unchanged behaviour and unchanged revenues from other taxes.

2.11 Where data was available, the overall cost of the schemes over the period of their duration was estimated. For some other tax expenditures it was not possible to quantify the full cost of measures over their lifetime. In these cases, a view was reached on general cost levels and on the risks of cost escalation, taking into account the design of the expenditures (e.g. safeguards etc) and the likely levels of take up. There are also a small number of expenditures where no cost is envisaged due to the technical nature of some of the changes or the underlying level of activity in the targeted sectors.

2.12 The potential compliance and administration costs arising from individual tax expenditures have also been considered, where relevant. Administration costs generally relate to the staffing resource requirements to manage the tax expenditures. Compliance costs arise from the administrative burden on the tax payer of meeting the conditions required to qualify for the tax expenditure.

Benefits

2.13 The types of benefits arising from the different tax expenditures vary depending on the specific objectives of the individual expenditures. Broadly speaking, the following main types of benefits are relevant:

- Jobs created;
- Foreign direct investment;
- Increased economic activity;
- Innovation;
- Environmental;
- Tourism;
- Cultural.

Further Considerations

2.14 Where relevant, due consideration has been given to issues such as deadweight, displacement and externalities. Deadweight measures the extent to which the intended outcomes targeted by the tax expenditure would have occurred anyway in the absence of the tax expenditure. Displacement considers the degree to which outputs resulting from the tax expenditure are created at the expense of output elsewhere in the economy. An externality is a side effect to an economic action that affects a third party e.g. pollution. It is not possible to quantify precise measurements for these non-monetary considerations. However, even in cases where quantification is not possible, it is still important to indicate their existence. In most cases, practical judgements have been reached based on past experience.

Data sources

2.15 The following sources of information were used for the analysis of tax expenditures.

- CSO;

- Previous programme evaluations where relevant;
- Revenue information on estimated costs, numbers of beneficiaries and tax forgone per beneficiary;
- Tax Strategy Group papers;
- Relevant pre budget submissions;
- Results of surveys of target beneficiaries;
- Academic and international literature.

2.16 In all cases, the level of detail of the analysis has been influenced by the extent of available data on costs and benefits.

CHAPTER 3

Section 3 - Relief from Income Levy for Certain Farm Expenditure

Description of Expenditure

3.1 Relief from the income levy is provided for capital expenditure specifically incurred for the purposes of complying with the EU Nitrates Directive.

Policy context

3.2 The Nitrates Directive (91/676/EEC) concerning the protection of waters against pollution caused by nitrates from agricultural sources has the objective of reducing water pollution.

3.3 Ireland's national Nitrates Action Programme has statutory effect under the European Communities (Good Agricultural Practice for Protection of Waters) Regulations 2009, which provide statutory support for the protection of waters against pollution from agricultural sources. The Regulations require the avoidance of careless practices by farmers which create a risk of causing pollution and also provides for inspections by local authorities.

3.4 Implementation of the Action Programme is supported by a package of financial supports for farmers from the Department of Agriculture, Fisheries & Food (DAFF). The financial support available can cover up to 70% of the costs of the required works and the balance of the expenditure must be funded by the farmer. The income levy relief is ring-fenced and only applies to the non-grant aided portion of the expenditure.

3.5 The legislation placed a mandatory requirement on the majority of farmers to make significant capital investments in farm buildings and facilities in recent years in order to comply with its requirements. There are cross-compliance inspections carried out by DAFF and there is cross reporting of breaches between local authorities and DAFF.

3.6 In order to maximise the yield obtainable from the income levy it was specifically designed to be chargeable on income that could otherwise be sheltered by capital allowances and other deductions. It was introduced with effect from 1 January 2009 and is generally payable on an individual's aggregate income from all sources before any tax relief, capital allowances, losses or pension contributions. Therefore, the income levy payable is calculated by reference to income before deductions.

Previous legislation

3.7 Section 659 of the Taxes Consolidated Act (TCA) 1997, which came into effect from 6 April 1997, provides for accelerated capital allowances for expenditure by farmers on construction of specific farm buildings or structures, associated with compliance with the EU Nitrates Directive. For the purposes of calculating Income Tax, these capital allowances can be written off against income from farming over 3 years, where expenditure is incurred after 1 January 2005. In addition, to qualify for the capital allowances relief, the expenditure must be incurred before 1 January 2011. Unused relief can be carried over where farm income is not sufficient to allow all of the qualifying relief to be claimed.

Conditions of scheme

3.8 The expenditure must be in accordance with a Farm Nutrient Management Plan and independently certified as being necessary for the purpose of securing a reduction in pollution arising from farming. The qualification criteria follows that set out in section 659 of the Taxes Consolidated Act 1997 with regard to the granting of the allowances. The specific types of buildings and structures to which allowances apply are listed in that section.

Method of application

3.9 The relief is given as a deduction in computing an individual's income for income levy purposes. It operates on a self-assessment basis and does not have to be claimed.

Duration of scheme

3.10 The income levy deduction is linked to the capital allowances provisions and can be written off over three years, where expenditure is incurred before 1 January 2011. Similarly, provision is made for a carry over of unused relief where farming income is not large enough to absorb all of the relief available.

Objectives of Tax Expenditure

3.11 The provision grants relief for past expenditure (to the extent that capital allowances are brought forward) and for current capital expenditure subject to the maximum deduction available for any year against current income.

3.12 The relief is implemented on equity grounds taking account of the fact that the affected expenditure is compulsory in nature. Farmers must, by law, comply with the terms of the Nitrates Directive.

Options Analysis

3.13 The alternative option of not introducing the relief would have led to inequity. It could have led to the failure of a number of farmers to comply with the terms of the Nitrates Directive and a reduction in the benefits envisaged by that Directive. This in turn could have led to farmers leaving the sector and turning to the State for support via the social welfare system.

3.14 No other options were considered.

Quantification of Costs

3.15 This measure will cost approximately €6 million over a three-year period viz. 1st year, 2nd year and 3rd year costs of €1.8 million, €3.8 million and €0.4 million respectively.

Beneficiaries

3.16 The number of beneficiaries is estimated to be 40,000 and is split as follows:

Year 1 – 12,000
Year 2 – 25,200
Year 3 – 2,800

Compliance and administration costs

3.17 There are minimal administration costs and no direct compliance costs.

Quantification of Benefits

Environmental benefits

3.18

- Supports the increased emphasis being placed by the EU on ensuring that agricultural production is carried out in much greater harmony with the environment;

- Contributes to the investment in necessary pollution control facilities to foster a clean and attractive countryside with a high quality of life that can be enjoyed and appreciated by all;

- Encourages compliance with the Nitrates Directive:

- Assists farmers to ensure that they have the necessary storage facilities to meet the higher environmental standards required by the Nitrates Directive and to protect farmers from threats to EU payments, following a judgment of the European Court of Justice in March 2004 that Ireland was in breach of the Nitrates Directive.

Farm investment

3.19

- Encourages ongoing investment in the Irish farming sector and compliance with increasing environment and animal welfare requirements;

- Encourages farmers to invest in waste storage facilities, to meet the national deficit in such facilities;

- Essential infrastructural investment is as important to the agri-food sector as other major infrastructural investments are to other sectors of the economy;

- Maintains the competitiveness of the agriculture sector in the economy, and encourages the restructuring of the agriculture sector.

3.20 It is not possible to quantify the benefits outlined above which are solely attributable to the tax change. This tax expenditure is a small measure relative to the overall policy response.

3.21 The measure ensures equity for farmers who are required to invest in specific infrastructure in order to comply with the Nitrates Directive. The measure acknowledges the importance of the agriculture sector to the economy, and acknowledges the particular competitive pressures faced by the sector at the current time. It also helps to ensure that the benefits outlined above will be realised.

CHAPTER 4

Section 10 – Amendment of Section 825B (repayment of tax where earnings not remitted) of Principal Act

Description of Expenditure

4.1 Section 10 of the Finance Act 2010 makes a number of amendments to the tax relief for unremitted foreign employment income under section 825B of the Taxes Consolidation Act (TCA) 1997 which was introduced in section 13 of the Finance (No. 2) Act 2008.

Policy context

4.2 In recent years, international investment has become increasingly mobile particularly in a number of areas of economic activity such as internationally traded services which is considered to constitute a key potential driver of future economic and employment growth. This development has been mirrored by an increased mobility of highly-skilled workers in those areas of economic activity who can generally command high salaries and associated benefits.

4.3 As a result, a number of jurisdictions have put measures in place to ensure that they can continue to attract investment either to maintain or increase existing levels of economic activity and employment. Increasingly, these efforts have focussed on attracting highly skilled workers. For example, favourable tax schemes have been used to attract highly skilled migrants in the Netherlands, Belgium, Denmark, Finland, Norway and Sweden. OECD research shows that the level of personal taxation affects the location choices of highly skilled workers.[12]

4.4 A scheme was introduced in the Finance (No. 2) Act 2008 to ensure that Ireland would continue to be able to compete internationally to attract skilled workers in the context of the increasingly scarce and mobile international investment in key areas of economic activity.

4.5 Research shows that while Income Tax rates are less important than Corporate Tax rates in attracting investment, they still influence investment location

[12] OECD (2005), *Taxation, Ethnic Ties and the Location Choice of Highly Skilled Immigrants*, OECD working paper by Liebig and Sousa-Poza.

decisions, particularly headquarters locations.[13] Important barriers to any investment decision are uncertainty and transaction costs. This scheme facilitates the access to the kinds of skills that should assist in minimising such costs. Individuals attracted to Ireland by this scheme may act as potential "magnets" to attract similar types of skilled workers, which would bring further business and investment gains over time. This can lead to clusters of companies developing in particular areas to achieve gains through economies of scale and agglomeration benefits. Networks of highly skilled individuals may then grow and develop as a result.

Previous legislation and details of scheme

4.6 Section 825B of the Taxes Consolidated Act, which was introduced in section 13 of the Finance (No. 2) Act 2008, provided that, where an individual not previously resident in Ireland, from a non-European Economic Area country with which Ireland has a Double Taxation Agreement (DTA), comes to Ireland to carry out the duties of a foreign employment, the Income Tax on the income from that employment would be reduced to the tax due on the greater of (a) the amount of the income from that employment remitted to the State, or (b) €100,000 plus 50% of the income from the employment above that amount.

4.7 The amount to be refunded will depend on the individual's tax liability and the rate bands or credits s/he can claim (married or single allowances and rate bands, PAYE allowance, etc.)

Specific Finance Act 2010 amendments

4.8 Section 10 of the Finance Act 2010 makes two amendments to the provisions which were introduced in section 13 of the Finance (No. 2) Act 2008.

4.9 The amendments, which are designed to enhance the effectiveness of the measure, cover:

(i) extension of the relief to individuals (other than Irish-domiciled individuals) from the European Economic Area (EEA) and EU Countries with which Ireland has a Double Taxation Agreement; and

[13] Egger and Radulescu (2008), *Labour Taxation and Foreign Direct Investment*, CESInfo working paper; Kugler and Rapoport (2005), *Skilled Emigration, Business Networks and Foreign Direct* Investment, CES Info working paper.

(ii) reduction of the minimum period for which employees wishing to avail of the relief must work in Ireland from three years to one year.

4.10 Apart from these amendments, the overall thrust of the measure and its operation as introduced in the Finance (No. 2) Act 2008 remains unchanged.

Conditions of the scheme

4.11 As noted above, the scheme originally applied to individuals who were not Irish domiciled and were citizens of a non-European Economic Area (EEA) Agreement country. It now applies to individuals from all countries outside Ireland with which Ireland has a DTA.

4.12 The time period the individual has to work in Ireland has been reduced from three years to one year. As already mentioned, the operation of the measure has not been changed by the provisions in the Finance Act 2010. The changes widen the potential pool of persons who can be covered by the measure rather than by enhancing the tax relief available to any one individual.

Method of application for tax expenditure scheme

4.13 The scheme is a relief from Income Tax on the income from a foreign employment where the duties of that employment are carried out in Ireland. Eligible individuals may apply for a repayment of Income Tax deducted under the PAYE system after the end of the tax year.

Duration of scheme

4.14 The measure is open-ended. However, in common with all taxation measures it remains under ongoing review, especially in the context of the annual Budget/Finance Bill cycle.

Objectives of Tax Expenditure

4.15 The objective of the measure is to ensure that Ireland remains in a position to attract increasingly scarce international investment and to ensure existing foreign direct investment is retained. As a consequence, the measure should encourage the retention of existing jobs and the creation of new employment. The measure aims to ensure that Ireland can develop value-added jobs in areas envisaged in “Building Ireland’s Smart Economy: A Framework for Sustainable Economic Renewal” which was published in December of 2008’ and the recently published Report of the Taskforce on Innovation – ‘Innovation

Ireland'. It should also lead to increased innovation capacity and an increase in the stock of human capital.[14]

Options Analysis

4.16 As with any policy measure, the *status quo* could have remained in place without any changes.

4.17 Given the intensification of international competitive pressures for mobile investment and highly-skilled workers, it would have been inappropriate simply to adopt a 'do-nothing approach'.

Any other options considered

4.18 The Commission on Taxation recommended the abolition of section 825B of the TCA (Recommendation 7.24) and its replacement by "a carefully targeted tax incentive to attract skilled persons into Ireland to meet short-term skills gaps".

4.19 This approach was not adopted. Making statutory provision for specific skills, ensuring that these skills were kept up to date and creating administrative procedures for the operation of the scheme (including appeals) bring with it a range of inflexibilities. The use of an income-based approach was considered a more durable and straight-forward method to achieve the policy objective.

4.20 It should also be noted that the recently published Report of the Taskforce on Innovation – "Innovation Ireland" did not specify defined skills but a key recommendation was to introduce a "mobile talent regime"[15] .

Quantifications of Costs

4.21 The original measure was introduced in section 13 of the Finance (No. 2) Act 2008, with an operative date of 1 January 2009. As it operates by way of refund of tax in the year following the tax year when a person was employed, specific data is not yet available on the amount of tax forgone, the number of individuals covered by the measure and the take-up of the measure. Detailed information on the tax forgone under the measure will begin to be available late in 2010 in respect of the 2009 tax year. However, information for the expenditure in

[14] OECD research shows that such measures can have these effects: OECD Policy Brief (2002) International Mobility of the Highly Skilled

[15] Innovation Task Force Report, page 63

Finance Act 2010 (the extension of the scheme to EU and EEA nationals) will not be available until late 2011.

4.22 Notwithstanding this, it is the case that an individual will be claiming relief on income which has been subject to tax at the higher income tax rate of 41%, so the amount refunded in any given case will be 41% of the amount of income excluded from tax by virtue of claiming the relief. An example is provided below to show how the scheme works:

- Example: If an employee earns €200,000 from her employment, the full employment income is subject to PAYE. If she remits €125,000 of this income to Ireland, she is then taxed on the greater of (a) the amount remitted, €125,000, or (b) €100,000 plus 50% of the employment income above that amount, which is €150,000. In this case (b) is greater, so her tax liability is reduced to the liability on €150,000 and she can apply for a refund of the difference between the tax deducted under PAYE on the full earnings of €200,000 and the liability on €150,000. If this employee's remitted salary was €175,000 instead, her tax liability would be reduced to the liability on €175,000 as this would be greater than (b) and she could apply for a refund of the difference between the tax deducted under PAYE on full earnings of €200,000 and the liability on €175,000.

4.23 In order to further illustrate the potential costs of the scheme, the tax forgone per 100 foreign skilled individuals has been calculated. The calculation is based on assumptions of deadweight of 40%, a salary range of between €100,000 and €250,000 and a range of different levels of remitted salary. The estimated cost in tax forgone in future years for every 100 skilled individuals is estimated to be between €0.4 million to €1.2 million.

Quantification of Benefits

4.24 The amendments made in the Finance Act 2010 do not increase the benefits accruing to any one individual, but rather serve to broaden the scope of persons to which the measure applies in addition to the qualifying conditions.

4.25 As stated earlier, this was done to ensure that Ireland remains in a position to be able to compete for highly mobile international investment and workers.

4.26 In addition to the highly skilled individuals attracted to Ireland as a result of this scheme, further jobs may also be created. In certain cases, attracting talented individuals from abroad may, along with other influencing factors, contribute to the corporate investment appraisal decision to locate entire business units or FDI facilities in Ireland. Jobs may also be created in the form of support staff and clusters of other skilled persons working in teams led by foreign professionals. Applying a conservative assumption of an additional average of 30 new positions for every 100 foreign workers, an illustrative calculation shows that the total personal tax yield[16] for these jobs could fall in the range €2 million to €4.5 million[17] even assuming a relatively high level deadweight of 40%. This does not take into account any potential positive innovation and productivity impacts on corporate profitability.

4.27 This measure was designed to operate as a "pump-priming" policy instrument aimed to ensure that Ireland continues to be able to compete internationally to attract skilled workers, to maintain and grow employment and to contribute to the development of value-added jobs. On balance it is considered that its medium to long term impacts will out-weigh any deadweight related tax costs that might arise from individuals accessing the relief whose companies would have sent them to carry out duties in Ireland anyway.

[16] Assuming average personal tax rates of 14% to 30%, an average salary of €100,000 to €250,000 for foreign skilled workers and an average salary for Irish workers of €30,000 to €60,000.
[17] The shadow cost of labour has not been taken into account for this illustrative example.

CHAPTER 5

Section 20 – Increase in Age Related Tax Relief for Private Health Insurance

Description of Expenditure

5.1 Section 20 of the Finance Act 2010 amends section 470B of the Taxes Consolidation Act (TCA) 1997 which provides an age-related tax credit in respect of health insurance premiums paid for individuals aged 50 years and over.

5.2 This credit was introduced via the Health Insurance (Miscellaneous Provisions) Act 2009. The purpose of that Act was to make the cost of private health insurance accessible to older people. It was enacted in response to the Supreme Court's decision in July 2008 to strike down elements of the Government's previous risk equalisation scheme as *ultra vires*[18].

5.3 This measure was introduced on an interim basis for a three year period, as a mechanism using the tax system to ensure that private health insurance cover is available to all persons, without differentiation on grounds of age or health status.

5.4 An annual levy is charged on health insurance companies based on the number of lives covered by policies underwritten by them and this is designed to balance the age-related tax credit introduced in respect of private health insurance premiums for insured persons aged 50 years and over. Both the age-related tax credit and the levy apply to contracts of insurance renewed or entered into on or after 1 January 2009 and before 31 December 2011.

5.5 In order to meet the Government's policy objective that the scheme should be revenue neutral over its three year life span, and to maintain compensation for the cost of claims by older persons at 50% of additional cost, Finance Act 2010 increased both the age related tax credit and the levy – the ability to increase the levy and age related Tax Relief at Source (TRS) was provided for in the Act. For contracts renewed or entered into on or after 1 January 2010 the age related credit is €200 (unchanged) for persons aged 50 to 59; €575 (increased from €500) for persons aged 60 to 69; €1,075 (increased from €900) for

[18] BUPA Ireland and another v Health Insurance Authority and others, [2008] IESC 42; available at http://www.courts.ie/judgments.nsf/

persons aged 70 to 79; and €1,375 (increased from €1,175) for persons aged 80 and over.

5.6 The scheme applies to individuals who are aged 50 or over and who are covered by a private health insurance policy.

5.7 The age related tax credits are delivered through the TRS system by the health insurance companies. The health insurance companies apply to Revenue for age related credits based on the number of individuals aged over 50 years of age for whom they have issued health insurance policies.

5.8 This measure was introduced on an interim basis for a three year period from 1 January 2009 until 31 December 2011. The Department of Health and Children will prepare a permanent risk equalisation/community rating scheme to be implemented at the end of this scheme.

Objectives of Tax Expenditure

5.9 This overall private health insurance arrangement (health insurance levy and age related tax credit) has been implemented, on an interim basis for three years, with the aim of using the tax system to ensure that health insurance cover is available to all without differentiation on grounds of age or health status.

5.10 The increase in the age related tax credit is necessary to preserve the level of compensation for the increased cost of insuring older persons at 50% of additional cost. Ensuring that health insurance cover is available to all without differentiation means that any health insurance company, with a largely older age profile, will not be disadvantaged.

Options Analysis

5.11 Under the Health Insurance (Miscellaneous Provisions) Act 2009, the Private Health Insurance Levy and the age-related tax credit are reviewed annually by the Department of Health and Children based on claims information collected by the Health Insurance Authority.

5.12 Having reviewed the scheme it was found that an increase in the age related credit was necessary to preserve the level of compensation for the increased cost of insuring older persons at 50% of additional cost. The levy on health insurance policies has been increased to meet the additional cost of the age related tax credit.

5.13 No other options were considered. The scheme has been approved by the European Commission and any material changes in structure would have required further approval.

Quantifications of Costs

Cost of overall scheme

5.14 It is intended that this measure will be “exchequer neutral” over its three year duration. However, given the nature of the scheme and the timing of payments of private health insurance premia (which has implications for the age TRS) there was a cash flow shortfall to the Exchequer in the first year. The levy yield in 2009 was just under €197 million; whereas the total payments by health insurance companies to their customers for the age related tax credit for 2009 was in the region of €280 million. This is because the companies paid only seven months’ worth of levy (in respect of health insurance policies taken out or renewed in January to July 2009) in the first year, whereas the Exchequer paid a full year’s tax relief at source. This means there is a shortfall of circa €83 million in 2009 of levy receipts versus payments to health insurance customers. The five month shortfall in levy receipts will be made up at the end of the scheme. Not all of the €280 million in age related credit paid by the companies to customers was claimed by the companies from Revenue in 2009.

Cost of change made in Finance Act 2010

5.15 It is estimated that the cost of the age related tax credit in 2010 will be circa €17 million higher than if it had not been increased (€322 million versus €305 million). However, as noted above, it is intended that the measure will be cost neutral over its three year duration and the health insurance levy has been increased to meet the additional costs of the credit.

5.16 More than 630,000 individuals aged 50 and over with health insurance are eligible for the age related credit. The precise number can change on a daily basis, depending on factors such as: individuals attaining the age of 50 and thereby becoming eligible for the credit; individuals taking out or cancelling a health insurance policy; and the death of individuals.

Quantification of Benefits

5.17 The benefit of the scheme is that private health insurance is available to all without differentiation on grounds of age or health status.

5.18 There is no net cost either to the scheme as a whole or to the increased credit, which has been matched by an increase to the health insurance levy. The benefits are qualitative rather than monetary in that this measure is part of a scheme which helps equalise the purchase of private health insurance for all regardless of age or health status.

CHAPTER 6

Section 27 - Mid Shannon Tourism Infrastructure Scheme - Extension of Qualifying Periods

Description of Expenditure

6.1 Section 29 of the Finance Act 2007 introduced a tax-based scheme for tourism facilities situated in a narrow corridor on both sides of the Shannon between Limerick and Lough Ree.[19] Tax relief in the form of capital allowances is available in respect of expenditure incurred on the construction or refurbishment of buildings or structures (excluding the cost of acquiring the site) that are used to provide tourism facilities. These allowances can be claimed over 7 years at the rate of 15% per annum for the first 6 years and 10% in year 7. The allowances are claimed under the self-assessment system (without any need for advance approval by Revenue)[20] in respect of qualifying expenditure incurred on appropriately certified projects that have commenced operations. In areas that are not in the Border, Midlands & Western (BMW) region, i.e. situated in Clare and Limerick, only 80 per cent of construction and refurbishment expenditure can qualify for relief.

6.2 When it was introduced the scheme was to run for three years from 1 June 2008. Projects were to apply for approval in principle before carrying out any work within a year of this commencement date.

Specific Finance Act 2010 Amendment

6.3 Section 27 of Finance Act 2010 simply provided that the latest date for the making of applications for approval in principle will be 31 May 2012 and the latest date by which qualifying expenditure can be incurred on construction or refurbishment will be 31 May 2015.[21] No substantive amendments were made to the scheme.

Objectives of Tax Expenditure

6.4 The primary objective of the scheme was to encourage sustainable tourism-related investment in an area that had underperformed economically in relation

[19] The qualifying areas are listed in Schedule 8B to the Taxes Consolidation Act 1997.
[20] Claims may, of course, be audited by Revenue as part of its normal control function.
[21] Contingent on the appropriate E.U. State-Aid approval being received and a Commencement Order being made.

to the rest of the country. This objective was first set out in a submission from the Shannon Development Company in 2005.

6.5 The Department of Finance commissioned Goodbody Economic Consultants to examine the costs and benefits of a tourism-related tax incentive scheme for the Shannon Corridor. Their report, (referred to hereafter as the Goodbody report) published in March 2006, confirmed that the relevant area had experienced lower than average per capita income and population growth. The Department of Arts, Sport and Tourism (DAST) also considered that an appropriate State incentive scheme with a stronger environmental emphasis could help the region carve out a special niche for itself.

6.6 As regards the section 27 amendment, the Department of Finance understands following representations from the Department of Arts, Sport and Tourism, the Mid Shannon Tourism Infrastructure Board and Fáilte Ireland that there are a number of significant projects currently in the pipeline which had not been submitted projects to the Board for approval. If the former deadline for submission of projects to the Board was retained some of the pipeline projects would not be able to proceed.

Options Analysis

6.7 The option of "doing nothing" (as the counterfactual) would have resulted in the closing of the scheme and losing the prospect to protect the investment outlined above.

Quantifications of Costs

6.8 To date the cost of the scheme has been nil. Once projects commence the main cost of the scheme is the tax that will be forgone when capital allowances are used by investors in the scheme to reduce their taxable income. The capital allowances will equate to the qualifying expenditure on the projects. This includes the cost of construction or refurbishment work but excludes the cost of acquiring a site, or an existing building in the case of refurbishment projects. The tax forgone will be 41%[22] of the qualifying expenditure. This is the current marginal Income Tax rate for individuals.

[22] There will also be health contributions (marginal rate 5%) and PRSI (rate 3% self employed and 4% employees) forgone. No income levy is forgone as capital allowances are not allowable for purposes of the income levy. The corporate marginal tax rate is either 12½% (trading) or 25% (non-trading). Investors in capital allowances schemes tend to be individual tax payers rather than companies as they obtain more benefit from the allowances because of their higher marginal tax rate

6.9 Four projects have received approval in principle. The projected qualifying expenditure for capital allowances purposes is €7.52 million, which at 41%, would equate to tax forgone of €3.08 million. There are currently another five projects that have been the subject of preliminary discussions with the Project Board but that have not yet made applications for approval in principle. The projected qualifying expenditure in the case of these projects for capital allowances purposes is €9.3 million, which at 41%, would equate to tax forgone of €3.8 million. However, it is not certain how many projects will actually go ahead. Construction has commenced on only one of the projects that have received approval in principle. A number of the projects have experienced problems with obtaining planning permission.

Quantification of Benefits

6.10 The Goodbody report said that measurement of the benefits of a scheme such as this can only be done ex post by identifying all of the projects that have benefited from the tax incentives and measuring the benefits of those investments, taking proper account of deadweight and diversion effects. All indications were that any qualifying investment would be unlikely to take place in the absence of the scheme and that the deadweight costs would be minimal.

6.11 It is possible to estimate some potential benefits from information provided on the four projects that have received approval in principle. It is projected that approximately 105 people will be employed during the construction phase of the projects and the completed projects will employ approximately 70 people. Those projects that have yet to apply for approval in principle could employ approximately 64 people.

6.12 Should the approved projects proceed to construction, completion and operation there will be additional tax receipts to off-set to some extent the cost of tax forgone in granting capital allowances; these include payroll taxes, Value Added Tax (VAT), and income taxes (if business profitable). However, it is not possible to provide an estimate of such taxes as they will depend on the numbers employed and a net increase in the number of tourists for the country as a whole.

6.13 The Goodbody report also identified some intangible benefits. The scheme would usefully transfer some economic activity to a relatively less developed part of the country. It would have the effect of developing tourism by opening up new areas rather than putting further pressure on already established tourism destinations in Ireland, which would be a clear contribution to current tourism policy. It concluded that the scheme would lead to small-scale benefits and would have very limited negative effects, particularly as any deadweight effect was estimated to be minimal.

CHAPTER 7

Section 31 - Amendment of Part 27 (unit trusts and offshore funds) of the Taxes Consolidated Act 1997

Description of Expenditure

Background to taxation of investment funds in Ireland

7.1 Investment undertakings (funds) are not taxed annually on the profits of the undertaking. Instead, the funds are allowed to roll up tax-free and tax is levied on the returns to Irish-resident investors when realised. Where an investment undertaking is located in Ireland, it is obliged to account for exit tax on any payment to a unit holder - except in the case of a non-resident investor who makes a non-resident declaration to the investment undertaking. (Non-resident investors in Irish funds are subject to tax in their home jurisdiction.) Foreign funds are not within the charge to tax in Ireland but Irish resident unit holders in such funds are taxed on their returns from the funds.

Description of the three measures introduced by Section 31 of Finance Act 2010

7.2 Section 31 makes a number of amendments to Part 27 of the Taxes Consolidation Act, 1997. That part contains rules for the tax treatment of collective investment undertakings.

Measure 1 - 'Qualifying management company' definition

7.3 ***Paragraph (a)*** of section 31 is a technical amendment to update the definition of a "qualifying management company" following the ending of the 10% Corporation Tax rate for certain international financial services companies in the IFSC and Shannon. A payment by a collective investment undertaking to a qualifying management company does not trigger exit tax because exit tax only applies in respect of investors in a fund. The original definition required amendment because it stipulated that the qualifying management company had to be an IFSC or Shannon financial services company and those regimes have now expired.

Measure 2 - International funds industry operating in Ireland

7.4 ***Paragraph (b)*** of section 31 is designed to facilitate the international funds industry operating in Ireland. It will ease the administrative burden for investment undertakings that are focussed on savings markets outside of Ireland and which will have few, if any, Irish-resident unit holders. Existing rules provide exemption from exit tax for non-resident unit holders who make non-resident declarations to the investment undertaking. The requirement to have such a declaration from each unit holder imposes a considerable administrative burden on such undertakings and is considered disproportionate where all of the unit holders are non-resident. The new subsection is designed to reduce this burden in the case of such undertakings.

7.5 The section allows the exemption to apply where appropriate equivalent measures have been put in place by the investment undertaking to ensure that unit holders in the undertaking are not resident or ordinarily resident in the State and the undertaking has received approval from the Revenue Commissioners. Approval may be given as respects any unit holder or class of unit holders, and subject to such conditions as the Revenue Commissioners consider necessary to satisfy themselves about the equivalent measures. The Revenue Commissioners can withdraw approval where the undertaking has failed to comply with the conditions.

7.6 This provision will ease the administrative burden on international funds operators in Ireland while at the same time providing assurance to the Revenue Commissioners.

Measure 3 - Management in Ireland of foreign funds

7.7 ***Paragraph (c)*** of section 31 is designed to facilitate the management in Ireland of foreign funds under the new EU management company passport regime. Under Directive 2009/65/EC on Undertakings for Collective Investment in Transferable Securities (known as UCITS IV), a UCITS (fund) formed under the laws of one Member State may be managed by a management company regulated under the laws of another Member State. Paragraph (c) ensures that a UCITS formed under the law of a Member State other than Ireland will not be liable to tax in Ireland by reason only of having a management company that is authorised under Irish law.

Objective of Tax Expenditure

Reasons for introduction of measures

7.8 The measures introduced by section 31 of Finance Act 2010 have the objective of increasing the competitiveness of the international funds industry in Ireland to ensure that Ireland becomes a more attractive location for centralising the international funds industry in Europe in the context of the new European UCITS IV Directive.

7.9 On 22 June 2009, the European Council of Ministers adopted the UCITS IV Directive. One of the key proposals of UCITS IV is the establishment and operation of a UCITS Management Company Passport. This will effectively enable UCITS management companies to offer portfolio management services to investment funds on a pan-European basis. It is anticipated that, as a result, firms will move to consolidate the management functions relating to their investment funds in one (or a small number of) location(s) (currently there must be a management company in each jurisdiction where there is a fund).

7.10 Ireland, along with Luxembourg, is one of the primary domiciles of choice for the UCITS fund product itself and it is anticipated that UCITS managers will - at least initially - choose to be tax resident in the same domicile as the underlying investment funds which they manage, provided that the appropriate tax and regulatory measures are in place. Therefore, UCITS IV provides a significant opportunity for Ireland to market itself as the jurisdiction of choice for the cross-border management of UCITS fund products.

7.11 However, there could be uncertainty, even between EU Member States, as to the tax status of an investment fund domiciled in one Member State where the UCITS management company is resident in a different Member State. In order to ensure that the Irish funds industry is well-placed to compete to attract to Ireland the management business of UCITS domiciled in another Member State, we opted to clarify the tax treatment that will apply in the case where an Irish management company is managing a fund located in another jurisdiction.

Options Analysis

7.12 The UCITS IV Directive will make the European funds industry more competitive vis-à-vis the rest of the world but it will also increase competition between member states to attract cross-border management business. It is anticipated that the introduction of the “management company passport” will encourage firms to consolidate the management functions relating to their investment funds in one (or a small number of) location(s). The absence of measures to provide clarity in respect of the tax treatment of foreign funds managed from Ireland could result in loss of the business to other jurisdictions.

Quantification of Costs

7.13 There are no costs associated with any of the three measures - this is explained as follows:

- The definition of a "qualifying management company" is simply removing a doubt as to the meaning of the term. Therefore, there are no costs associated with this proposal;

- The change regarding the non-resident declaration will not involve any cost as it does not remove any charge that applies under existing law. Therefore, there are no costs associated with this proposal. Revenue will set out, in guidelines, the conditions subject to which a fund will be approved to operate this alternative arrangement to the non-resident declaration requirement;

- The change regarding the management - in Ireland - of foreign funds will not have a cost because no such funds would be managed in Ireland if the management of the fund here were to result in it becoming liable to tax here. However, it might give rise to some Exchequer receipts because the management fee payable to the Irish-based manager would be liable to tax here. However, it is not possible to estimate the extent of any tax receipts arising - this will depend on the uptake. In addition, the management here of foreign UCITS cannot arise until the UCITS IV Directive is implemented in 2011.

Quantification of Benefits

7.14 It is not possible to quantify the benefits of the measures partly because the UCITS IV Directive is expected to significantly change the shape of the funds industry across the European Union. It is worth highlighting the value of the international funds industry in Ireland because it is possible that in the absence of these measures, Ireland may have lost business to other jurisdictions.

- Ireland is the fifth largest investment funds jurisdiction in the EU behind countries such as France, the UK, Germany and Luxembourg. If one looks at jurisdictions which focus on the international distribution of funds rather than the sale of funds into their domestic market, then Ireland is the second largest investment funds jurisdiction in the EU, behind Luxembourg. 14% of all European funds are domiciled in Ireland;

- There are currently more than 10,000 funds and sub-funds serviced in Ireland providing employment to over 12,500 people.

7.15 The development of international financial services sector is directed towards ensuring that it continues to create employment and contribute taxes to the Irish economy. It is estimated that every one hundred new funds or sub funds attracted to domicile in Ireland results in the creation of an additional one hundred and fifty jobs. The measures introduced will assist in achieving job creation at no cost to the exchequer.

CHAPTER 8

Section 37 - extension of Deposit Interest Retention Tax (DIRT) exemption to Personal Retirement Savings Accounts (PRSAs)

Description of Expenditure

8.1 Section 256(1) of the Taxes Consolidated Act (TCA) 1997 has been amended to exclude deposits held by Personal Retirement Savings Accounts (PRSAs) providers from being treated as “relevant deposits”.

8.2 The effect of the amendment is that DIRT will not be deducted from such deposits. PRSA legislation was introduced in 2002. The legislation provided that PRSAs would be exempt from:

- Collective Investment Undertaking Exit Tax by virtue of section 739D(6)of the TCA;
- Life Assurance Exit Tax by virtue of section 730(D)(2)(b)(iv) of the TCA;
- Dividend Withholding Tax by virtue of section 172C(2)(bb) of the TCA;
- Income Tax by virtue of section 787I of the TCA.

8.3 The taxation principle underlying Irish pensions for tax purposes is that money is tax exempt within a pension fund but tax applies when the money is paid out to a pension recipient. Currently pension schemes other than PRSAs are exempt from DIRT by virtue of section 256(1) of the TCA. This amendment brings PRSAs into line with other pension schemes.

8.4 This amendment provides that a deposit, the interest on which is beneficially owned by a PRSA provider as defined in the Pensions Act, 1990, will not be a “relevant deposit”. The effect of the amendment is to remove such deposits from the scope of the DIRT regime.

8.5 The exemption from DIRT applies in respect of interest paid or credited on or after the date of the passing of the Finance Act 2010 on the 3 April 2010.

8.6 There is no time limit placed on this DIRT exemption for PRSAs.

Objectives of Tax Expenditure

8.7 The amendment brings PRSAs into line with other pension schemes which are already exempt from DIRT – that is, it provides parity of treatment or tax neutrality between pension products. Exemption from DIRT will ensure tax-free growth in all of the underlying investments in a PRSA account.

8.8 It may help preserve the value of PRSAs by encouraging investment in deposit accounts and facilitate moving funds from investments which have suffered heavy losses in recent times. It could also encourage investment of PRSA money in Irish bank accounts, which could improve liquidity in the banking system.

Options Analysis

8.9 To do nothing would be inequitable as income from pension funds and accounts is exempt from tax, but even if DIRT was deducted from an account held by a PRSA, there was no mechanism for reclaiming the tax.

8.10 To bring all pension products into line and ensure that PRSAs are treated for tax purposes in the same way as other pension products, the only option available was to make the amendment as set out in section of 37 of the Finance Act 2010.

Quantifications of Costs

8.11 The number of PRSA contracts in force at 31 December 2008 was 175,000. The value of assets under management was €2 billion.[23] As with all pension products, PRSAs are regulated by the Pensions Board.

8.12 The current rates of DIRT are 25% and 28%. The 28% applies in the case of interest which is not payable annually or at more frequent intervals or where the interest cannot be calculated until maturity of the investment. This includes investments such as tracker bonds where the amount of interest payable depends on the changes in a financial or other index over a number of years.

8.13 No information is available about how much PRSA money is invested in deposit accounts. Given that there is no mechanism for reclaiming DIRT deducted from these accounts, it is probable that PRSA funds have not been invested in such

[23]http://www.pensionsboard.ie.

products – they were more likely to be invested in products where the income was not subject to a tax which could not be reclaimed. On that basis, while it is not possible to cost the annual tax expenditure per beneficiary accurately, there may be no cost from the change – PRSA money would not be invested in deposit accounts unless the deposit interest was not subject to DIRT, which has been achieved by this amendment. Even, in the event that there is a certain level of PRSA funds currently invested in deposit accounts, the annual cost of this measure is still envisaged to be relatively low. Given that PRSA's provided by life assurance companies are DIRT exempt, the estimated cost of the measure is likely to be €0.5 million to €1.9 million[24] .

Quantification of Benefits

8.14 The change ensures consistency of treatment between pension products. If PRSA money is moved into deposit accounts as a result, this could mean it has moved from investments which have recently suffered significant falls in value (such as property and equities). The measure may therefore have the effect of preserving the value of pension investments. However, the measure has only been introduced and it would be difficult to predict to what extent this will happen. In any event, it appears the Pensions Board does not have information about how PRSA money is invested, so it may not be possible to ascertain whether such a movement occurs or to what extent it is attributable to this measure.

8.15 The benefits are more qualitative than monetary in that this measure equalises the DIRT-exempt treatment of different pension products.

[24] The value of PRSA assets for 2010 was calculated by taking the 2009 PRSA assets figure set out in the Pensions Board Annual Report 2009 (€2bn) and inflating by 10% to reflect estimated 2010 values. The share of these assets liable for DIRT (i.e. excluding PRSA assets held by life assurance companies) was estimated at 24% to 33%. Other assumptions include a range for the proportion of PRSA funds on deposit of 10% to 25%, an approximate rate of deposit interest of 4% and a DIRT rate of 25% (DIRT may also be charged at 28% however a single rate has been used here for the purposes of analysis).

CHAPTER 9

Section 39 - Specified Financial Transactions

Description of Expenditure

Policy Context

9.1 Islamic compliant finance is considered to be the fastest growing sector of finance in the world, growing at roughly 10% per annum. In 2009 Islamic financial assets amounted to $822 billion. It has been forecast by Standard & Poor's that the industry could potentially have assets totalling $4 trillion under control.

9.2 Islamic finance requires that all transactions comply with Shari'a principles. Specifically these are sets of strict rules that forbid the making or receiving of interest payments. In order to be compliant, loans, deposits and other financial transactions are structured so that the parties to the transaction do not pay or receive interest.

9.3 In the absence of specific tax legislation, the structure of certain Islamic finance transactions would cause them to be treated differently for tax purposes than conventional transactions, which are similar in substance. This disparity of substantive treatment created a disincentive to such Islamic transactions occurring or being sited in Ireland.

Any previous legislation

9.4 There was no previous legislation dealing with Islamic finance.

Effect of legislation /conditions of the scheme

9.5 Section 39 provides for parity of tax treatment between conventional finance transactions and certain Islamic financial products which achieve the same economic result in substance.

9.6 The new legislation applies to three "Specified Financial Transactions". These transactions will be treated for all purposes of the Tax Acts in the same way as conventional financial products attracting interest. Consequential amendments to the Stamp Duty Consolidated Acts and the VAT Acts also form part of this amendment.

9.7 The transactions covered by the legislation are: *credit transactions, deposit transactions* and *investment transactions*. Essentially, the new legislation treats the return paid to the financial institution in respect of these transactions as interest for tax purposes and applies all relevant tax legislation pertaining to an interest payment to that return.

Method of application for the scheme

9.8 A finance undertaking must elect into the scheme.

Duration

9.9 There is no time limit on the new legislation.

Objectives of Tax Expenditure

Objectives

9.10 The objective of the legislation is to encourage Islamic financial institutions to set up business in Ireland and to facilitate Islamic-compliant business being transacted from Ireland. It does this by ensuring parity of treatment between a financial transaction structured to conform to Islamic principles and a similar conventional transaction. The principles of Islamic finance include a prohibition on earning interest. The legislation treats a return on a Shari'a-compliant investment as interest for tax purposes. This parity of treatment will remove a tax barrier to a business based on Islamic principles setting up in Ireland.

Economic rationale

9.11 As outlined, Islamic compliant finance is considered to be the fastest growing sector of finance in the world and in 2009 assets in Islamic finance amounted to $822 billion. The Gulf Region has been highlighted as an area of potential growth for Irish businesses and investors.

9.12 The Region is also home to large numbers of Sovereign Wealth Funds, large Regional Banks and finance houses with access to significant investment capital. Ireland is in the process of concluding four Double Taxation Agreements with Gulf States (Saudi Arabia, Bahrain, Kuwait and United Arab Emirates). Significant opportunities for investment are now available provided the necessary framework is in place for Islamic financial products.

Option Analysis

9.13 The options considered were:

- do nothing;
- ensure full equality of treatment between all Islamic finance products and the equivalent conventional financial products;
- introduce change on a limited basis.

Do nothing

9.14 Countries including the UK, France, the Netherlands and Luxembourg have introduced or are planning to introduce legislation allowing Islamic Financial Transactions. If nothing was done Ireland would not be in a position to compete for the business opportunities outlined above.

Ensure full parity of treatment

9.15 While there are about 30,000 members of the Muslim community in Ireland at present and while there have been some indications that they would like to see Islamic mortgages offered by banks, there is no evidence of any strong demand for retail financial products as yet. In addition, there are regulatory issues related to retail products which will have to be explored with and by the Regulator before tax legislation would come into play. The provisions in the Finance Act 2010 are designed to cater only for particular products. The Department, in conjunction with the industry, will carry out an examination of expanding the rollout of financial products in future Finance Bills.

Introduce changes on a limited basis

9.16 This was the preferred option and seemed to be the most practical. It means that the legislation will be focused where there is a known demand (wholesale money markets).

Quantification of Costs

Tax Forgone

9.17 From a Direct Tax (Corporation Tax, Income Tax and Capital Gains) perspective, the legislation should not be viewed as relieving: it provides parity of treatment for transactions based on their substance. Similarly the VAT legislation merely clarified that Islamic financial transactions would be treated as financial transactions for the purposes of VAT. In relation to Stamp Duty, while there is an exemption where Sukuk (Islamic investment certificates) are issued or transferred this equates with the current exemption for section 110 securitisation companies. It is unlikely that there would be any cost to the exchequer in this. These provisions will facilitate and apply to new business only.

Quantification of Benefits

9.18 Section 39 is designed to facilitate further expansion of the Islamic product base in Ireland. There are opportunities for Islamic financial services institutions to establish EU headquarters locations here. As is currently the case with conventional financial services products the majority of business activity associated with Islamic financial products can be "passported" from Ireland into the EU in accordance with the relevant EU Directives.

9.19 Aside from opportunities associated with headquarter operations Islamic finance also offers a wide range of commercial products, which would be of interest in Ireland and could open new sources of capital for Irish businesses from Islamic finance houses.

9.20 There is significant potential for the Irish Financial Services Sector in this area given the new tax changes, the new Double Taxation Agreements (DTA) in the Gulf and building on the existing DTA with Malaysia. However, the tax changes in the Finance Act 2010 are enabling provisions and it is up to Industry and the relevant development authorities to take advantage of opportunities now afforded by the changes in the legislation.

CHAPTER 10

Section 43 – Intangible Assets

Description of Expenditure

10.1 Section 43 of Finance Act 2010 makes a number of amendments to the scheme of capital allowances for expenditure on intangible assets under section 291A of the Taxes Consolidated Act (TCA) 1997 (introduced by the Finance Act 2009) in order to enhance the scheme's effectiveness and ensure that it operates as intended.

Policy context

10.2 Intangible assets are an increasingly important contributor to growth. It is estimated that 70% of a typical company's value arises from its intangible assets, a share which has increased from 40% since the 1980s.[25] The OECD has shown that expenditure on intellectual assets has grown faster than expenditure on machinery and equipment in recent years and firms now often spend as much on intellectual assets as on tangible assets. The OECD also notes that a large number of studies show intellectual assets make a substantial contribution to economic growth.

10.3 The scheme in the Finance Act 2010 builds upon already established schemes to enhance the attractiveness of Ireland from the perspective of international investment. The OECD confirms that many countries are continuing to develop fiscal policy tools to promote investments in intellectual assets. The increased use of fiscal instruments is a reflection of governments' need to enhance the business environment in order to attract new investment.[26] The scheme is in line with the Government's plan for "Building Ireland's Smart Economy". It will also help to eliminate distortions arising from the differing treatment of different assets types and removal these inefficiencies will contribute to increased investment.

Previous legislation and details of scheme

10.4 The scheme was introduced by section 13 of the Finance Act 2009. Under the scheme, relief in the form of capital allowances against trading income is given on capital expenditure incurred by companies on the provision of intangible

[25] *Gowers Review of Intellectual Property*, a report for Her Majesty's Treasury (2006); *Innovation Ireland,* a report of the Innovation Taskforce (2010).
[26] OECD (2006), *Tax Treatment of Business Investments in Intellectual Assets: An International Comparison*, OECD working paper.

assets for the purposes of a trade. The scheme applies to a broad range of intangible assets which are recognised as such under generally accepted accounting practice and which are listed as specified intangible assets in the legislation.

10.5 The scheme applies to expenditure arising on assets which are externally acquired from a third party or connected person and on assets which are internally developed within the company. Allowances available under the scheme are based on the amount charged to the profit and loss account of the company for the accounting period in respect of the amortisation, and any impairment, of the intangible asset. However, companies can opt instead for a fixed write-down period of 15 years at a rate of 7% per annum with 2% in the final year.

10.6 Certain restrictions apply to ensure that the scheme operates effectively. Activities (referred to as “relevant activities”) which are carried on as part of a trade and which consist of managing, developing or exploiting specified intangible assets for which allowances have been claimed are to be treated as a separate trade. Allowances may only be offset against income from such activities and not against any other profits.

10.7 For any accounting period, the aggregate amount of capital allowances, plus any deductions for interest on borrowings in respect of specified intangible assets, may not exceed 80% of trading income of the relevant trade for that period, before such allowances and interest. This will ensure that a minimum 20% of trading income will remain in charge for the accounting period. Any excess allowances (and any related interest expense) not deductible in an accounting period are available for carry forward to succeeding accounting periods.

Specific Finance Act 2010 amendments

10.8 The amendments provided for in Finance Act 2010 are as follows:

- in order to provide greater flexibility for companies locating their intellectual property business in Ireland, the period for which assets must be used in the trade to avoid a claw-back of allowances has been reduced from 15 to 10 years;

- a more coherent treatment of computer software is provided by distinguishing between computer software for end use within a business, which will continue to qualify for the normal plant and machinery allowances (under section 291 of the TCA), and computer software acquired for commercial exploitation which will qualify for allowances under the intangible assets scheme (under section 291A);

- the list of specified intangible assets has been extended to include *applications* for patents, copyright etc; also the definition of know-how, previously confined to industrial information and techniques, has been broadened to include commercial and scientific know-how in line with the requirements of the knowledge economy;

- clarification is provided that the scheme will apply to expenditure incurred prior to the commencement of a trade on the provision of specified intangible assets for the purposes of the trade;

- provision has been made to ensure that companies availing of the accounts-based allowance will be able to obtain relief for any impairment of a specified intangible asset where the resulting impairment charge to the profit and loss account is computed in accordance with generally accepted accounting practice, and

- clarification is provided on the activities constituting a separate trade for the purposes of determining the trading income of the trade against which allowances under the scheme may be offset.

Duration of scheme

10.9 The original scheme as introduced in the Finance Act 2009 applies to expenditure incurred after 7 May 2009, while certain transitional arrangements have been made for expenditure in respect of patent rights and know-how which qualify under separate schemes that are being wound up for companies. The amendments provided for in the Finance Act 2010 apply to expenditure incurred after 4 February 2010, with transitional arrangements for computer software. There is no termination date for the scheme.

Objectives of Tax Expenditure

10.10 The scheme is aimed at supporting the development of the knowledge economy by encouraging companies to locate the management and exploitation of their intellectual property business in Ireland with the potential to create high-quality employment in the process. Intellectual property has become a key component of competitive advantage for business in the global economy and this has now been recognised in our tax system by the provision of relief for expenditure incurred on a broad range of intangible assets for use in a trade. Prior to the introduction of the scheme in Finance Act 2009, relief was only available for a limited number of intangible assets, mainly patent rights, computer software and industrial know-how.

10.11 In order to avoid EU State-aid issues, this measure has general application and is not targeted at any specific sector. The incentive is open to companies in any sector to avail of the capital allowances in the context of the management and exploitation of intangible assets qualifying under the legislation.

10.12 The purpose of the amendments contained in Finance Act 2010, already detailed above, is to clarify the operation of certain aspects of the scheme and to enhance its effectiveness as an incentive for companies to manage and exploit their intellectual property assets from Ireland.

Options Analysis

10.13 As regards the provisions included in the Finance Act 2010, alternative options to the approaches actually taken were considered in relation to:

- *Clawback period*: The purpose of a clawback provision is to protect the exchequer by applying a balancing charge in the event that the intangible assets are sold or transferred within the holding period at a value in excess of the written-down value. Companies were looking for greater flexibility than the 15 year holding period required under the original legislation. The options were to leave matters stand, have no holding period or opt for a holding period somewhere in between. The 10 year holding period was decided on the basis that it provided greater flexibility in relation to investment decisions while still encouraging companies to locate their business operations here for the long-term;

- *Computer software*: The Finance Act changes reflect a desire to provide for a more coherent treatment of computer software assets depending on the purpose for which they were acquired. Capital expenditure on computer software acquired for use in a business can qualify for standard wear and tear allowances under section 291 of the TCA. Capital expenditure on computer software acquired for the purposes of earning income from the exploitation of the software can qualify under the scheme of relief for specified intangible assets (section 291A). The option of abolishing section 291 and including all computer software under section 291A was rejected as it would have made routine purchases of proprietary software for end use within a business subject to the "separate trade" restriction and 80% limit on allowances, which would be unwarranted and unduly onerous for business. Conversely, the option of excluding computer software expenditure from section 291A so that allowances for computer software would only be available under section 291 was rejected as it would have enabled companies acquiring high-value software Intellectual Property (IP) for commercial exploitation to reduce their Corporation Tax without the restrictions under section 291A. Including commercially exploitable software IP under section 291A brings the treatment of such IP into line with other similar IP assets;

- *Extension of range of qualifying assets*; The definition of qualifying assets on the basis of a list provides clarity and transparency in relation to what assets qualify and allows for extensions to the list to be considered, where appropriate, by way of legislative amendment. A general, open-ended definition, with exclusions, could have unintended consequences;

- *Pre-trade expenditure, impairment and separate trade provisions*: Interpretation issues had arisen about these issues and there was always the option here of not making any change on the grounds that existing legislation could be interpreted in a way that satisfied the enquiries. Changes in the legislation were introduced in order to provide certainty in the matters involved.

10.14 Following consideration of the various options, it was considered that the amendments included in the Finance Act and already detailed above, provided the appropriate measures to deal effectively with the issues raised.

Quantification of Costs

10.15 The scheme of tax relief for intangible assets is specifically structured so that it should not give rise to a net cost to the exchequer.

10.16 It is designed so that the capital allowances are ring-fenced for offset only against income arising from the management and exploitation of assets qualifying under the scheme – they specifically cannot be offset against other income. Moreover, the value of capital allowances and interest available for set-off in any accounting period is capped at 80% of the income arising so that a minimum of 20% of income must remain within the charge to tax. None of the amendments to the 2010 Act change this.

10.17 The scheme contains strong safeguards to ensure that it operates on a cost-effective and value added basis.

10.18 Notwithstanding these safeguards there may be some deadweight costs associated with the scheme to the extent that some of the capital expenditure qualifying for allowances under the scheme might have arisen in any event in the absence of such allowances. While it is not possible to quantify this, it is unlikely to be significant because of the design of the scheme and the availability of allowances in other jurisdictions.

10.19 Data on the tax relief claimed and tax forgone from the scheme, generally, will become available when corporation tax returns for accounting periods ending after the commencement date are received. Companies must indicate the amount of allowances claimed under the scheme for the relevant accounting period.

Quantification of Benefits

10.20 The scheme is expected to provide economic benefits arising from new investment and employment provided by companies (foreign-owned or indigenous) establishing intellectual property management activities in Ireland on foot of the new incentive and its promotion by IDA Ireland, and other development agencies. The scheme will help facilitate innovation arising from the exploitation of intellectual property in Ireland together with increased job creation, enhanced product development and foreign direct investment.

10.21 Given the ways in which companies exploit intangible assets in their business, it is likely that the levels of new direct employment created per project will be low but that the jobs created will be high-quality. There are also likely to be positive indirect employment spin-offs from projects as intangible assets provide a competitive edge for business and the commercial exploitation of these assets will provide a platform for Irish-based companies to expand and diversify their business interests.

10.22 The scheme is focussed exclusively on encouraging new business activities and employment from investment in intangible assets, which would be unlikely to arise in the absence of the relief. Capital expenditure on intangible assets acquired prior to the effective date of operation of this scheme does not qualify for capital allowances and the scheme is designed to ensure that any deadweight costs are minimised. Data is not available on the number of companies currently established in Ireland that are managing and exploiting intellectual property assets.

CHAPTER 11

Section 44 – Acceleration of wear and tear allowances for certain energy-efficient equipment

Description of Expenditure

11.1 Section 44 of the Finance Act 2010 adds three additional classes of technology to the scheme of accelerated capital allowances for energy-efficient equipment under section 285A of the Taxes Consolidated Act (TCA) 1997. The three additional classes are refrigeration and cooling systems, electro-mechanical systems and catering and hospitality equipment. This brings to ten the total number of technology classes covered by the scheme. Technical amendments have also been made to two of the classes covered.

Policy context

11.2 This incentive is aimed at supporting investment in new energy-efficient equipment by companies. It follows from work undertaken by economic consultants on behalf of the Sustainable Energy Authority of Ireland (SEAI) which recommended a role for Government intervention in providing supports to businesses to incentivise investment in energy-saving technologies. The incentive will assist in improving companies' cost competitiveness and should also lead to a reduction in overall energy demand and help reduce carbon emissions.

Previous legislation and details of scheme

11.3 The scheme was introduced by section 46 of the Finance Act 2008 (which inserted a new section 285A into the Taxes Consolidation Act) and provides accelerated capital allowances for capital expenditure incurred by companies on certain energy-efficient equipment purchased for use in the trade, subject to expenditure being in excess of minimum amounts as specified in the legislation. Normally, wear and tear allowances for plant and machinery are spread over 8 years at an annual rate of 12½% of the capital expenditure incurred. In the case of qualifying energy-efficient equipment, this rate is accelerated so that 100% of the allowances can be claimed in the year in which the expenditure is incurred. The scheme therefore provides an upfront cash-flow benefit deferring tax compared with standard allowances to companies.

11.4 The scheme applies to equipment within designated classes of technology in areas such as heating, lighting, electricity provision, electric motors/drives, building energy management systems, ICT, electric and alternative fuel vehicles, refrigeration and cooling systems, electro-mechanical and catering/hospitality equipment. The equipment must be included in the list of eligible equipment approved by the Minister for Communications, Energy and Natural Resources by Order and published by SEAI on its dedicated website (www.seai.ie/aca).

Duration of scheme

11.5 The scheme applies to companies only and operates for a 3-year trial period commencing 9 October 2008. However, expenditure incurred on or after 31 January 2008 on equipment coming within the three classes of technology included in the Finance Act 2008 will qualify for relief if that equipment is on the approved list**.**

Objectives of Tax Expenditure

11.6 The scheme is aimed at encouraging companies to invest in energy-efficient equipment meeting specified criteria in designated classes of technology with a view to promoting energy saving and reducing emissions in industrial and commercial operations. It is also intended that the scheme should improve the cost competitiveness of firms purchasing energy-efficient equipment specified under the scheme. The purpose of the Finance Act 2010 measure is to extend the scheme to energy-efficient equipment in three additional classes of technology so that energy savings can be achieved in sectors where such equipment is used while also improving the cost competitiveness of companies in those sectors. For example, the inclusion of refrigeration and cooling systems and catering/hospitality equipment will be of particular benefit in the hotel and catering sectors.

Options Analysis

11.7 The inclusion of the three additional classes of technology in the Finance Act 2010 follows from a recommendation in this regard from the Minister for Communications, Energy and Natural Resources in conjunction with SEAI. No other class of technology was considered.

Quantification of Costs

11.8 In Budget 2010 it was tentatively estimated that extension of the scheme to include three additional classes of technology may cost an additional €1 million in 2010 and €2 million in a full year. The scheme provides an upfront cash-flow and time-value of money benefit to companies in terms of tax saved. This benefit is at the expense of the exchequer which suffers a full 100% deduction of eligible expenditure incurred against trading income taxable at 12.5% in the first year under this scheme as compared to a deduction of one-eight of the expenditure each year over 8 years under the general scheme of wear and tear allowances for plant and machinery expenditure. Companies would get the deduction anyway but over a longer period and this explains the relatively small estimated cost. Part of the cost would also be made up of additional take-up of the scheme on foot of the improved tax incentive.

11.9 From 2009 on, companies are required to indicate the amount of allowances claimed under the scheme for the relevant accounting period. However, it will not be possible to measure the actual cost of the scheme until Corporation Tax returns for accounting periods ending in 2009 are received and processed. As the CT1 return is not filed until 9 months after the end of the relevant accounting period, it will be late 2010 when returns for that year are processed. Nevertheless, Revenue will be in a position to determine the first full year cost of the scheme, based on returns received, before the end of the 3 year trial period in late 2011.

Quantification of Benefits

11.10 The scheme is expected to provide economic and environmental benefits arising from investment by companies in specified equipment meeting energy-efficient criteria and consequential savings in energy usage and a reduction in carbon emissions. Survey data from 2008 is available. Briefly, this showed that for the technologies and suppliers surveyed, 30% of products sold were eligible under the scheme of capital allowances. Importantly, the survey found that 90% of the scheme-eligible products sold directly replaced sales of non-eligible products. However, some of these sales could include an element of deadweight i.e. some replacement sales of eligible products would have happened anyway. SEAI is currently in the process of carrying out a comprehensive survey of Irish Industry to determine the impact of the scheme, both in terms of awareness and the resulting procurement of highly energy efficient equipment. The SEAI surveys will also gather data from companies on the energy savings attributable to the equipment purchased with the aid of the scheme. The information gathered through the surveys will enable a detailed analysis in 2010 of the scheme's benefits, both in terms of energy savings and resulting CO^2 emission reductions.

11.11 This incentive is relatively new and in common with other incentives provided through the self-assessment tax system there is a considerable time-lag before details on the take-up (and thus the costs) of the scheme become apparent. Similar timing and data capture issues arise in determining the actual benefits from the scheme. Having said that, any additional cost to the exchequer will be largely cash-flow in nature to the extent that companies purchase qualifying equipment under this scheme as opposed to other equipment on which standard plant and machinery allowances over 8 years are available.

CHAPTER 12

Section 45 – Extension of relief from tax for certain start-up companies

Description of Expenditure

12.1 Section 45 of the Finance Act 2010 extends the relief from Corporation Tax for start-up companies introduced by section 31 of the Finance (No.2) Act 2008, for new companies commencing to trade in 2009, to new companies that commence trading in 2010.

Policy context

12.2 The scheme of tax relief for start-up companies was introduced in 2009 as a support to encourage new business development in the prevailing difficult economic environment. Tax relief under the scheme is for a maximum of 3 years from the commencement of a new trade to which the relief applies. In view of the continuing need to incentivise new business start-ups, it was decided to extend the relief to companies commencing trading in 2010.

Previous legislation and details of scheme

12.3 Section 31 of the Finance (No.2) Act 2008 introduced a new section 486C of the Taxes Consolidation Act (TCA) 1997 which provides relief from Corporation Tax for new companies. The tax relief applies to companies incorporated on and from 14 October 2008 that commence carrying on a new trade in 2009. Section 45 of the Finance Act 2010 extends the provisions of section 486C to new companies commencing a trade in 2010.

12.4 Under the scheme, tax exemption applies to profits of a new trade and chargeable gains on the disposal of any assets used for the purposes of a trade. The exemption is granted by reducing the Corporation Tax relating to the trade and chargeable gains to nil.

12.5 The exemption period is for 3 years from the commencement of the new trade. There is full relief on income and gains relating to the trade where total Corporation Tax liability in any of the first 3 accounting periods does not exceed €40,000. Marginal relief applies where the tax liability falls between €40,000 and €60,000. Marginal relief in the context of start-up company relief is an adjustment in the amount of tax payable by a firm whose tax liability is just over the exempt limit of €40,000 but is below €60,000. There is no relief where a company's tax liability is over €60,000 in any year of its first 3 years. Marginal relief will be given by way of a standard marginal relief formula detailed in the legislation. In short, the closer its liability is to €40,000 the greater the marginal relief a company will receive. For example, a company with a total Corporation Tax liability of €42,000 in its first year will pay Corporation Tax of €6,000 – its marginal relief will amount to €36,000. On the other hand, a company with a liability of €59,000 will pay €57,000 in tax - its marginal relief will amount to €2,000.

12.6 The maximum relief that can be availed of by a company over 3 years is €120,000 (€100,000 for companies in the transport sector – a requirement of the EU Commission's *de minimis* aid Regulations in accordance with which this scheme operates).

12.7 A company that takes over an existing trade or part of a trade carried on in Ireland by another person will not qualify for the relief in respect of the income of the trade taken over. Service companies within the meaning of section 441 of the TCA will not qualify and trades liable to tax at the higher 25% rate of corporation tax are excluded. Relief ceases where part of a new trade is transferred to a connected person.

Duration

12.8 The relief applies to new companies incorporated on or after 14 October 2008 who commence a new trade in 2009 or 2010 and is available for a period of three years from the commencement of a new trade.

Objectives of Tax Expenditure

12.9 The scheme is aimed at encouraging new business creation in the current economic downturn by providing tax relief to trading companies in the critical early stages of development.

12.10 The intention is that this incentive will encourage new entrepreneurial activities in the productive sectors of our economy and provide opportunities for increased employment in those sectors. The money that would be otherwise paid in tax can be used to help secure the business over the start-up phase and that is the benefit of the measure to those establishing a new company qualifying for this relief.

Options Analysis

12.11 Proposals were made at the Committee and Report stages of the Finance Bill 2010 that the scheme should be extended beyond corporates to non-corporate businesses and to sole traders. A recommendation to this effect is included in the Report of the Commission on Taxation. This approach was considered but not accepted on the grounds that it would not be possible to control the incentive in an appropriate way and ensure the re- investment of the tax savings in the business if the scheme was extended to the non-corporate business sector.

Quantification of Costs

12.12 The Revenue Commissioners have estimated that the total cost of the 2010 Finance Act amendment to the scheme will be €15 million over the three year period. The Revenue Commissioners estimate is based on an assessment of the tax returns for 7,663 start-up companies with relevant tax liabilities if any in the range €0 to €40,000 for 2006. It has not been possible to ascertain the figures for the actual relief claimed by start-up companies in 2009 (the year the relief was first introduced), as the tax returns for 2009 are not yet available.

12.13 Notwithstanding the above, the cost of the scheme will vary in accordance with the impact of economic conditions on the number of start-up companies and company profitability. It is considered that the prospects for the latter (company profitability) would be worse over the period of the extended scheme than when the scheme was first announced in 2008 for companies commencing a new trade in 2009.

Quantification of Benefits

12.14 New company registrations and companies registering for tax purposes with the Revenue Commissioners in the period October 2008 to October 2009 have fallen compared to the previous year (CRO registrations are down 16% while numbers registering with Revenue are down 19% compared to the same period in 07/08). This occurred over a period of deepening recession. To the extent that the relief from tax supports companies in their start-up phase, it has the potential to help their survival in these difficult circumstances.

12.15 Examining the CSO *Business Demography* survey data for employment by start-up companies[27] offers some insights into the potential employment benefits of this scheme. 10,354 companies were created in 2006 and survived into 2007 according to CSO data (these are the most recent years for which data are available). 10.16 In their first year (2006), these companies employed 17,926 people and in their second year (2007) employed 35,360 people. This suggests that, on average, each start up company that survives employs 1.73 people in its first year and 3.42 people in its second year.

12.16 The goal of this scheme is to sustain employment in newly created companies. Available statistics show that in the period 14 October 2008 (when the scheme was announced) and April 2010, close to 12,500 companies were registered with the Revenue Commissioners for the first time for tax purposes. On an annualised basis, this level of registration would suggest a figure of about 8,000 new tax registrations for companies for 2010. For illustrative purposes, if it was assumed that 5% of companies registering for tax purposes in 2010 were in a position to avail of the relief from tax for start-ups, this would amount to 400 companies. Assuming the same employment patterns hold as indicated from the CSO data for 2006 and 2007, if the scheme assists about 400 companies to survive through the first year of their existence, it would be helping to support about 700 jobs.[28] Similarly, if those 400 companies survive into their second year, there would be close to 1,400 jobs[29] sustained at least in part by this measure. This example is purely illustrative of the potential employment benefits from this scheme.

[27] The CSO defines a new enterprise birth as "the creation of a combination of production factors with the restriction that no other enterprises are involved in the event. Births do not include entries into the population due to mergers, break-ups, split-off or restructuring of a set of enterprises. It does not include entries into a sub-population resulting only from a change of activity. A birth occurs when an enterprise starts from scratch and actually starts activity. An enterprise creation can be considered an enterprise birth if new production factors, in particular new jobs, are created. If a dormant unit is reactivated within two years, this event is not considered a birth.

[28] 400*1.73 = 692 jobs.

[29] 400*3.42 = 1,368 jobs.

CHAPTER 13

Section 46 - Unilateral Relief (Royalty Income)

Description of Expenditure

Background

13.1 Double taxation can arise where a person who is resident in Ireland has income arising in another country. The income may be taxed in that other country because it is sourced there. It will also be taxable in Ireland as part of the person's worldwide income.

13.2 Tax treaties are designed to prevent double taxation. They do this by allocating the right to tax particular types of income between the two countries concerned. This might involve one of the countries having the sole right to tax income. An alternative approach is that both of the countries would be entitled to tax the income but tax paid in the source country would be credited against the tax payable on that income in the residence country. Many countries adopt this approach in relation to royalty payments.

13.3 In certain cases where Ireland does not have a tax treaty in place, relief is given unilaterally under Irish law (unilateral credit relief (UCR) is already available in respect of foreign taxes on dividends and on interest which is taxed as trading income). This involves giving credit for tax suffered in the source country against Irish tax on the income concerned.

13.4 Double taxation relief is seen as part of the benchmark tax system. Based on past experience the provisions in section 46 will not be withdrawn in the future.

13.5 Unilateral relief in respect of foreign tax on royalties is currently available to companies entitled to the 10% Corporate Tax Manufacturing regime[30]. This regime expires at the end of 2010.

Description of the Finance Act Measure

13.6 Section 46 of the Finance Act 2010, in providing for double taxation relief in respect of foreign tax on royalty payments received by Irish companies from persons resident in jurisdictions with which Ireland does not have a Double Taxation Agreement, retains the existing relief for manufacturing companies

[30] Section 449 TCA 1997

and extends the scope of the relief to all trading companies and in respect of all royalties.

13.7 The legislation classifies royalties as payments in respect of

- copyright of literary, artistic or scientific work, (this includes cinematograph films and software);
- patents;
- trade marks;
- designs or models;
- plans;
- secret formulae or processes, or
- information concerning industrial, commercial or scientific experience.

13.8 The majority of royalty payments into Ireland from non-treaty countries are in respect of software.

Objective of Tax Expenditure

Reasons for introduction of measures

13.9 Relief from foreign withholding taxes on royalties is a key issue for software and other companies which have royalty flows from the country where their product is sold or licensed. Withholding tax is applied to many royalty payments and can impose a much greater burden than corporate tax as it is imposed on turnover rather than profits. Countries typically impose withholding taxes of between 10 and 30 percent on royalties and these rates are generally reduced under tax treaties. The provision removes barriers to Irish companies conducting business with persons resident in non-treaty countries where withholding taxes apply to royalties.

13.10 Many other countries (e.g. UK, Germany, Denmark, Portugal) grant unilateral relief. Other countries use different methods to grant similar relief. Numerous representations have been made by software companies to the effect that Ireland is not getting business because it did not provide this relief and it was available elsewhere. In addition, Forfás and the Commission on Taxation both made recommendations in favour of the extension of unilateral credit relief for royalties.

13.11 Unilateral relief in respect of foreign tax on royalties is currently available to companies entitled to the 10% Corporate Tax Manufacturing regime [31] in respect of withholding taxes on such income from non-treaty countries. However, this entitlement will cease on 31 December 2010 as part of the ending of the 10% Corporate Tax Manufacturing Regime. It is estimated that 53 companies availed of unilateral credit relief under this regime in 2007.[32]

13.12 For equity and EU requirements (State Aid rules would prevent extension of the relief to only one sector), it was considered appropriate that unilateral credit relief be extended to such companies also.

Options Analysis

13.13 There were three possible options:

- Do nothing and allow unilateral relief for royalties from companies currently getting it under the 10% regime to be withdrawn when the regime expires at end-2010;
- Extend unilateral credit relief for royalties for those companies currently availing of the 10% regime only;
- Extend unilateral credit relief for royalties to all trading companies.

13.14 Forfás and the Commission on Taxation both considered the importance of the unilateral credit relief measure to the software sector in Ireland and came to the conclusion that its retention was merited in order to support the continued expansion of this important sector.

Quantification of Costs

13.15 It is estimated that the additional cost[33] of *extending unilateral relief,* beyond the companies currently availing of the 10% Corporate Tax Manufacturing regime, is circa €1.5 million. This estimate is based on 2006 data. It is considered that the equivalent figure for 2010 would not be greater than this. It is difficult to estimate the number of companies currently paying tax which will avail of this relief. The number of cases in Large Cases Division in Revenue is

[31] Section 449 TCA 1997.
[32] This is based on the assumption that the companies that claimed manufacturing relief and also credit for foreign tax had income from both treaty and non-treaty countries. Source: Revenue Commissioners.
[33] Forfás estimate based on a number of assumptions, including no change in behaviour and that the current levels of royalty receipts would be maintained.

approximately 25 [34]. It might be reasonable to assume a similar number for the other regions combined.

13.16 The cost, in terms of tax forgone, *of maintaining unilateral relief* for companies under the 10% regime, was estimated to be circa €4.2 million [35], based on 2006 figures. This figure does not take into account the fact that the activities of some companies may have been curtailed had the relief not been retained. However, it was considered inappropriate to limit the extension of UCR to the companies that already have it under the manufacturing regime in the light of EU considerations with the result that the €1.5 million cost represents the actual additional cost of this measure.

13.17 This €1.5 million cost represents deadweight (companies not currently getting UCR that are operating anyway).

13.18 Compliance and administrative costs relating to this provision would appear be negligible.

Quantification of Benefits

13.19 It is envisaged that the availability of unilateral relief will assist in maintaining the competitiveness of the software industry in Ireland and may help to attract new business over time. While it may not be a make or break issue for companies making investment decisions, it is considered to be an important factor nonetheless.

13.20 Given the importance of the software industry, in terms of employment etc, it was considered that the benefit of keeping the unilateral relief in terms of maintaining the competitiveness of companies outweighed the costs of the measure.

13.21 Due to State Aid and equity issues, it would not have been possible to limit the extension of the credit relief to companies who are currently being taxed at ten percent. Hence the decision to extend it to all trading companies at an estimated additional cost of €1.5 million.

[34] Source: Revenue Commissioners

[35] Forfás estimate based on a number of assumptions, including no change in behaviour and that the current levels of royalty receipts would be maintained.

13.22 It is difficult to quantify the benefits of the measure when it is just one of a number of factors that encourage investment in the software industry in Ireland. However, it is worth noting the importance of the sector. The 2008 CSO figures on *Services Exports and Imports* shows exports of computer services (the bulk of which is thought to be software) of €23.3 billion. The CSO *Annual Services Inquiry 2007* estimates that 18,674 people were employed in the software consultancy and supply sector in 2007. More recent data from the Forfás *Annual Employment Survey 2009* reports that the numbers employed in computer programming have stayed stable in the last three years and that 18,724 were employed in this sector in 2009.

CHAPTER 14

Section 50 – Taxation of foreign dividends received by Irish resident companies

Description of Expenditure

14.1 Section 50 of the Finance Act, 2010, deals with three issues relating to the taxation of foreign dividends. The section provides (i) for the extension of the 12.5% Corporation Tax rate to dividends paid out of the underlying trading profits of companies resident in non-treaty countries where the paying company is owned directly or indirectly by a quoted company, (ii) simplifies the rules for identifying the underlying trading or non-trading profits out of which dividends are paid for the purposes of determining the rate of tax to be applied to those dividends (12.5% trading or 25% non-trading as the case may be) and (iii) exempts from corporation tax certain foreign dividends that form part of the trading income of a company.

Policy context

14.2 The various changes provided for by Section 50 are designed to enhance and simplify the tax treatment of foreign dividends received by Irish resident companies. The changes, variously, will help make Ireland more attractive as a location for the Head Office operations of foreign multi-nationals, simplify existing cumbersome arrangements for the tax treatment of foreign dividends, depending on whether they are sourced from trading or non-trading profits and put the tax treatment of foreign dividends received as trading income by companies investing in share holdings of less than 5% on the same footing as the treatment of Irish-sourced dividends. The changes will improve the position of Irish companies with foreign investment interests.

Previous legislation and details of changes

14.3 As regards the extension of the 12.5% rate to certain foreign dividends, section 21B of the Taxes Consolidation Act 1997 previously restricted the application of the 12.5% rate to foreign dividends received by an Irish resident company, which are paid out of the trading profits of a company resident in an EU Member State or in a country with which Ireland has a tax treaty. Dividends paid out of other profits, which would include trading profits arising in a non-treaty country, were taxed at the 25% rate. Section 50 of Finance Act 2010 extends the 12½% rate to dividends paid out of trading profits of companies resident in non-treaty countries. However, in the case of most non-treaty countries there is no equivalent system to the “exchange of information” articles in treaties. With a view to ensuring that information will be available so the section can function as intended, this provision is restricted to dividends paid by quoted companies and subsidiaries of quoted companies.

14.4 Regarding the simplification of rules for identifying the underlying profits out of which foreign dividends are paid for the purposes of applying the appropriate tax rate, the position has been that where a dividend is paid partly out of trading profits and partly out of other profits then apportionment is required. Dividends paid up through a group are treated as trading profits in so far as they can be traced through one or more layers of dividends to a trading profits source. In this way, when a foreign dividend is ultimately received by a company within the charge to Corporation Tax in Ireland, trading profits of lower tier companies are recognised in determining the proportion of the dividend paid out of trading profits.

14.5 This apportionment must be traced back if some of the trading income was itself received in the form of dividends from another company. In the context of multinational groups which hold trading companies through tiers of holding companies, given that such holding companies can earn a combination of different incomes and gains, it had been noted that the requirement to apply dilution at every holding company level could unduly limit the ability to obtain the benefit of the 12.5% rate of tax on dividends that originated with trading subsidiaries.

14.6 Section 50 provides that once a dividend is identified by the paying company as paid out of specified profits (which could be trading or non-trading profits), the rate of tax will be determined by reference to the trading or non-trading nature of those specified profits. This provision represents a significant simplification to the taxation of foreign dividends.

14.7 On the issue of foreign dividend income of Irish companies from portfolio investment, the gross amount of dividends received from resident companies (referred to as Franked Investment Income) is exempt from Corporation Tax, while the attributable expenses are deductible in arriving at taxable trading income. Prior to Section 50 Finance Act 2010, foreign dividends were included and the attributable expenses were deducted in calculating trading income, with the credit for foreign tax being available against the Corporation Tax payable on the *net* measure of Irish income. Essentially, the exemption system applied to Franked Investment Income which operated on a "gross" basis, leaving the attributable expenses to be set off against other income, while the credit system applied to foreign dividends operated on a "net" basis.

14.8 Section 50 provides that foreign dividends from portfolio investments (that is, holdings of less than 5%), which form part of trading income of a company, will be exempt from Corporation Tax in the same manner as Irish dividends are exempt.

Duration

14.9 Section 50 applies to dividends received on or after 1 January 2010. There is no future termination date to the revised treatment of the foreign dividends provided for by this provision.

Objectives of Tax Expenditure

14.10 Multi-national companies may have various holding company structures in separate jurisdictions for different reasons.

14.11 The objectives of the amendment introduced by section 50 are:

- to make Ireland more attractive as a location for the Head Office operations of multinational companies;
- to reduce the compliance burden on companies by simplifying the arrangements required in identifying the foreign profits out of which the foreign dividends are paid;
- to introduce equity in the tax treatment of specific foreign dividends arising from portfolio investments.

14.12 The objective of the extension of the 12.5% rate to foreign dividends received out of trading profits of companies located in non-treaty countries is to increase the attractiveness of Ireland as a location for holding company operations of multi-national companies. Such holding company arrangements can lead to the downstream location of other activities of multi-nationals in Ireland with the potential for increased employment and substantive activity here.

14.13 The other changes introduced by section 50 are designed to simplify administrative arrangements for businesses and to introduce equity in the treatment of specific foreign dividends arising from portfolio investments.

Options Analysis

14.14 The only other options considered were not to make the changes provided for by Section 50. This approach was rejected in favour of the changes made.

Quantification of Costs

Extension of 12.5% rate treatment to dividends from non-treaty countries paid out of trading profits

14.15 There is no breakdown available to the Revenue Commissioners of the foreign dividends received by Irish companies and up to now liable to tax at 25% which relate to trading income and what proportion of such trading income would be paid by way of dividend by quoted companies or their subsidiaries. Moreover, since credits for foreign tax in respect of all foreign income (dividends, interest, branch income and so on) are aggregated on tax returns, it is not possible for the Revenue Commissioners to identify the credit for foreign tax associated solely with foreign dividends.

14.16 However, it is estimated that the additional cost of reducing from 25% to 12.5% the rate of tax applicable to foreign dividends paid out of trading income received from non-treaty countries will not be significant for the following reasons:

- as appropriate credit will be given against any Irish tax due, for foreign tax paid in relation to the dividend income, it is only where the foreign tax suffered is lower than the Irish tax rate that the prospect of additional Irish tax being due and paid would arise;

- where a holding company here receives dividends from both high and low tax jurisdictions, tax credit "pooling" rules allow excess foreign tax credits to be set-off against Irish tax which would otherwise be due on foreign dividends received;

- where, under the previous 25% tax rate arrangements for trading profit dividends received from non-treaty countries, a holding company here would either have had to pay significant additional Irish taxes on affected foreign dividend income or would not have had sufficient foreign tax credits to minimise that liability, it is unlikely that such dividends would have been paid to a holding company here in the first place.

14.17 An analysis by the Revenue Commissioners of a sample of cases with foreign dividends totalling €250 million showed that the liability to corporation tax on those dividends, after taking account of the credit for foreign tax, was close to nil. While the relief afforded by section 50 may be considered significant by some individual companies, this analysis supports the estimate that the overall cost to the Exchequer of the relief provided for in section 50 of the Act will be small.

Rules for identifying the underlying profits

14.18 Identifying the profits out of which a dividend is paid, particularly where the profits arise in subsidiaries is complex. Section 50 simplifies the process somewhat and was introduced to reduce the compliance burden on companies. Data necessary to estimate the difference in yield between the previous and new methods are not picked up on Tax Returns. It is not expected that the cost in tax forgone would be significant.

Dividends forming part of the trading income of a company

14.19 It is not possible to identify the companies here as such dividends are included as part of trading receipts and do not appear separately on a Tax Return. Dividends that are treated as trading receipts occur in very limited circumstances (mainly non-life insurance companies) and the cost in terms of Irish tax forgone would not be significant.

Quantification of Benefits

14.20 The extension of the 12.5% Corporation Tax rate to certain dividends paid out of trading profits received by Irish companies from non-treaty countries was undertaken to enhance the attractiveness and competitiveness of Ireland as a location for the holding company operations of multi-national companies. Apart from giving rise to employment in their own right, holding company operations here can give rise to further opportunities to attract additional high-value or employment-intensive activities of multi-national company groups to Ireland. The other changes introduced by Section 50 reduce the cost of compliance on affected companies and the costs of doing business in Ireland.

14.21 The changes introduced by Section 50 have the benefit of increasing the attractiveness of Ireland from the point of view of foreign investment and from the perspective of reducing the cost of doing business in Ireland. These benefits are considered to outweigh the cost of Irish tax forgone on certain foreign dividends, which is unlikely to be significant.

CHAPTER 15

Section 52 – Leasing Provision - Amendment of Section 80A of the Taxes Consolidation Act 1997

Description of Expenditure

Policy Context

15.1 Tax legislation permits leasing companies and other traders to claim a “wear and tear” allowance instead of depreciation on plant and machinery used for the purposes of their business. This wear and tear allowance (capital allowance) is granted at the rate of 12.5% over 8 years regardless of the actual rate of wear and tear on the asset. This causes problems, in particular for leasing companies, because there may be a mismatch between the period in respect of which lease income is earned and the period over which a wear and tear allowance may be claimed. For example, where a lessor leases an asset which has a useful life of 3 years, that person’s rental income and accounting depreciation will be spread over the 3 years. However, the capital allowances due on the asset must be calculated over an 8 year period. The result is that the taxable profits are higher than the accounting profits for the period in which the income is earned.

Previous Legislation

15.2 Section 80A of the Taxes Consolidated Act (TCA), 1997 was introduced in 2004 in order to resolve this mismatch in the case of finance leases [36]. In such cases, the section allows a lessor to elect to forgo capital allowances on the asset and instead to be taxed on the interest element only (this represents the profit on the transaction) of the lease payment. This means that the company is taxed on its actual accounting profits from the lease. It is important to note that the overall amount of tax relief given is the same as under the 8-year capital allowances regime but it is given over a shorter period of time, corresponding to the life-span of the asset, thus giving a benefit in terms of cash-flow.

Effect of new legislation

15.3 Section 52 enables a lessor of short life assets held on operating lease to elect to claim the wear and tear allowance (capital allowance) due in respect of those

[36] A finance lease is a lease that transfers all the risks and rewards of ownership of an asset to the lessee. It is presumed that such a transfer will have occurred if at the inception of the lease, it is anticipated that the total value of lease payments over the term of the lease will equate to 90 per cent or more of the fair value of the asset.

assets at the rate at which the assets are depreciated in the accounts instead of at the 12.5% (8-year) rate. This:

- resolves the mismatch between the rental income brought into charge and the allowance for wear and tear on the asset and

- reconciles the accounting and tax profits.

15.4 In order to eliminate cash flow costs to the exchequer the new treatment applies only to increases in the asset portfolio of the lessor over a "threshold amount". This threshold amount equals the total value of short life assets held by the lessor at the end of the accounting period preceding the change to the new treatment. The effect of this is that the amount of wear and tear allowance granted at the higher rate (i.e. over a shorter period than the 8 years) is restricted to increases in the portfolio of assets held.

15.5 Where the new treatment applies, a lessor is not entitled to set losses made from the leasing of other (long life) assets against the profits earned from the leasing of short life assets.

Conditions of Scheme

15.6 In order to avail of the new treatment, a lessor must make a claim to have the section apply.

Method of application

15.7 The lessor must submit a claim to the inspector of taxes to have the treatment applied. The claim must be submitted at the same time as the tax return for an accounting period. Where such a claim is made, the new treatment applies as respects expenditure on leased assets incurred on or after the date on which the accounting period begins.

Duration of scheme

15.8 There is no time limit on the application of the legislation.

Objective of Tax Expenditure

Reasons for introduction of measure

15.9 Cross-border leasing of short-life assets is a significant industry that initially became established under the IFSC regime. The availability of 100% capital allowances in Year 1 (under the IFSC regime), combined with our strong reputation in the related aircraft leasing field, encouraged a number of large multinationals to use Ireland as a base for their small-ticket leasing operations. A recent industry survey estimates that there are currently 435 people directly employed in the sector.

15.10 The objective of the measure is to increase the competitiveness of the cross-border leasing industry in Ireland and to address the bias in the tax code which favoured the use of finance leases over operating leases.

Options Analysis

15.11 As described above, the tax treatment of finance leases was changed in Finance Act 2004 in order to increase Ireland's attractiveness as a centre for cross-border small-ticket leasing operations. The inclusion of operating leases was not considered at that time. However, the use of operating leases has become increasingly important in the intervening period due to the economic downturn and for accounting reasons.

15.12 There are equity and tax neutrality arguments in favour of addressing the bias in the tax code which favoured finance leases over operating leases. In addition, the opportunity to improve the competitiveness of the sector was also an objective. The key issue to be addressed was the cash-flow cost of the measure to the exchequer.

15.13 Take an example of a lessor, with a portfolio of assets worth €10 million: The assets typically have a lifespan of 3 years and are replaced at the end of their lives so the portfolio remains at a constant €10 million. It is contended that lessors are reluctant to expand their portfolios because, for the first 3 years in the life of the asset, they will be paying tax on profits they have yet to make due to the mismatch between the capital allowance (1/8th of €10 million) and the actual depreciation on the assets (1/3rd of €10 million). This mismatch is balanced out in year three as a balancing allowance (representing the unused capital allowance) which is paid out by Revenue upon sale/scrapping of the asset. Where a lessor maintains his portfolio in such a "steady state", the annual capital allowance (€10 million x 1/8th = €125,000) plus the balancing allowance on the 1/3rd of the portfolio disposed of (€10 million x 5/8th x 1\3rd = €208,333) is equal to the annual depreciation on the portfolio (€10 million x 1/3rd = €333,333).

15.14 When an asset is scrapped at the end of year 3, the lessor will only have claimed 3/8ths of the capital allowance due on that asset and so is given a balancing allowance by Revenue in respect of the 5/8ths unused capital allowance. If the new tax treatment were to be extended to all operating leases, an existing lessor would be getting the new treatment for new assets (capital allowance equal to depreciation) but would remain on the old system for old assets. Therefore the balancing allowances paid out by Revenue on old assets would no longer be compensated for by accelerated tax on new assets.

15.15 In order to establish the cost to the exchequer, it was necessary to make an estimate of the size of the balancing allowances that would fall due. It was estimated using information provided by industry, that the short life operating lease portfolios of the international lessors was approximately €1 billion. On the assumption that the assets have an average useful life of 3 years and are disposed of on average every 3 years this implies these companies have a deferred tax asset of approximately €78m[37] which would be encashed over 3 years following the change in tax treatment. This cost would be offset to a certain extent by the tax payable under the new regime on the profit from the leases.

15.16 In order to eliminate this potential cost, it was decided to limit the new tax treatment to increases in the asset portfolio of the lessor only. This means that unless the lessor increases his portfolio above its current size which is called the "threshold amount" – he cannot claim the new tax treatment. Where a lessor increases the size of his portfolio, he can benefit from the new tax treatment in respect of the value of assets in excess of the "threshold amount" only. The value of assets represented by his existing portfolio continues to be taxed under the capital allowances regime thus eliminating any cost to the exchequer but giving an incentive for new business.

Quantification of Costs

15.17 The measure only applies in respect of additional assets over and above existing portfolios. There is, therefore, no cost in terms of tax forgone.

15.18 Even in relation to new business to which the measure will be beneficial – the benefit is only a cash-flow benefit (when compared to the 8-year capital allowances regime) rather than a permanent transfer of resources from the State.

[37] €1bn asset portfolio x 5/8ths (balancing allowance representing unused capital allowances) x 12.5% CT rate.

15.19 The number of beneficiaries qualifying will depend entirely on expansion of business in the area. There are currently 10 companies engaged in this business at the moment with an estimated €1 billion in assets. These companies will only benefit from the new measure to the extent that they increase their portfolio of assets.

15.20 There may be a certain level of compliance cost for industry as the threshold system is quite complex.

Quantification of Benefits

15.21 The success achieved by Ireland in attracting the vast majority of the major aircraft lessors to establish businesses here gives an indication as to the potential impact the proposed amendments could have. It is estimated that approximately 35% of all the aircraft leased in the world are leased from Ireland[38].

15.22 The majority of the workforce currently employed by the aviation leasing industry in Ireland are highly skilled and highly paid individuals who represent a significant Income Tax source for the Irish exchequer. The 2008 FAEI Cross Border Leasing Survey showed that the average annual salary of an individual employed in the aircraft leasing industry in Ireland was €111,956 with 60% of the employees earning greater than €100,000 per annum. The short life asset leasing industry tends to be engaged in a high volume of small and medium ticket transactions and is therefore more labour intensive than the aviation leasing industry.

15.23 It is conservatively estimated that there are approximately 50,000[39] people directly employed worldwide in the short life leasing business. The 2008 cross border leasing survey estimated that only 435 of these employees are based in Ireland. If even 1% of these jobs were to move to Ireland, over 800 additional jobs could be created (500 direct and 333 indirect - the incremental indirect employment is largely in professional services such as accountancy and legal).

[38] Derived from 2008 FAEI Cross Border Aircraft Leasing Survey.
[39] These additional job estimates are taken as a % of the current estimate of 50,000 of short life leasing jobs worldwide. The 50,000 estimate is arrived at by using the European estimate of 11,000 grossed up to a worldwide figure using the latest Europe GDP figures as a % of the worldwide GDP figures. The indirect jobs numbers use the ratio of direct: indirect jobs for small ticket lessors found in the IAF 2008 Cross Border Leasing Survey.

Existing Lessors

15.24 The majority of the short life asset lessors currently operating in Ireland were contacted by the Clearing House Banking and Treasury Tax Subgroup and asked directly what impact the measure may have on their business. They indicated that the introduction of the proposed amendments to Section 80A would result in an expansion of their short life leasing operations in Ireland. It was estimated that the 435 strong workforce currently employed in Ireland in the short life leasing sector could increase by 200 within a few years of the introduction of the proposed amendments. As set out above, it is expected that the vast majority of jobs created would be highly skilled and highly paid jobs. A similar percentage increase in indirect employment could result in an additional 133 jobs created in the indirect sector.

15.25 In addition, they were of the view that the introduction of the amendments could save up to 100 back office jobs in the leasing companies currently established in Ireland which would be otherwise lost, due to the static nature of the lease portfolios here.

Incremental Employment

15.26 It is expected that the proposed changes would have a positive impact on employment within the leasing sector in Ireland both in terms of the leasing companies currently established in Ireland and the larger European and worldwide leasing companies who have no presence in Ireland.

15.27 Even if only 1% of the jobs available worldwide were to move here it could result in an additional 833 jobs in Ireland.

15.28 Thus, the total combined positive employment effect (among existing lessors and new entrants) if 1% of the world's short life leasing business was to move to Ireland could be 1,166[40].

Exchequer Impact

15.29 It is estimated that there is approximately €2.85 trillion of short life assets held by leasing companies worldwide. If 1% of the assets were moved to Ireland, it is expected that an additional €215 million per annum in taxes could be generated (€178 million in corporate tax revenues and €37 million in personal taxes). These revenues would be supplemented by other taxes on amounts

[40] 50,000*1% = 500 (new entrants) + 333 indirect jobs (66%) = 833 + 200 (existing lessors) + 133 (indirect) = 1,166. For the purposes of analysis, this total does not take into account shadow cost of labour considerations which could reduce the overall benefits.

spent in the economy. The industry generates a large amount of additional economic activity including inbound and outbound business travel, conferences and spin off projects.

15.30 The corporate tax numbers are based on the assumption that companies will earn a margin of 5% per annum on their assets and pay tax at 12.5% on this margin. The personal revenue increase is based on the assumption that a total of 1,166 additional jobs will be created each of which will contribute €31,714[41] in personal tax per annum.

15.31 Any profitable lease portfolios which move to Ireland on the back of the proposed amendments should be in a tax payable position immediately.

15.32 It was considered that the combination of positive factors:

- it was possible to introduce this measure at no cost to the Exchequer;
- tax treatment was already in place for finance leases, and
- potential exists for expansion of the small ticket leasing industry,

outweighed any potential negative factor and so the measure was introduced.

[41] This individual tax number is sourced from the responses received for the IAF 2008 Cross Border Leasing Survey.

CHAPTER 16

Section 54 – Research and Development (R&D) tax credit

Description of Expenditure

16.1 Section 54 of the Finance Act 2010 amends section 766 of the Taxes Consolidation Act (TCA) 1997 which provides for a tax credit of 25% of incremental expenditure on certain research and development (R&D) activities over such expenditure in a base year 2003 - defined as the “threshold amount”. Under previous legislation the threshold amount included all group R&D expenditure in 2003, even expenditure incurred in respect of R&D centres which had since closed down. Section 54 provides a measure of relief in a situation where a company group operated two or more research and development centres in separate geographical locations in 2003, and subsequently closes down one of those centres on a permanent basis.

Policy context

16.2 The R&D tax credit scheme was introduced in 2004 as an incentive to foreign-owned multinational companies to increase investment in R&D in Ireland and to encourage indigenous companies to increase the level of spending on R&D. The scheme was introduced in the context of low levels of R&D intensity in high technology manufacturing sectors and an identified need to increase the overall level of business expenditure on R&D (BERD).

Previous legislation and details of scheme

16.3 The scheme was introduced in the Finance Act 2004 and has been enhanced by provisions in most Finance Acts since then. A credit of 25% of the incremental spend on R&D can be offset against a company’s Corporation Tax (CT) liability or carried forward for offset against future CT liabilities. Options have been introduced to allow companies to set off unused tax credits against their previous year’s Corporation Tax payment, if there is insufficient corporate tax liability in the current year, thereby creating a tax refund. If an unused tax credit still remains, companies have a further option to have the remaining unused amount paid to it by Revenue over a 3 year period. Where a company is a member of a group, the scheme works on a group basis. In this case, group incremental expenditure qualifies for the credit which can then be used to reduce Corporation Tax liability of members of the group. It is considered that an incremental tax credit is preferable to a volume-based credit in that it lessens the dead-weight expenditure qualifying for the credit and encourages increases in R&D expenditure, which is the policy aim behind the incentive. Expenditure on buildings used for R&D operates on a volume-based system and a credit of 25% of the cost of such capital expenditure is available.

Specific Finance Act 2010 amendments

16.4 The intention is to facilitate companies which need to restructure in order to continue to operate in Ireland, albeit on a scaled-down basis. The base year R&D expenditure provisions against which additional R&D expenditure is measured under the scheme for the purpose of the tax credit, presents difficulties for company restructuring: The inclusion of R&D expenditure in the base year in respect of centres which have since closed, increases the cost base, prevents a company group benefiting from the tax credit, and puts the remaining R&D employment at risk.

Duration of the scheme

16.5 The Section 54 amendment applies to all relevant periods commencing on or after 1 January 2010. The R&D tax credit scheme, generally, does not have a termination date.

Objective of Tax Expenditure

16.6 The objective of the 2010 Finance Act amendment is to provide an opportunity for a company group to be able to continue some of its R&D and perhaps other activities in Ireland in a situation where it might otherwise decide that it cannot do so.

Options Analysis

16.7 The only other option to the section 54 amendment was to leave the existing arrangements in place in which case a company group making a decision to close down one of its R&D centres would continue to be burdened by the inclusion under the R&D tax credit scheme of the previous R&D expenditure of that centre in the base expenditure (threshold amount) used to benchmark increased R&D expenditure under the scheme. This may have acted as a disincentive to carry out further R&D or to retain the remaining R&D activities here.

16.8 There have been calls over the years for the complete removal of the 2003 base year expenditure requirement. This would turn the tax credit scheme from one which rewards incremental or additional expenditure into a scheme under which every EURO of R&D expenditure is subsidised by the tax system, including levels of R&D that were previously undertaken up to 2003 (and subsequently) without the need for a fiscal stimulus. This option has not been accepted on the grounds of the significant deadweight cost to the exchequer. Such a move would represent poor value for public expenditure, especially in the current environment. In any event, changes made to the scheme in recent years, in particular the permanent setting of 2003 as the base year will mean that the scheme will, over time, become volume-based in effect.

Quantification of Costs

16.9 The 2010 Finance Act amendment to the scheme is not an additional incentive but rather a safeguard to protect some element of R&D activities and employment here in circumstances where two or more R&D centres of a company group exist in separate locations and one is being irrevocably closed down. In the absence of the amendment, access to the benefits of the R&D tax credit scheme by the remaining Irish R&D facilities could be closed off or reduced, putting the continued existence of such facilities also at risk. The tax forgone arising from the amendment is estimated to be minimal because the provision will only arise in very specific circumstances and because in most cases it is not envisaged that a claim made by a group company under the new rules would significantly exceed the claim made in the previous year. It is possible that the new claim may well be less than the claim made for the prior year.

Quantification of Benefits

16.10 The benefits from the specific Finance Act 2010 measure relates to safeguarding remaining R&D employment and activity in situations were separate facilities exist within a company group and one of those facilities is closed down. The measure retains remaining employment and R&D activity in circumstances where they would otherwise be under increased risk or also closed down. In facilitating continued access to the R&D tax credit scheme in these circumstances, the measure maintains the potential for new projects and employment in an improved economic environment. While, as stated, the expectation and intention is that this provision will not need to be widely availed of, a threat to at least 650 direct jobs has been significantly reduced by the introduction of this measure.

16.11 The 2010 Finance Act amendment is critical to maintaining employment and activities in the circumstances outlined above. It also allows affected companies here to carry out necessary restructuring during periods of economic pressure but to remain competitive in an R&D context to attract funding and projects.

CHAPTER 17

Section 55 – Withholding tax on outbound patent royalty payments

Description of Expenditure

17.1 Section 55 of the Finance Act 2010 provides an exemption from Irish tax on patent royalty payments made for bona fide commercial reasons (and subject to other conditions) by an Irish company to a company resident in another EU State or in a State with which Ireland has a tax treaty.

17.2 In a large number of cases covered by this exemption, tax exemption is already provided. Some 23 out of 48 double taxation treaties in force exempt outbound patent royalties from source country taxation. Of the 25 treaties that permit source taxation, 13 are with other Member States of the EU where it would be expected that the Interest and Royalties Directive would exempt flows of patent royalty income between associated companies from withholding tax.

Policy context

17.3 The exemption provided in section 55, while not significant in itself add to the suite of incentives introduced and enhanced over the years with the aim of facilitating the growth of the knowledge economy (e.g. the R&D tax credit scheme and the scheme of tax relief for acquiring intangible assets). It will encourage companies to exploit foreign intangible property such as patents to their benefit because of the lower costs involved.

Previous legislation and details of the scheme

17.4 Royalty payments made from Ireland to non-resident persons are generally subject to Irish tax. The liability of the non-resident payee is collected through a withholding tax obligation on the person making the payment to deduct tax at the standard rate of Income Tax (20%). Generally the royalty payments that are subject to the withholding tax are patent royalties (section 237(2) TCA). Other royalties, such as copyright royalties, are generally not subject to withholding tax.

17.5 There are, however, many cases where patent royalties paid to non-residents are not subject to Irish tax. The EU Interest and Royalties Directive provides that royalty payments paid by a company of one Member State to its (25%) associated company in another Member State may not be subject to tax in the paying State. Tax treaties may also exempt or substantially reduce the rate of tax. Just less than half of Irish tax treaties provide for source state exemption of royalty payments.

New Scheme

17.6 Section 55 removes the Irish tax charge on outbound royalties where the conditions of the section are met and it allows the qualifying royalties to be deducted for Irish tax purposes as charges, notwithstanding that no withholding tax has been charged. The following conditions must be met: The recipient of the royalty income must be resident for tax purposes in another EU Member State or a State with which Ireland has a tax treaty. The other State must impose a tax that generally applies to royalties receivable by companies resident in that state from sources outside it and the payment must be made for bona fide commercial reasons and not for tax avoidance purposes. Furthermore, the recipient company must not be carrying on a trade or business in Ireland with which the royalties are connected.

17.7 By having the exemption included in the domestic tax law as distinguished from tax treaties it removes the administrative burden on the taxpayer to make specific claims (where exemption would have been previously available under a tax treaty).

Duration of scheme

17.8 There is no termination date.

Objectives of Tax Expenditure

17.9 The objective of the measure is to remove Irish taxation on patent royalties paid by Irish resident companies to companies resident in another EU Member State or a State with which Ireland has a tax treaty. Only patent royalties were generally subject to Irish withholding tax.

17.10 The exemption will make it more attractive for foreign multinational companies to establish affiliates in Ireland using patents licensed from their foreign affiliates, where exemption under the EU Interest and Royalties Directive or under the relevant tax treaty would not apply. Even where exemption would have applied under the relevant tax treaty, the domestic law exemption removes the administrative burden of making a formal tax treaty claim.

17.11 The measure will also lower the cost for Irish indigenous business using foreign patents that would not qualify for treaty exemption as the exemption from Irish tax may be reflected in a lower royalty fee. The measure is in line with policies designed to grow the knowledge economy in Ireland.

Options analysis

17.12 The option to leave matters as they were was considered but rejected in favour of a broadening of the existing tax exemption. An even broader exemption, that would not be confined to recipients in EU or tax treaty States, was also considered but rejected on the grounds that it could give rise to the use of tax-aggressive structures.

Quantification of Costs

17.13 It is likely that the cost of the measure in terms of the amount of tax forgone will be small. Royalties paid by Irish companies to associated companies resident in EU member states would already be exempt from Irish tax under the EU Interest and Royalties Directive (2003/49/EC). Also, just less than half of Irish tax treaties provide for source state exemption of royalty payments. Moreover, companies making outbound patent royalty payments could route the payments to their final destination through associated companies in Irish treaty countries where there is exemption under the treaty. It is unlikely; therefore, that Ireland is obtaining much tax revenue from this source.

Quantification of Benefits

17.14 While limited in scope, as explained above it may be expected that this measure will add to the attractiveness of Ireland for inward investment by companies engaged in exploiting intangible property such as patents. To the extent that they use non-treaty country foreign patents indigenous companies exploiting will also benefit from lower royalty charges as a result of the exemption which could lead to greater use of such patents. The measure will also benefit and therefore encourage foreign direct investment by companies that use foreign patents.

17.15 Given that the use of intangible property is a key component in innovation, the measure may be expected to encourage greater innovation in Ireland. These benefits have the potential to lead to increased employment in the companies affected by this measure.

CHAPTER 18

Section 61 - Extension of the relief of Section 611 of the Taxes Consolidated Act (disposals to State, public bodies and charities)

18.1 Section 61 has two elements. Firstly, it clarifies the cultural bodies to which items may be donated in order to qualify for relief by specifically updating and naming the bodies concerned rather than relying on the current wording of the provision which first lists some of the cultural bodies concerned, such as the National Gallery of Ireland, and then goes on to give the relief to other unspecified cultural bodies which are "similar national institutions". This aspect of section 61 is not considered as the introduction or extension of a tax expenditure.

18.2 The second element of section 61 is the extension of the relief to all local authorities and joint bodies within the meaning of the Local Government Act 2001. It is this aspect of section 61 that is considered as an extension of the relief and is examined below.

Description of Expenditure

18.3 Section 611 of the Taxes Consolidated Act (TCA) previously provided a Capital Gains Tax (CGT) exemption for disposals (other than by way of a bargain at arm's length) to "any county council or municipal corporation, in Saorstát Éireann". This definition is outdated because the categories of local authority were redefined in the Local Government Act 2001 and the designation "municipal corporation" no longer has legal standing.

18.4 Section 61 amends the exemption so that it will now apply relief now applies to "a Local Authority within the meaning of the Local Government Act 2001", which means "a County Council, a City Council and a Town Council". This wording effectively extends the relief to former Urban District Councils and Town Commissioners, which now have the same legal status as the five former Municipal Corporations – Clonmel, Drogheda, Kilkenny, Sligo and Wexford – which are now Town Councils (the other five former Municipal Corporations – Cork, Dublin, Galway, Limerick and Waterford – are now City Councils).

18.5 The relief has also been extended to disposals (other than by way of a bargain at arm's length) to "a joint body within the meaning of section 2(1) of the Local

Government Act 2001". This includes Joint Library Committees, Joint Drainage Committees and Boards, Joint Burial Committees and Boards, Joint Committees within Section 52 of the 2001 Act, and any other Body which the Minister for the Environment, Heritage and Local Government prescribes to be a joint body for the purposes of Section 144 of that Act. These joint bodies are established to fulfil duties of County Councils so the extension of the relief to cover such Bodies is logical.

18.6 The legislation provides relief from CGT to donors on the making of gifts to the bodies mentioned. However, the relief may be clawed back later if the recipient disposes of the asset and the gain on the subsequent disposal would be chargeable.

18.7 In many instances, donors are likely to be entities owned or established by local authorities for particular purposes. As local authorities[42] are themselves exempt from capital gains tax it is reasonable that, on completion of their function, such entities should be able to pass back to local authorities any assets originally owned by the local authority or acquired or created during the existence of the entity without triggering a tax charge. This provision enables such assets to revert to local authority ownership without such a tax cost and avoids the exchequer having to make up the loss of funds, which without this relief, would otherwise have to be paid in tax. Of course, the relief is also available to any other person who might wish to make a gift to a local authority or a joint body.

18.8 There is no time limit placed on the extension of the relieving provision to the bodies mentioned.

Objectives of Tax Expenditure

18.9 To widen the range of bodies (namely, to all local authorities and joint bodies as described above) to which disposals can be made, without the person making the disposal incurring a CGT liability.

18.10 In encouraging gifts of these items to the bodies mentioned, the State is effectively acquiring assets at 25% (the current rate of CGT) of their market value.

[42] Section 610 of, and Schedule 15 to, the Taxes Consolidated Act 1997 refers.

Options Analysis

18.11 As stated above, the relief previously applied to County Councils and Municipal Corporations. As there are no longer “Municipal Corporations”, it was necessary to apply the relief to Local Authorities as currently defined (County Councils, City Councils and Town Councils).

Quantification of Costs

18.12 The extent to which the CGT relief for the Local Authorities listed before 2010, has been availed of, is not readily ascertainable.

18.13 Given that the scheme is designed to allow the State (i.e. local authorities and joint bodies) to acquire assets at 25% of their market value, there is no net cost to this relief.

Quantification of Benefits

18.14 Local authorities may be able to put donated property or objects to a variety of uses, depending on the nature of the asset donated. The possible benefits include job creation, indigenous business investment, and cultural, tourism or environmental improvements.

18.15 Assets donated are acquired by local authorities and joint bodies at a cost of 25% of the market value of the asset.

18.16 The relief allows assets that are effectively fully owned and utilised by local authorities through entities such as companies to be passed back to full local authorities ownership without a tax cost. This helps to reduce the size of the funds the Exchequer needs to give to local authorities to allow them fulfil their functions. Overall, this is simply a rational and consistent extension of an existing relief.

CHAPTER 19

Section 107 – Repayment of amounts of vehicle registration tax in respect of the registration of certain new vehicles (Vehicle Scrappage Scheme)

Description of Expenditure

Policy Context

19.1 A sharp reduction in new car sales has taken place over the last two years but especially in 2009. This has lead to a sharp fall in Vehicle Registation Tax (VRT) receipts and in employment in the motor industry in Ireland. Further sizeable reductions in employment were anticipated in 2010 unless some increase in new car sales took place, which would facilitate firms in surviving and in retaining staff until economic recovery got under way. The scrappage scheme was introduced to provide a boost to the motor industry in Ireland and thereby assist in maintaining employment in the sector and to encourage the replacement of older cars with low CO_2 emission new cars.

Any previous legislation

19.2 A previous scrappage scheme was introduced from 1 July 1995 to 31 December 1997 - section 135B of the Finance Act 1992 (as amended) – inserted by section 98 of the Finance Act 1995, and amended by section 73 of the Finance Act 1996.

Conditions of the scheme

19.3 VRT relief of up to €1,500 is available upon registration of a new vehicle, subject to the scrappage of a qualifying old vehicle. The VRT relief is provided where a new Category A (passenger) car of emissions Band A or B (i.e. with CO_2 emissions of 140g/km or lower) is purchased and registered; and an old car – ten years or older - is scrapped at an End of Life Vehicles authorised treatment facility and a Certificate of Destruction is issued by the facility in respect of the car.

Method of Application for tax expenditure scheme

19.4 The VRT relief is applied for by the dealer submitting a completed application form to Revenue (or an individual when s/he imports a new qualifying vehicle).

Duration of Scheme

19.5 1 January 2010 to 31 December 2010.

Objectives of Tax Expenditure

19.6 The scrappage scheme was introduced

- To provide an incentive to increase the purchase of new cars, thereby assisting in maintaining economic activity and employment in the motor sector;

- To encourage the replacement of older, less safe, higher CO_2 emission cars, with low CO_2 emission, safer new cars.

Economic Rationale

19.7 The tax relief should increase activity in the motor sector, thereby assisting to protect jobs in the motor sector, and restore confidence in that market. The tax take (both VAT and VRT) on the increased new car sales should offset the Exchequer cost of the VRT relief provided.

Options Analysis

Do nothing

19.8 Given the sharp reduction in new car sales, especially in 2009, it was considered that the introduction of a targeted VRT relief was justified at this time given that similar type schemes introduced in other countries were having some success.

Introduce Scrappage Scheme

19.9 Introduce targeted scrappage scheme of VRT relief of up to €1,500 upon registration of a new vehicle of emissions Band A or B, subject to the scrappage of an old car of ten years or older as outlined above.

Any other options considered

19.10 Scrappage schemes allowing for higher and lower VRT relief amounts, different qualifying ages for the cars being scrapped, and different CO_2 emission levels for the new cars being purchased were considered. On balance it was decided that a scheme of the terms introduced was the most appropriate.

Quantifications of Costs

Tax forgone

19.11 The maximum VRT relief/expenditure per beneficiary is €1,500.

19.12 Overall it is considered the scheme should be broadly exchequer revenue neutral. The cost of the scheme will depend on the degree to which the new cars purchased under the scheme are genuine additional new car purchases that would not have arisen if the scheme did not exist. The tax take (both VAT and VRT) on the genuine additional new car sales should offset the exchequer cost of the VRT relief provided to all cars purchased under the scheme.

19.13 For example on the basis of 10,000 new cars being purchased though the scrappage scheme, the maximum potential loss to the exchequer would be €15 million, even if all those cars were deadweight, which is extremely unlikely. On the assumption that a quarter of the yield in VAT would have been achieved otherwise through the purchase of other taxable goods if the scrappage scheme had not been introduced, provided around 30% of the cars purchased are genuine additional new car purchases, the scrappage scheme, in terms of VRT and VAT, would be revenue neutral to the exchequer. If the proportion of cars purchased that are genuine additional new car purchases is lower than 30% there would be a small loss to the exchequer; at 20% the loss would be around €5 million. To the extent that the proportion of cars purchased that are genuine additional new car is higher than 30% there is an overall gain for the exchequer; at 40% the gain would around €5 million and at 50% the gain would be around €10 million in 2010.

Compliance and administration costs

19.14 The scheme has been designed so that the compliance and administrative costs should be minimal. Some minor ICT development was required to Revenue ICT systems, some Revenue resources will be used in carrying out the VRT repayment procedures and subsequent audits, and in addition there will be some small cost to the dealers to ensure the correct paperwork is presented with each claim and is maintained for audit purposes.

Quantification of Benefits

Job creation

19.15 The scrappage scheme, by stimulating the new car market should protect some jobs in the motoring sector. In addition the scheme should increase business in End of Life Vehicles authorised treatment facilities which will carry out the scrapping of vehicles under the scheme.

Indigenous business investment

19.16 The section should assist in maintaining some investment in the motor sector which otherwise would have been lost.

Environmental benefits

19.17 The replacement of older and more polluting cars in the national fleet with new low CO_2 emission cars will produce a net reduction in CO_2 emissions from the motoring sector relative to what it otherwise would be. For example, for each 10,000 cars purchased in bands A + B in 2010 under the scrappage scheme as replacement of cars aged ten years or more, the annual CO_2 saving would be approximately 7,600 tonnes. The net present value[43] of the reduction in CO_2 emissions is estimated to be approximately €162,000[44] based on an expected average lifespan of eighteen months[45] for vehicles being scrapped.

19.18 There will also be carbon emissions savings due to the fact that cars purchased under the scrappage scheme have to be in the A or B bands i.e. the proportion of cars in the A and B bands being purchased under the scrappage scheme is higher than the proportion for all new cars being purchased (100% compared to 73%). It is envisaged that the annual carbon saving arising from this effect is approximately 500 tonnes annually for every 10,000 vehicles purchased under the scrappage scheme. The net present value of the reduction in CO_2 emissions over the remaining life of these vehicles (13 years) is around €160,000. For a period of 18 months, there is a certain overlap between these emission savings and those arising from the scrappage of older cars outlined in the previous paragraph.

Other benefits

19.19 The replacement of older vehicles with newer vehicles will have road safety benefits as general vehicle safety standards associated with newer vehicles are constantly being updated and improved.

19.20 The potential cost or gain to the Exchequer from the scrappage scheme is finely balanced and depends on consumer behaviour and especially on the likely degree of deadweight involved is such a scheme.

[43] 4% Discount Rate.
[44] Based on DoF guidance on carbon price per tonne and assuming a full year effect from 2011 onwards.
[45] Based on Revenue estimates of average age of cars scrapped to date (12 years) under the scheme.

CHAPTER 20

Section 108 – Remission or repayment in respect of vehicle registration tax on certain plug-in hybrid electric vehicles, certain electric vehicles and certain electric motorcycles

Description of Expenditure

Policy Context

20.1 Increasing the use of electric vehicles is one component towards a policy of reducing overall CO^2 emissions, including in the transport sector, and the State's dependency on imported fossil fuels. Extending the VRT reliefs for the purchase of electric vehicles assists in underpinning this policy of increasing the use of electric vehicles. However, this measure is just one small element in the overall package of measures to increase the use of electric vehicles; other elements include introducing the infrastructure for the recharging of electric vehicles and the provision of a grant towards the purchase of electric vehicles.

Any previous legislation

20.2 Section 135C of the Finance Act 1992 (as amended) inserted by Section 168 of the Finance Act 2001.

Conditions of the scheme

20.3 The existing scheme providing full VRT exemption on the registration of series production Category A and Category B electric vehicles is extended for two years until 31 December 2012.

20.4 In addition, an existing VRT remission of up to €2,500 for hybrids is, in the case of *"plug-in"* hybrid electric vehicles only, extended for two years until 31 December 2012.

Method of Application for tax expenditure scheme

20.5 Revenue's On-Line Service (ROS) automatically allows for the exemption of the relief, as appropriate, on input of specific engine codes at registration.

Duration of Scheme

20.6 1 January 2011 to 31 December 2012.

Objectives of Tax Expenditure

20.7 The scheme was introduced to

- Assist towards increasing the use of electric vehicles;
- Reduce CO_2 emissions in the transport sector by extending the VRT incentives for the purchase of environmentally-friendly electric and plug-in hybrid electric vehicles.

Economic Rationale

20.8 Increased use of electric vehicles will reduce CO_2 emissions in the transport sector and our dependency on imported fossil fuels.

Options Analysis

20.9 The option of "doing nothing" as the counterfactual would not have incentivised the sale of electric vehicles.

20.10 No other options were considered as part of the analysis

Quantifications of Costs

Tax forgone

20.11 The overall cost to the Exchequer in VRT tax terms should be relatively small and is contingent on both the availability and sales of electric vehicles. While some VRT revenue will be forgone this will, at least in part, be offset by an increase in VAT due to electric vehicles being more expensive than other existing vehicles. In the case of *"plug-in"* hybrid electric vehicles, the VRT forgone is up to €2,500 per vehicle. In the case of full electric vehicles the VRT forgone will depend on the price of the vehicles being purchased which can vary significantly. For example if the full electric vehicle is priced at €40,000, exclusive of VRT, the VRT forgone is around €6,500.

20.12 Since full electric vehicles, as mentioned, are more expensive than other vehicles, some of the VRT forgone would be offset by an increase in VAT; for example if the full electric vehicle is €15,000 more than other similar type vehicles it would result in increased VAT of €2,650, giving a net tax loss to the exchequer of around €3,900 per full electrical vehicle purchased. Consequently, with a combination of both *"plug-in"* hybrid electric and full electric vehicles being purchased the net tax cost to the exchequer could be around €3.5 million per 1,000 electric vehicles purchased.

20.13 To the extent that electric vehicles may be substituted for combustion engine cars, there is the potential for a reduction in excise and VAT taxes paid to the exchequer on motor fuel purchases. This depends on the level of take up.

20.14 It must be remembered that the VRT remission/repayment tax measure is only one small element in the overall package. It is in no way a determining factor in the scheme. The tax cost and the quantity of electric vehicles purchased will depend on the success of the overall package of measures to increase the use of electric vehicles in Ireland, of which this measure is but one element.

Compliance and administration costs

20.15 Such costs are minimal, as the ICT and administrative systems are already in place.

Quantification of Benefits

Environmental benefits

20.16 The replacement of existing fossil fuels driven vehicles with electric vehicles will produce a net reduction in CO_2 emissions from the motoring sector relative to what it otherwise would be. The net present value[46] of the reduction in CO_2 emissions is estimated to be €240,000[47] for every 1,000 combustion engine vehicles that are substituted by electric vehicles. This is based on an annual level of carbon savings of around 800 tonnes per 1,000 vehicles and assumes an expected lifespan of 13 years for the vehicle. The CO_2 emissions savings have been calculated by comparing the emissions from a standard combustion engine and making an allowance for the CO_2 emissions produced by the generation of the electricity[48] used by the electric vehicle.

20.17 Depending on the level of take up, the increased numbers of electric vehicles may also lead to reductions in the levels of nitrous oxides emissions, sulphur dioxide emissions and particulate matter with consequent positive impacts on

[46] 4% Discount Rate.

[47] Based on DoF guidance on carbon price per tonne and assuming a full year effect from 2011 onwards.

[48] This analysis is based on the energy mix for 2007 as no data for later years was available. The analysis does not take into account potential carbon emissions benefits arising from any increase in the proportion of renewables in the energy generation mix. Carbon emission savings could well be higher depending on the extent of renewables used and the level of night time charging.

air quality. There may also be potential benefits in terms of reduced noise levels.

Other tangible benefits

20.18 Positioning Ireland as a leading early player in the electric vehicle space would have a positive outcome.

20.19 As indicated above this VRT measure is but one element in the overall package of measures to increase the use of electric vehicles in Ireland thereby reducing CO_2 emissions in the transport sector. The decision to extend the existing VRT reliefs for electric vehicles for two years was taken in that context.

APPENDIX A

FINANCE ACT 2010 – ARRANGEMENT OF SECTIONS

Section No.	Description	Classification
	Part 1 **Cost Benefit Analysis of tax expenditures**	
1	Cost Benefit Analysis of Tax Expenditures.	**Report produced**
	Part 2 **Income Levy, Income Tax, Corporation Tax and Capital Gains Tax**	
	Chapter 1 ***Interpretation***	
2	Interpretation (Part 2).	
	Chapter 2 ***Income Levy***	
3	Income Levy.	**Chapter 3 Report**
	Chapter 3 ***Income Tax***	
4	Amendment of Section 122 (preferential loan arrangements) of Principal Act.	**Administrative Amendment**
5	Cesser of certain reliefs.	**Abolition of Tax Expenditure**
6	Amendment of section 469 (relief for health expenses) of Principal Act.	**Administrative Amendment**
7	Amendment of section 244 (relief for interest paid) on certain home loans) of Principal Act.	**Abolition of Tax Expenditure**
8	Amendment of section 997A (credit in respect of tax deducted from emoluments of certain directors) of Principal Act.	**Administrative Amendment**
9	Amendment of section 71 (foreign securities and possessions) of Principal Act.	**Abolition of Tax Expenditure**
10	Amendment of section 825B (repayment of tax where earnings not remitted) of Principal Act.	**Chapter 4 Report**
11	Amendment of section 825A (reduction in income tax for certain income earned outside the State) of Principal Act.	**Administrative Amendment**
12	Amendment of section 477 (relief for service charges) of Principal Act.	**Abolition of Tax Expenditure**
13	Amendment of section 216A (rent-a-room relief) of Principal Act.	**Anti-Avoidance Measure**

Section No.	Description	Classification
14	Amendment of section 667B (new arrangements for qualifying farmers) of Principal Act.	**Administrative Amendment**
15	Amendment of section 384 (relief under Case V for losses) of Principal Act.	**Administrative Amendment**
16	Retirement Benefits.	**Administrative Amendment**
17	Amendment of Section 128D (tax treatment of directors of companies and employees who acquire restricted shares) of Principal Act.	**Administrative Amendment**
18	Information in respect of awards of shares.	**Administrative Amendment**
19	Amendment of Schedule 11 (profit sharing schemes) to principal Act.	**Anti-Avoidance Measure**
20	Amendment of section 470B (age-related relief for health insurance premiums) of Principal Act.	**Chapter 5 Report**
21	Income tax restriction on use of losses on approved buildings.	**Restriction of Tax Expenditure**
22	Amendment of Schedule 13 (accountable persons for purposes of Chapter 1 Part 18) to principal Act.	**Administrative Amendment**
23	Limitations on amount of certain reliefs used by certain high income individuals.	**Curtailment of multiple tax Expenditures**
	Chapter 4 ***Income Tax, Corporation Tax and Capital Gains Tax***	
24	Provisions relating to charities and donations to approved bodies.	**Measure to Comply with EU Law**
25	Amendment of Part 22 (provisions relating to dealing in or developing land and disposals of development land) of Principal Act.	**Anti-Avoidance Measure/Administrative Amendment**
26	Amendment of section 843A (capital allowances for buildings used for certain childcare purposes) of Principal Act.	**Abolition of Tax Expenditure**
27	Mid-Shannon corridor tourism infrastructure investment scheme.	**Chapter 6 Report**
28	Payment of tax by means of donation of heritage property.	**Administrative Amendment**
29	Payments to subcontractors in certain industries.	**Administrative Amendment**
30	Amendment of section 731 (chargeable gains accruing to unit trusts) of Principal Act.	**Anti-Avoidance Measure** **Administrative Amendment**
31	Amendment of Part 27 (unit trusts and offshore funds) of Principal Act.	**Chapter 7 Report**
32	Amendment of section 1035A (relieving provision to section 1035) of Principal Act.	**Administrative Amendment**
33	Dividend withholding tax.	**Administrative Amendment**

Section No.	Description	Classification
34	Amendment of section 175 (purchase of own shares by quoted company) of Principal Act.	**Anti-Avoidance Provision**
35	Amendment of Part 3 (provisions relating to the Schedule C charge and government and other public securities) of Principal Act.	**Measure to Comply with EU Law**
36	Amendment of section 299 (allowances to lessees) of principal Act.	**Anti-Avoidance Provision**
37	Amendment of Chapter 4 (interest payment by certain deposit takers) of Part 8 of Principal Act.	**Chapter 8 Report**
38	Amendment of section 481 (relief for investment in films) of Principal Act.	**Technical Amendment**
39	Specified financial transactions.	**Chapter 9 Report**
40	Interest payments to residents in relevant territories.	**Anti-Avoidance Measure/Administrative Amendment**
41	Credit for foreign tax.	**Anti-Avoidance Measure**
42	Transfer pricing.	**Clarification and Codification**
	Chapter 5 ***Corporation Tax***	
43	Intangible assets, etc.	**Chapter 10 Report**
44	Acceleration of wear and tear allowances for certain energy efficient equipment.	**Chapter 11 Report**
45	Amendment of section 486C (relief from tax for certain start-up companies) of Principal Act.	**Chapter 12 Report**
46	Unilateral relief (royalty income).	**Chapter 13 Report**
47	Carry forward of unrelieved foreign tax.	**Administrative Amendment (Double Taxation Agreement)**
48	Amendment of section 847 (tax relief for certain branch profits) of principal Act.	**Technical Amendment**
49	Dividends paid out of foreign profits.	**Anti-Avoidance Measure**
50	Foreign Dividends.	**Chapter 14 Report**
51	Assets transferred in course of scheme of reconstruction or amalgamation.	**Measure to Comply with EU Law**
52	Amendment of section 80A (taxation of certain short-term leases of plant and machinery) of Principal Act.	**Chapter 15 Report**
53	Amendment of section 402 (foreign currency: tax treatment of capital allowances and trading losses of a company) of Principal Act.	**Administrative Amendment**
54	Amendment of section 766 (tax credit for research and development expenditure) of Principal Act.	**Chapter 16 Report**
55	Tax Treatment of certain outbound patent royalties.	**Chapter 17 Report**

Section No.	Description	Classification
	Chapter 6 ***Capital Gains Tax***	
56	Amendment of Section 542 (time of disposal and acquisition) of Principal Act.	**Administrative Amendment**
57	Amendment of section 590 (attribution to participators of chargeable gains accruing to non-resident company) of Principal Act.	**Administrative Amendment**
58	Amendment of section 598 (disposals of business or farm on “retirement”) of Principal Act.	**Anti-Avoidance Measure**
59	Restriction on allowable losses.	**Anti-Avoidance Measure**
60	Amendment of section 607 (Government and certain other securities) of principal Act.	**Anti-Avoidance Measure**
61	Amendment of section 611 (disposals to State, public bodies and charities) of Principal Act.	**Chapter 18 Report**
62	Amendment of section 958 (date for payment of tax) of Principal Act.	**Administrative Amendment**
63	Amendment of Schedule 15 (list of bodies for purposes of section 610) to Principal Act.	**Administrative Amendment**
	Part 3 **Custom and Excise**	
	Chapter 1 ***Mineral Oil Tax Carbon Charge***	
64	Mineral oil tax carbon charge.	**New Tax**
65	Cesser of application of mineral oil tax to coal.	**New tax**
	Chapter 2 ***Natural Gas Carbon Tax***	
66	Definitions (*Chapter 2*).	**Part of introducing new tax**
67	Charging and rates of natural gas carbon tax.	**Introduces New Tax**
68	Liability to pay natural gas carbon tax.	**New tax**
69	Registration of natural gas suppliers.	**New tax**
70	Returns and payment by natural gas suppliers.	**New tax**
71	Reliefs from natural gas carbon tax.	**New tax**
72	Repayments of natural gas carbon tax.	**New tax**
73	Offence and penalty (*Chapter 2*).	**New tax**
74	Regulations (*Chapter 2*).	**New tax**
75	Care and management (*Chapter 2*).	**New tax**
76	Commencement (*Chapter 2*).	**New tax**
	Chapter 3 ***Solid Fuel Carbon Tax***	
77	Interpretation (*Chapter 3*).	
78	Charging and rates of solid fuel carbon tax.	**New Tax**
79	Liability to pay solid fuel carbon tax.	**New tax**

Section No.	Description	Classification
80	Registration of solid fuel suppliers.	**New tax**
81	Returns and payment by solid fuel suppliers.	**New tax**
82	Reliefs from solid fuel carbon tax.	**New tax**
83	Repayments of solid fuel carbon tax.	**New tax**
84	Offence and penalty (*Chapter 3*).	**New tax**
85	Regulations (*Chapter 3*).	**New tax**
86	Care and management (*Chapter 3*).	**New tax**
87	Commencement (*Chapter 3*).	**New tax**
	Chapter 4 ***Miscellaneous***	
88	Rates of alcohol products tax.	**Rate change**
89	Amendment of section 98A (relief for biofuel) of Finance Act 1999.	**Availability of tax expenditure**
90	Amendment of Chapter 1 (mineral oil tax) of Part 2 of Finance Act 1999.	**Measure to comply with EU Law**
91	Amendment of Chapter 3 (tobacco products tax) of Part 2 of Finance Act 2005.	**Measure to comply with EU Law**
92	Amendment of Chapter 1 (alcohol products tax) of Part 2 of Finance Act 2003.	**Measure to comply with EU Law**
93	Amendment of Part 2 (consolidation and modernisation of general excise law) of Finance Act 2001.	**Measure to comply with EU Law**
94	Amendment of section 34 (amendments relative to penalties) of Finance Act 1963.	**Administrative Amendment**
95	Section 186 (illegally importing) of Customs Consolidation Act 1876 and penalties for offences.	**Amendment to criminal customs fines**
96	Amendment of section 3 (penalty for illegally exporting goods) of Customs Act 1956.	**Amendment to criminal customs fines**
97	Provision of information relating to persons, conveyances and goods.	**Administrative Provision**
98	Amendment of section 102 (penalties for certain mineral oil tax offences) of Finance Act 1999.	**Amendment of criminal excise fines**
99	Amendment of section 119 (penalties for certain excise offences) of Finance Act 2001.	**Amendment of criminal excise fines**
100	Amendment of section 79 (penalties for certain alcohol products tax offences) of Finance Act 2003.	**Amendment of criminal excise fines**
101	Amendment of section 78 (penalties for certain tobacco products tax offences) of Finance Act 2005.	**Amendment of criminal excise fines**
102	Amendment of section 130 (interpretation) of Finance Act 1992.	**Administrative Amendment**

Section No.	Description	Classification
103	Amendment of section 130B (delegation of certain powers of the Revenue Commissioners) of Finance Act 1992.	**Administrative Amendment**
104	Amendment of section 131 (registration of vehicles by Revenue Commissioners) of Finance Act 1992.	**Administrative Amendment**
105	Amendment of section 132 (charge of excise duty) of Finance Act 1992.	**Administrative Amendment**
106	Amendment of section 135 (temporary exemption from registration) of Finance Act 1992.	**Administrative Amendment**
107	Repayment of amounts of vehicle registration tax in respect of the registration of certain new vehicles.	**Chapter 19 Report**
108	Remission or repayment in respect of vehicle registration tax on certain plug-in hybrid electric vehicles, certain electric vehicles and certain electric motorcycles.	**Chapter 20 Report**
109	Authorisation of competent persons.	**Administrative Amendment**
110	Amendment of section 141 (regulations) of Finance Act 1992.	**Administrative Amendment**
111	Return of motor insurance particulars.	**Administrative Provision**
	Part 4 **Value–Added Tax**	
112	Interpretation (*Part 4*).	
113	Amendment of section 1 (interpretation) of Principal Act.	**Administrative Amendment**
114	Amendment of section 4B (supplies of immovable goods) of Principal Act.	**Administrative Amendment**
115	Amendment of section 4C (transitional measures for supplies of immovable goods) of Principal Act.	**Anti-Avoidance Measure**
116	Amendment of section 5 (supply of services) of Principal Act.	**Administrative Amendment**
117	Amendment of section 8 (accountable persons) of Principal Act.	**Measure to comply with EU Law**
118	Amendment of section 10 (amount on which tax is chargeable) of Principal Act.	**Administrative Amendment**
119	Amendment of section 10A (margin scheme goods) of Principal Act.	**Administrative Amendment**
120	Amendment of section 10B (special scheme for auctioneers) of Principal Act.	**Administrative Amendment**
121	Amendment of section 11 (rates of tax) of Principal Act.	**Rate reduction**

Section No.	Description	Classification
122	Amendment of section 12B (special scheme for means of transport supplied by taxable dealers) of Principal Act.	**Administrative Amendment**
123	Amendment of section 12C (special scheme for agricultural machinery) of Principal Act.	**Administrative Amendment**
124	Amendment of section 13 (remission of tax on goods exported, etc.) of Principal Act.	**Anti-Avoidance Measure**
125	Amendment of section 15 (charge of tax on imported goods) of Principal Act.	**Measure to comply with EU Law**
126	Amendment of section 16 (duty to keep records) of Principal Act.	**Anti-Avoidance Measure**
127	Amendment of section 17 (invoices) of Principal Act.	**Administrative Amendment**
128	Amendment of section 26 (penalties generally) of Principal Act.	**Application of civil penalty**
129	Addition of Schedule 7 to Principal Act.	**Measure to comply with EU Law**
130	Substitution of First and Second Schedules to Principal Act.	**See CBA under Section 39 (Islamic finance). Otherwise, CBA Not Required - Administrative Amendment and Measure to comply with EU Law**
131	Consequential amendment of Value-Added Tax Act 1972.	**Administrative Amendment**
132	Pre-consolidation amendments and repeals (*Part 4*).	**Administrative Amendment**
133	Supply of greenhouse gas emission allowances.	**Anti-Avoidance Measure**
	Part 5 **Stamp Duties**	
134	Interpretation (*Part 5*).	
135	Information exchange with Property Registration Authority.	**Administrative Amendment**
136	Conveyance in consideration of debt.	**Anti-Avoidance Measure**
137	Certain investment certificates.	**CBA Report Completed (See Section 39)**
138	Funds: reorganisation.	**Administrative Amendment**
139	Levy on certain life insurance premiums.	**Technical Administrative**
140	Levy on authorised insurers.	**Rate Increase**
141	Amendment of Schedule 2B (qualifications for applying for relief from stamp duty in respect of transfers to young trained farmers) to Principal Act.	**Administrative Amendment**
	Part 6 **Capital Acquisitions Tax**	

Section No.	Description	Classification
142	Interpretation (*Part 6*).	
143	Amendment of section 57 (overpayment of tax) of Principal Act.	**Administrative Amendment**
144	Exemption of certain investment entities.	**Technical Amendment**
145	Amendment of section 82 (exemption of certain receipts) of Principal Act.	**Administrative Amendment**
146	Amendment of section 89 (provisions relating to agricultural property) of Principal Act.	**Anti-Avoidance Measure**
147	Modernisation of capital acquisitions tax administration.	**Administrative Amendment**
	Part 7 **Miscellaneous**	
148	Interpretation (*Part 7*).	
149	Amendment of Part 33 (anti-avoidance) of Principal Act.	**Anti-Avoidance Measure**
150	Domicile levy.	**Introduces New Tax**
151	Cesser of section 825 (residence treatment of donors of gifts to the State) of Principal Act.	**Abolition of Tax Expenditure**
152	Provision of information by Commission for Taxi Regulation.	**Compliance Measure**
153	Revenue powers.	**Anti-Evasion Measure**
154	Provision of information by National Asset Management Agency.	**Anti-Evasion Measure**
155	Amendment of section 1078 (revenue offences) of Principal Act.	**Administrative Amendment**
156	Tax clearance certificates.	**Compliance Measure**
157	Amendment of section 826 (agreements for relief from double taxation) of Principal Act.	**Measure to comply with International Convention**
158	Amendment of Schedule 24A (arrangements made by the Government with the government of any territory outside the State in relation to affording relief from double taxation and exchanging information in relation to tax) to Principal Act.	**Administrative Amendment**
159	Miscellaneous technical amendments in relation to tax.	**Administrative Amendments**
160	Amendment of section 1 (definitions) of Provisional Collection of Taxes Act 1927.	**Administrative Amendment**
161	Gifts to the State by certain donors.	**Scheme to allow gifts to be made to State**
162	Capital Services Redemption Account.	**Administrative Amendment**
163	Amendment of Bretton Woods Agreements Act 1957.	**Measure to Comply with International Agreement**
164	Care and management of taxes and duties.	**Administrative Amendment**
165	Short title, construction and commencement.	**Administrative Amendment**