TAX STRATEGY GROUP

Capital and Savings Taxation Issues

1. Introduction and context

1.1 Scope of this paper

This paper covers Capital and Savings taxes; Capital Gains Tax (CGT), Capital Acquisitions Tax (CAT), Stamp Duties and DIRT. It sets out the current position of each and examines potential options for change in the context of the Budget/Finance Bill 2013.

2. Capital Gains Tax

2.1 Introduction

Capital Gains Tax (CGT) was introduced in 1975. The tax is charged on the value of the capital gain made on the disposal of an asset. Disposals are not limited to sales of assets – a gift of an asset counts as a disposal and will be liable to CGT if a gain is made. All classes of assets are covered by CGT, but the majority of the yield relates to property.

2.2 Evolution of CGT

- **1975** – CGT at a rate of 26% was introduced
- **1978 - 1990** – indexation relief introduced and rates periodically changed. In general, the longer the asset was held, the lower the CGT rate.
- **1991** – CGT brought within self-assessment system.
- **1992** – multiple rate system (based on how long the asset was held) changed to a single rate of 40%.
- **1998** – Rate reduced from 40% to 20% (other than for offshore funds and foreign life policies, still charged at 40%).
- **2003** – abolition of indexation relief, change in the CGT payment date to current year, and abolition of roll-over relief.
- **2008** – Budget 2009: rate increased from 20% to 22%
- **2009** – Supplementary Budget 2009: rate increased from 22% to 25%;
  NAMA Act – introduction of windfall tax at 80% on disposals of development land.
- **2011** – Finance (No. 3) Act 2011 transposes Civil Partnership Act provisions into tax law.
- **2012** - Budget and Finance Act 2012 increased the CGT rate to 30% and introduced an incentive under which the accrued gains on properties purchased between Budget night (6 December 2011) and end- 2013 would not attract CGT if the properties were held for more than seven years

2.3 CGT Yield

The amount of CGT received for each year since 2005 is shown below.

Year	Yield €m	% change Y-on-Y
2005	1,960	-
2006	3,100	+58%
2007	3,105	-
2008	1,430	-54%
2009	542	-62%
2010	347	-36%
2011	416	+20%
2012 (p)	355	-

The CGT yield in 2011 at €416m represented a 20% increase on the 2010 outturn. This was largely due to an increase in transactions on foot of an expected increase in the rate of CGT**.** The yield to end- August 2012 is also marginally ahead of expectations. Nevertheless. the 2011 yield represents only 13% of the CGT yield in its peak year of 2007.

The significant drop in the CGT yield is due to declining asset values and a reduction in the number of property and share transactions. Given the likely continuation of this trend, or at best, a maintenance of current values and low transaction figures, there is little chance of any significant underlying improvement in the CGT yield in the short to medium term as the tax is currently structured.

2.4 CGT Exemptions and Reliefs

The main exemptions and reliefs from CGT are as follows:

- Annual exemption
  An annual CGT exemption of €1,270 for all assets disposed of in a calendar year by an individual.

- Disposals to spouses, separated and divorcing spouses, registered civil partners and to former co-habitants under a court order
  Such disposals are treated as being at "no gain/no loss" and the recipient is treated as having acquired the asset at the same date and for the same value at which it was acquired by the donor. The treatment afforded to married persons was extended to civil partners and former co-habitants under Finance (No. 3) Act 2011, which transposed the provisions of the Civil Partnership Act into tax law.

- Principal Private Residence Relief
  An individual's principal private residence is exempt from CGT. Where the individual resides in the property for part rather than the whole of the duration of ownership, the relief is apportioned accordingly.

- Retirement Relief

Business or farming assets are relieved from CGT where the person disposing of the assets is aged 55 or over and had owned and used the asset for the ten years prior to disposal. The operation of the relief differs as between persons aged 55 to 65 and persons aged 66 and over. In the former cases, the relief applies to assets valued up to €750,000 where the assets are transferred outside the family. Where the disposal is made to a child or favourite niece/nephew, there is no monetary limit to the relief.

For individuals aged 66 years and over disposing of business or farm assets outside the family, the consideration limit is being reduced from €750,000 to €500,000. For individuals aged 66 years and over disposing of business or farm assets to a child or nephew/niece who has worked full time in the business/on the farm for the previous five years, the relief can be claimed up to a consideration or value limit of €3 million. The changes for individuals aged 66 years and over come into effect from 1 January 2014, in order to encourage transfers by individuals who are already aged 66 year or who reach that age before then.

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

2.7 Possible Capital Gains Tax issues - Budget/Finance Act 2013

(i) Increase CGT yield by increasing the rate

- Increase rate from the existing 30% level
- Increase CGT rate for higher rate income tax payers
- Re-introduce multiple rates based on length of holding of asset
- Apply higher rates to larger gains
- Re-introduce a higher CGT rate for disposals of development land (possibly in conjunction with the abolition of the windfall tax)

(ii) Broaden the base for CGT by abolishing or restricting existing reliefs/exemptions

- Abolish/amend the annual exemption of €1,270
- Abolish/amend principal private residence relief
- Amend loss relief

(iii) Restructure the CGT regime to support enterprise and investment.

- Re-introduce indexation (inflation) relief
- Re-introduce "roll-over relief" for farm compulsory purchase orders (CPOs) and/or, on a once-off basis, for the disposal of certain business assets (intangible assets) where re-investment would give rise to economic activity and employment.

(i) Options for increasing CGT rates

The rate has increased three times since late 2008:

- Budget 2009: rate increased from 20% to 22%
- Supplementary Budget 2009: rate increased from 22% to 25%
- Budget and Finance Act 2012: rate increased from 25% to 30%

The rate increase in Budget 2009 was the first rate change since Budget 1998 when the rate was decreased from 40% to 20%.

It is often argued that the doubling of the CGT yield after the reduction of the rate from 40% to 20% proves that lower rates lead to increased yield. This was probably more a function of the increase in transactions and asset values – the CGT yield had doubled year on year for several years prior to the rate reduction.

The yield from an increase in CGT rates can be uncertain. CGT yield is dependent on disposals of assets and both the number of disposals and the value of the assets being disposed of have decreased, which makes it difficult to achieve an increase in yield. In addition, ongoing increases in the CGT rate could have behavioural impacts in that while they could encourage disposals in the short term in anticipation of further rate increases, they could also deter taxpayers from disposing of assets over the longer term, particularly when asset values remain depressed.

Apart from a straight-forward rate increase, there are a number of other possible options for increasing CGT yield:

- <u>Increase CGT rate for higher rate income tax payers</u>
  The UK Government increased the CGT rate for higher rate income tax payers from 18% to 28%. A similar measure could be introduced here. It is estimated that c. 70% of individuals declaring capital gains are higher rate income tax payers, so a similar measure would increase the CGT yield from this cohort.

- <u>Re-introduce multiple rates based on length of ownership of asset</u>
  Up to 1992, the longer an asset was held, the lower the rate of CGT which applied. A similar system is currently in place in the USA – assets held for a short period are taxable at income tax rates, whereas assets held for longer periods are taxed at a reduced rate. This system would encourage longer term investment. Consideration could be given to re-introducing a multiple rate system on this basis. As against this, such a system could influence the timing of disposals over the short to medium term.

- <u>Apply higher rates to larger gains</u>
  Consideration could be given to introducing a higher rate or higher rates of CGT on disposals over a certain amount. For example, the first €50,000 of gains could be taxed at 30%, the next €50,000 at 35%, and the balance at 40%.

(ii) Abolition/amendment of reliefs/exemptions

<u>Re-introduce a higher CGT rate for disposals of development land</u>

- Disposals of development land were previously charged at a higher rate. [Indexation relief cannot be claimed on the "development value" portion of development land, and losses made on "ordinary assets" cannot be set against gains made on development land.] An 80% windfall rate of tax applies to the portion of a gain made on the disposal of development land attributable to a rezoning (subsequently amended to include the portion of a gain attributable to a material contravention decision by a local authority). Consideration could be given to abolishing the windfall rate and replacing it with a higher CGT rate for disposals of development land (for example, the previous rate of 40%). There has been negligible yield from windfall tax. Sales of development land are virtually non-existent due to a lack of availability of credit. While a windfall tax may be justifiable on the basis that it will discourage speculative activity in future if/when sales pick up, the 80% charge on windfall gains may be considered too high.

- <u>Abolition or amendment of annual exemption</u>
  The annual exemption is currently €1,270. It can only be claimed by individuals (not by companies). The exemption has not changed since 1992, when it was reduced from the equivalent of €2,540. Consideration could be given to reducing the exemption (for example, to €1,000 or €500) or removing it altogether, although this could lead to some smaller gains becoming taxable for little additional yield.

- <u>Abolition or amendment of principal private residence relief</u>
  Consideration could be given to abolishing principal private residence relief or amending it – for example, only allowing relief on residences up to €1 m in value. This could be presented as a quid pro quo for the reduction in Stamp Duty on residential property. In most cases property owners have not "earned" the increase in the value of their properties, and on that basis there is justification for taxing the increased value. However, as property prices are now at 2001 levels there will obviously be no gain on any property originally purchased in the last ten years. Given that a considerable yield from this source is unlikely, and the forthcoming introduction of a property tax, it may not be worthwhile at this point to pursue what would be another unpopular measure.

- <u>Amendment of loss relief</u>
  At present if a taxpayer makes a loss on the disposal of an asset that loss can be set against gains made in the current year and carried forward indefinitely against gains in subsequent years. The significant decline in value of capital assets in recent years has the potential to affect the CGT yield for several years to come. [It appears many people are either holding onto assets or are unable to dispose of them in the current market.] To protect the CGT yield into the future, consideration could be given to restricting loss relief to a maximum amount per year (for example, €50,000) or to a maximum of 50% of all chargeable gains made in a year.

(iii) Restructuring the CGT regime to support enterprise and investment

Two ways in which CGT could be restructured as a means of supporting enterprise and investment are the re-introduction of indexation (inflation) relief, and the re-introduction of "roll-over relief" for farm CPOs. Both were considered in depth by the Commission on Taxation, which supported their reintroduction, and they have featured in pre-Budget submissions from various interest groups in previous years.

- Re-introduce indexation (inflation) relief
  The Commission on Taxation recommended the re-introduction of indexation relief – this seeks to limit CGT to 'real' gains in asset values by excluding the impact of inflation as measured by the Consumer Price Index (CPI). Indexation relief was brought in a number of years after the introduction of CGT in 1975 to take account of high levels of inflation when CGT rates were relatively high. With a marked decline in inflation, and in light of the reduced standard rate of CGT, the relief was abolished in 2003 but still can be claimed for allowable expenditure incurred up to 31 December 2002.

  There may be little grounds for reintroducing indexation relief given the declines in asset values and recent low rates of inflation (the CPI fell in both 2009 and 2010) and the fact that other jurisdictions do not exclude inflation from capital gains. It may not be appropriate to link CGT to the CPI. The CPI continued to rise in 2007 and 2008 while the main assets which are subject to CGT, property and shares, fell in value.

  The rate of CGT is still relatively low in historic terms. In addition, the cost associated with introducing indexation relief would adversely affect the CGT yield.

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

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

  However, if conceded, this change may lead to added pressure for the general re-introduction of roll-over relief for the business and agricultural sectors in the context of transfers of assets. This was not recommended by the Commission and would be extremely expensive. Also, gains which were deferred under roll-over relief were often never taxed.

3. Capital Acquisitions Tax (CAT)

3.1 Introduction

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

The tax is charged on the amount gifted to, or inherited by, the donee (the person receiving the gift/inheritance). There is a tax-free threshold (referred to as a 'group threshold'), based on the relationship between the disponer (the person making the gift/leaving the inheritance) and the donee (the beneficiary). Previous gifts/inheritances since 1991 from other disponers in the relevant group are counted when calculating the taxable amount over the threshold. The balance of the gift/inheritance above the threshold is taxable, currently at a single rate of 30%.

The group thresholds are set out in a table below. The tax-free thresholds have been adjusted over the years up to early 2010 in line with movements in the Consumer Price Index (CPI). However, indexation has not been applied since then and the group A thresholds, in particular, were considerably reduced in Budgets 2011 and 2012.

CAT Group tax-free thresholds

Group	Relationship to Disponer	Group Thresholds 01/01/2010 – 07/12/2010	Group Thresholds 08/12/2010 – 6/12/11	Grou[Threshol ds from 712/11
A	Son/Daughter*	€414,799	€332,084	€250,000
B	Parent/Brother/Sister/Niece/Nephew/ Grandchild	€41,481	€33,208	€33,500
C	Relations other than Group A or B	€20,740	€16,604	€16,750

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

Finance Act 2009 saw, for the first time, a reduction of approximately 20% in the tax-free threshold amounts for all groups reflecting a general fall in asset values. This measure was coupled with an increase in the rate from 22% to 25%. (The rate had been raised in Finance (No. 2) Act 2008 from 20% to 22%). As shown in the table above, Budget 2011 reduced the thresholds by a further 20% from 8 December 2010. Budget 2012 reduced the Group A threshold to €250,000 and this threshold is now 54% below its peak level in early 2009.

The CAT yield so far this year is not significant as a single payment date of 30 September applies for all gifts or inheritances taken on or before 31 August in any year. As the CAT yield arises mainly from inheritances /gifts, increases and falls in the yield can be mainly attributable to changing asset values. Unlike CGT and Stamp Duty, the number of CAT transactions has not suffered a significant decline.

The CAT yield for each year since 2005 is as shown below:

Year	Yield €m	% change Y-on-Y
2005	249	-
2006	353	+42%
2007	392	+11%
2008	332	-15%
2009	254	-23%
2010	238	-6%
2011	244	+3%
2012 (p)	295	-

The CAT yield was €244m in 2011 (up close to 3% on 2010). The projected CAT yield for 2012 is €295m which is some 21% higher than the 2011 outturn but from a relatively small base.

3.2 Evolution of CAT

- 1976 – CAT introduced; rates vary between 5% and 50% depending on the relationship between the disponer and the donee, and the amount of the gift/inheritance
- 1980 – Agricultural relief introduced.
- 1985 – gifts/inheritances between spouses exempted from CAT.
- 1990 – Group tax free thresholds linked to CPI –
- 1994 - CAT payable at 20% on first €12,700 above tax-free threshold, 30% on next €38,100 and 40% on the balance.
- 1994 – Business property relief introduced.
- 1995 – Agricultural and business property relief set at 50% of the taxable value of the relevant assets (previously the rates varied depending on the value of the assets received and the nature of the asset)
- 1996 - Agricultural relief and business property relief increased to 75% of the taxable value of the relevant assets
- 1997 – Agricultural relief and business property relief increased to 90% of the taxable value of the relevant assets.
- 1999 - CAT tax-free thresholds increased: Group A – to €381,000; Group B – to €38,100 and Group C – to €19,046. The Group A threshold now 10 times the Group B threshold and 20 times the Group C threshold.
- Introduction of single CAT rate of 20% on all amounts above tax-free thresholds.
- 2008 – Finance (No. 2) Act 2008 increased the rate to 22% on all amounts above the relevant tax-free threshold.
- 2009 - Supplementary Budget 2009 increased the rate to 25% on all amounts above the relevant tax-free thresholds; and group tax-free thresholds reduced by 20%.
- 2010 – Modernisation of CAT system, including introduction of a single payment date (31 October), abolition of secondary liability, and mandatory electronic filing where claiming major reliefs.
- 2011 - Budget 2011 reduced Group tax-free thresholds by 20%: Group A - €332,089; Group B - €33,208 and Group C - €16,604.
- No CPI link from January 2011
- Single payment date brought forward from 31 October to 30 September
- Finance (No. 3) Act transposed provisions of Civil Partnership Act into tax law.
- Budget and Finance Act 2012 -CAT rate increased to 30% and Group A threshold reduced to €250,000.

3.3 CAT Reliefs/Exemptions

The main CAT reliefs and exemptions are as follows:

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

- Spouses, Registered Civil Partners and former co-habiting spouses
  Gifts and inheritances between spouses are exempt from CAT. Finance (No. 3) Act extended this treatment to registered civil partners and former co-habiting spouses who transfer property under a court order.

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

- CAT Agricultural/Business Relief
  Qualifying farmers and business owners can avail of CAT agricultural/business relief which reduces liability to CAT by 90%. To qualify for agricultural relief, 80% of the beneficiary's assets, after having received the gift/inheritance, must consist of qualifying agricultural assets.

- CGT/CAT "same event" relief
  If CGT and CAT is payable on the same event (for example, a gift of land by a parent to a child) any CGT paid by the parent can be used by the child as a credit against her/his CAT liability.

3.4 Possible Capital Acquisition Tax issues - Budget/Finance Act 2013

A number of possibilities can be identified for consideration:

(i) Increase CAT yield by increasing the rate

- Increase the current single rate of 30%
- Re-introduce 'slicing'

(ii) Broaden the base for CAT by abolishing or restricting existing reliefs/exemptions

- Reduce the three tax-free thresholds (Groups)
- Reduce agricultural and business property relief
- Reduce the small gift exemption (currently €3,000)

(i) Options for increasing the CAT rate

- Increase the current single CAT rate of 30%

  The CAT rate has increased three times since late 2008, mirroring the developments in CGT:

  - Finance (No. 2) Act 2008: increase in the rate from 20% to 22%
  - Supplementary Budget 2009: increase in the rate from 22% to 25%
  - Budget and Finance Act 2012 – increase in the rate from 25% to 30%

  The rate increase in Budget 2008 was the first rate change since Budget 1999 when a single 20% rate was introduced on all amounts above the three tax-free thresholds – previously there were different rates depending on the amount received. As with CGT, any consideration of changing the CAT rates has to be considered within the overall context of taxation policy for Budget 2013; in particular, with regard to the balance between taxes on employment/employment creation (i.e. Income and Corporation Taxes) and taxes on capital/wealth. The potential impact of a rate change on the owners of assets subject to CAT on disposal is also a factor. However, CAT is less dependent on behaviour than CGT.

- Re-introducing "slicing"
  As an alternative to a single CAT rate, consideration could be given to reintroducing "slicing". Up to 1999 CAT was payable in "slices", with rates increasing depending on the amount inherited above the tax free thresholds. Consideration could be given to re-introducing slicing on higher inheritances (for example, 30% on the first €100,000 gifted/inherited over the threshold and a higher rate on greater amounts).

(ii) Options for broadening the CAT base

- Reduce tax-free thresholds
  The Group A threshold is currently 7.5 times the Group B threshold and 15 times the Group C threshold. This excludes many inheritances within families from CAT. It also contributes to the largest share of the CAT yield coming from gifts/inheritances within the Group B threshold. Consideration could be given to further reducing the differential.

- Reduce agricultural and business property relief
  The Commission on Taxation recommended reducing these two reliefs from 90% to 75% of the taxable value of the relevant assets and capping the relief at €3 m. This would increase the yield from CAT and could be a useful measure in terms of base-broadening and ensuring equity for different classes of taxpayers. However, it could have a negative impact on the development and growth of family businesses. The Commission also recommended that the two reliefs be amalgamated by aligning the conditions for availing of the reliefs.

  Alternatively, consideration could be given to providing that an individual could only claim either the CAT tax-free threshold or agricultural/business relief in respect of a gift or inheritance, rather than being able to claim both, as is the case at present. This would mean that at least some CAT would be payable on most inheritances/gifts of such agricultural and business property.

- Reduce the small gift exemption
  This is currently €3,000 and was previously €1,270. Consideration could be given to reducing it but any additional yield is likely to be minor.

4. Stamp Duty

4.1 Introduction

Stamp Duty is generally a tax on documents or transactions. It has been in existence since the late 17th Century. There are a variety of Stamp Duties; some are fixed (e.g., Stamp Duty on credit and debit cards, which is a fixed amount irrespective of how much the card is used), while others are levied on an *ad valorum* basis, i.e. according to value (e.g., Stamp Duty at 1% on the value of shares sold).

The main (non-property) Stamp Duties are:

- Financial Cards (including ATM, credit and debit cards) and cheques
- Insurance and other Levies
    - Non-Life
    - Life
    - Health Insurance
    - Pension Fund Levy (introduced in Finance (No. 2) Act 2011)
- Shares

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

4.2.1 Introduction

Stamp Duty on cheques, bills of exchange and promissory notes has been place for over 100 years. When electronic means of money transfer (credit cards, ATM cards and debit cards) were introduced, Stamp Duty was gradually extended to those products to ensure that receipts from financial transactions and products were not eroded.

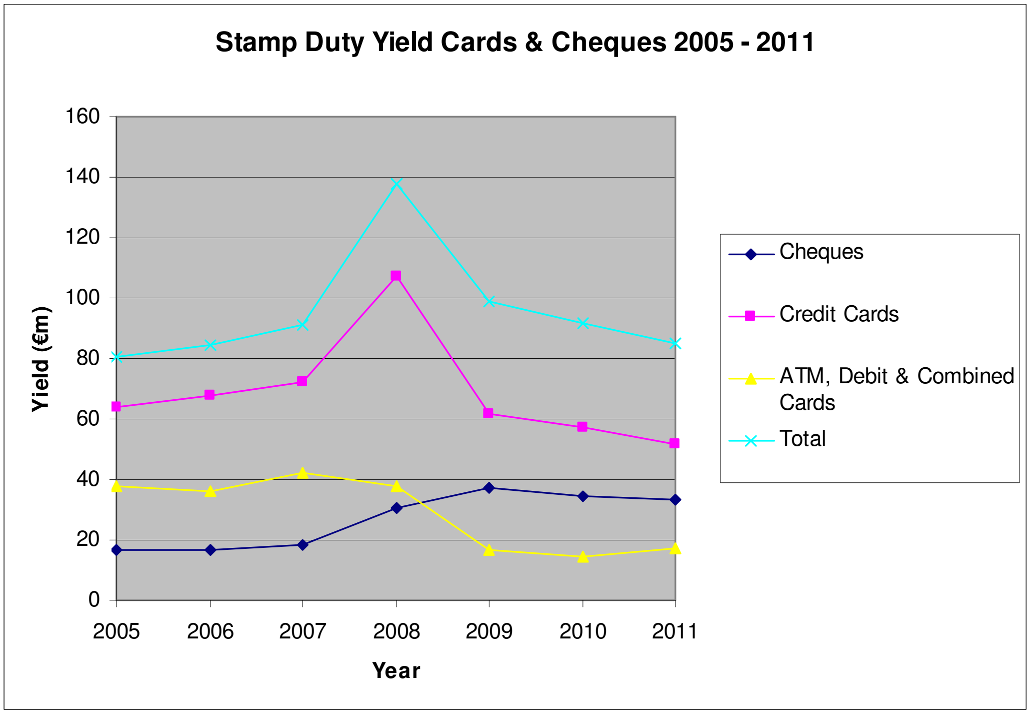
Stamp Duty on cheques is charged per cheque. The Stamp Duty on credit cards is charged on accounts open at any stage during the year and is payable on 1st April of each year in arrears, or on the date the account is closed. The Duty on credit cards is not apportioned – for example, if a credit card account is closed on 2 April, the full Stamp Duty for the year is chargeable. The Stamp Duty on ATM and debit cards is charged on relevant accounts at 31 December each year.

Current stamp duty charges are as follows:

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

4.2.2. Yield from financial cards and bills of exchange

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



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

The Stamp Duty yield from financial cards and cheques rose every year between 2002 and 2008, but declined considerably in 2009 – this can be attributed to a decline in their use. The yield for 2010 was €106 million, down from €115 million in the previous year, and the yield for 2011 was €102 million.

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

Consideration may be given to reducing/eliminating Stamp Duty on ATM/debit/combined cards, in line with the Commission on Taxation's recommendations. If considered, this could be balanced by increasing the charge on cheques and Bills of Exchange. However, the increased charge is unlikely to compensate for the reduced Stamp Duty yield from cards, etc.

The Government (and the European Commission by way of a Recommendation) has announced its support for a scheme for banks to provide "basic payment accounts" for individuals who currently do not have a bank account, to encourage financial in inclusion. The scheme was launched on a pilot basis in mid-2011. No Stamp Duty is charged on ATM/debit cards attached to "Basic Payment Accounts". The introduction of such accounts would not prevent consideration of reducing or abolishing the duty on ATM, debit and combined cards on mainstream accounts.

Consideration could also be given to reducing Stamp Duty on credit cards, in order to facilitate electronic commerce, although this could lead to criticism that the State was encouraging individuals to get into debt via credit cards. No other European country has a Stamp Duty on credit cards, although there is such a duty in Malaysia.

In light of 'tiger' bank robberies, there was some discussion of imposing a charge for using ATMs. Although it was unclear whether this would be charged (and kept) by financial institutions or levied as part of the existing Stamp Duty regime, there would again be implications for the existing Stamp Duty on financial cards and instruments.

4.3 Insurance Levies and the Pension Fund Levy

4.3.1 Non-Life Insurance Levy

A 2% stamp duty on certain non-life insurance products (for example, house and motor insurance) was introduced in 1982 and it is charged on most non-life insurance premiums. The exceptions are re-insurance, voluntary health insurance, marine, aviation and transit insurance and export credit insurance. Finance Act 2009 increased the rate to 3% for premiums received by an insurer on or after 1 June 2009. The rate is still low relative to insurance levies in other European countries.

The non-life levy yielded €109m in 2010, up from €86.4 million in 2009 – the difference is at least partly attributable to the fact that the 3% rate only applied for half of 2009. The yield for the year 2011 was €106.4 million.

The non-life levy previously co-existed with an insurance compensation levy which was used to fund the bailouts of the Insurance Corporation of Ireland and the PMPA. A new insurance compensation levy at 2% has now been introduced to deal with the difficulties of Quinn Insurance.

4.3.2. Life Insurance Levy

Finance Act 2009 introduced a new levy on life insurance policies at a rate of 1% on premiums received by an insurer on or after 1 August 2009. An earlier life insurance levy was in place from 1982 to 1993. After some intensive lobbying from the insurance industry, it was amended in Finance Act 2010 so that it did not apply to life insurance premium income attributable to pension products – new business in the pension sector had declined sharply as a reflection of the general economic position.

It now applies to life insurance protection products (e.g., mortgage protection) and investment products. There are ongoing requests from the industry for additional changes to the levy which will further restrict its nature, thus reducing the yield from this source – this pressure relates to continued business difficulties for this sector and an argument that they are losing business to competitors in the banking sector because customers are not investing in products which would be subject to the levy, but instead putting their money in other investment products.

Consideration could be given to imposing the levy on products which would be in direct competition with life insurance-based investment (such as unit trusts and tracker bonds, which are also subject to similar exit taxes to life insurance products).

Alternatively, consideration could be given to removing the levy from life insurance investment products and imposing it solely on protection products at a rate of 3% - this is the same rate as the non-life insurance levy, which is imposed on products such as motor or home insurance which are analogous to life assurance protection products. This could protect the current yield and prevent any arguments that the life assurance industry was being discriminated against. However, mortgage protection policies would be one product affected (albeit that the actual increase in premium payments would be small) and such an increase could lead to criticism at a time when some people are having difficulties paying their mortgages.

The life insurance levy yielded €45 m in 2010 and €31.6m in 2011. In the six months ending 30 June 2012 was €12.6m. . The fall in the yield may reflect moves to transfer portable investment business away from life insurance and into products not subject to the levy.

4.3.3 Health insurance levy

A levy on health insurance premiums was introduced in the Health Insurance (Miscellaneous Provisions) Act 2009. It was introduced to facilitate community rating on health insurance following the judgment in *BUPA Ireland Ltd and another* v *Health Insurance Authority and others* [2008] IESC 42 which struck down the Government's community rating scheme. The levy is accompanied by an income tax relief at source for health insurance policy holders aged 60 and over – this is paid by Revenue to the health insurance companies. The scheme is intended to be Exchequer neutral (the amount of levy collected is intended to equal the tax relief paid out). In January 2012 the levy was increased by 40% - from €205 to €285 for an adult and from €66 to €95 for a child.

The scheme, and a related EU State Aid approval, is predicated on the Department of Health developing a more sustainable policy response to the BUPA judgement to replace the current temporary scheme.

The current "interim" scheme will expire on 31 December 2012. Legislation is forthcoming from the Department of Health to replace it with a permanent risk equalisation scheme, under which the Health Insurance Levy will continue to be collected as a Stamp Duty but the age related income tax credits will be replaced with more targeted "health credits" which will not be administered through the income tax system..

This health insurance levy yielded €196.9 million in 2009 (in respect of seven months of renewals) and yielded €317 million in 2010. The yield for 2011 was €347m (almost 25% of the total stamp duty take) and in 2012 was €436 m.

The legislation provides that the levy and TRS are reviewed on an annual basis so that any changes (usually upwards to reflect claims history and costs) can be announced and made in December well in advance of the vast majority of renewals by customers.

The continued cancellation of policies by customers in the context of financial difficulties and, in many cases, unemployment will ensure that the levy will continue to rise in the coming years because higher claim costs will have to be borne by a decreasing number of customers.

4.3.4 Pension Fund Levy

A levy on funded pension schemes was introduced in Finance (No. 2) Act 2011 to fund the tax reduction and expenditure measures of the Jobs Initiative. The levy will apply for four years (2011 to 2014) at a rate of 0.6% on pension fund assets as of 30 June in each year. The levy yielded €463 m in 2011 and seems on target to produce a similar yield in 2012 (the payment date deadline is 25 September and details of the full yield were not to hand at the time this paper was finalised)

4.4 Stamp Duty on share transfers

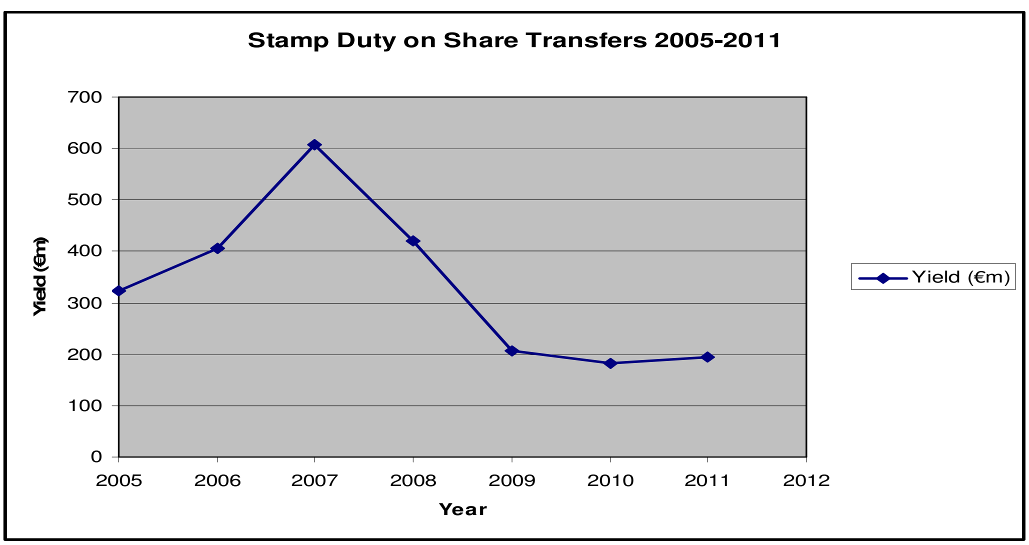
4.4.1 Introduction

Under rules laid down by the Department of Jobs, Enterprise, and Innovation, the only approved operator that can transfer legal title in Irish quoted companies is ‘CREST’ and all dematerialised shares must be transferred in CREST. Share transfers outside of CREST require a share transfer certificate and this must be stamped by Revenue. Share transfers incur a 1% stamp duty charge; there are exemptions for intermediaries. Any instrument executed on or after 24 December 2008 which transfers stock or marketable securities on sale where the amount or value of the consideration is €1,000 or less, is exempt from stamp duty, where the sale or transfer does not form part of a larger transaction or of a series of transactions in respect of which the amount or value, or the aggregate amount or value, of the consideration which is attributable to stocks or marketable securities exceeds €1,000 and the instrument of transfer contains the necessary certification by the transferee.

4.4.2. Yield from Stamp Duty on Share Transfers

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

Year	Yield (€m)
2005	324.00
2006	406.00
2007	608.70
2008	419.40
2009	207.60
2010	181.74
2011	194.76



The estimated yield in the six months to 30 June 2012 is €87.83 million.

The recent significant decline in the yield from Stamp Duty on shares can be attributed to declining asset values and a reduction in the number of transactions. Given the likely continuation of this trend, or at best, maintenance of the current asset values and low transaction figures, there is little chance of an improvement in the yield from Stamp Duty on shares in the short to medium term.

4.4.3 Financial Transactions Tax (FTT)

In September 2011 the European Commission presented a proposal for a financial transaction tax (FTT) in the 27 Member States of the European Union to be levied on all financial instrument transactions between financial institutions where at least one of the transaction parties is located within the EU. The proposed rate on exchanges of shares was 0.1%. The tax would be levied on financial institutions – non-financial institutions will not be covered. At the Economic and Financial Affairs Council meeting in June it became clear that an EU-wide FTT would not be agreed, and those countries who favour the tax will now try to introduce it by way of "enhanced co-operation" (under which at least nine countries must participate). Ireland will not be among the participating countries. If the FTT proceeds by way of enhanced co-operation, we would have to ensure compatibility with our current Stamp Duty on shares (it is possible that a transaction could be liable both to Irish Stamp Duty and an FTT in another Member State).

4.4.4 Stamp Duty on Share transfers – issue for consideration

Consideration might be given to reducing/eliminating Stamp Duty on share sales, as recommended by the Commission on Taxation. There is also an initiative to introduce an EU-wide system for clearing share transactions, which would have implications for collecting Stamp Duty on shares. However, the cost of abolishing the duty would be considerable at over €194m, based on 2011 yields.

5. Deposit Interest Retention Tax (DIRT)

5.1 Introduction

Deposit Interest Retention Tax (DIRT) is deducted by Irish financial institutions from deposit interest paid to the accounts of Irish residents. The basic rate is 30% where interest is paid or credited at least once annually (most bank accounts) and 33% where it is paid less frequently. An exit tax applies to life assurance and funds products, at the same rates (30% and 33%).

DIRT is a "final liability tax" – that is, it satisfies the individual's full liability to Income Tax in respect of deposit interest, although the individual may still be liable to PRSI. Deposit interest subject to DIRT is not subject to the Universal Social Charge. [Previously, income subject to DIRT was subject to the Health Contribution but not to the Income Levy.] Subject to certain statutory exceptions, financial institutions are required to deduct the tax from interest paid or credited in respect of the income on deposit.

Up to Budget 2009, the rate of DIRT was equal to the standard rate of Income Tax at 20%. In line with policy on capital and savings taxation to shift the burden from labour and consumption to wealth/capital and the sources of wealth, the DIRT rate was increased in line with increases for CGT and CAT, namely:

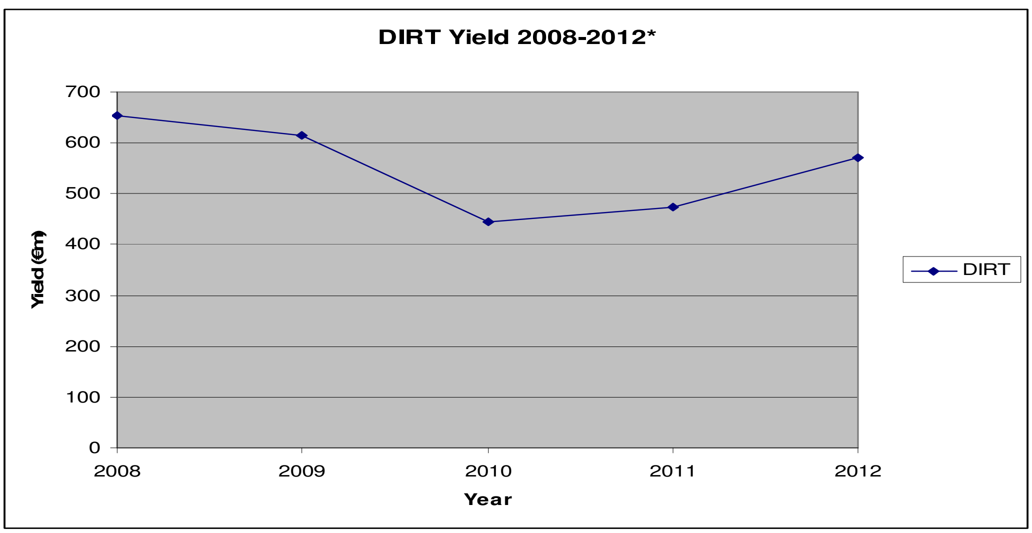
- Budget 2009: increase from 20% to 23%[1]
- Supplementary Budget 2009: from 23% to 25%[2]
- Budget 2011 from 25% to 27%[3].
- Budget 2012: from 27% to 30%[4]

5.2 Evolution of DIRT

- 1986 – DIRT introduced at 35% (pegged to the standard rate of income tax)
- 1994 - DIRT becomes a final liability tax (see above).
- 2007 - Finance Act 2007 introduced a new scheme to allow the operation of DIRT free savings accounts for two groups: (a) account holders aged over 65 years of age whose total income does not exceed the relevant exemption threshold. (€20,000 (for an individual) or €40,000 (for a married couple) in 2010; and (b) permanently incapacitated persons. These groups were already entitled to have DIRT refunded.
- 2009 - Standard rate of DIRT increased from 20% to 23% for all payments, including deemed payments made on or after 1 January 2009.
  Standard rate of DIRT increased from 23% to 25% for all payments, including deemed payments made on or after 8 April 2009.
- 2011 – Standard rate of DIRT increased from 25% to 27% for all payments, including deemed payments made on or after 1 January 2011.
- The age exemption limits were reduced to €18,000 (single persons) and €36,000 (married couple).
- Budget 2012 – Standard rate increased to 30% for payments nad deemed payments after 1 January 2012
-

5.3 Net Yield from DIRT

The graph shows the yield from DIRT since 2008:



[1] From 23% to 26% for interest paid less frequently than annually, life assurance and funds products.
[2] From 26% to 28% for interest paid less frequently than annually, life assurance and funds products.
[3] From 28% to 30% for interest paid less frequently than annually, life assurance and funds products.
[4] From 30% to 33% for interest paid less frequently than annually, life assurance and funds products.

The DIRT yield in all 12 months of 2011 (ie, as at end December 2011) was €473.3m. By end August 2012 the yield had reached €445.8m.
The yield for 2012 is expected to come in at about €48m ahead of the Budget target of €524m.

5.4 DIRT issues for consideration

The sharp increase in the DIRT yield in 2007 and 2008 can be attributed to an increase in deposit interest rates and rising savings levels in the economy as investors moved away from more-risky investments such as property and shares. Interest rates fell in 2009, but the yield held up reasonably well, although this may be attributable to the increased rate (all DIRT received in 2008 would have been at the 20% rate whereas DIRT received in 2009 would have been at the 23% or 25% rate). Although the DIRT rate remained unchanged in 2010, the yield fell by 28% (down from €614 m to €445 m). The increases in the rate in 2011 and 2012 helped to protect the yield.

The standard DIRT rate, as well as the CGT and CAT rates are now aligned with the minimum Income Tax rate for high earners, i.e., 30%.

Given the current high rates of saving in the economy, consideration could be given to an increase in the two DIRT rates – there may be some potential 'leakage' of savings to other jurisdictions, primarily the UK, but many people would not move their savings. However, the rate is now one and a half times what it was in late 2008. [Deposit interest income is subject to PRSI in certain circumstances, but not to the USC.] A further increase in the DIRT rate could also have consequences for the banking sector in Ireland.

Consideration could be given to making DIRT no longer a final liability tax – that is, higher rate taxpayers would have an additional liability to income tax on deposit interest over and above any DIRT deducted. This would require individuals to declare the income, either through the PAYE system or by self-assessment, and this could lead to compliance issues. If such a change was made, in the interest of equity the DIRT rate might also have to be re-aligned with the standard rate of Income Tax. It is possible that no additional yield would result from such a move.

Consideration could be given to restricting or abolishing the current age-related exemption limits, or to excluding deposit interest income from the income taken into account for the exemption limits. The exemption limits were reduced by 10% in Budget 2010 (down from €20,000 to €18,000 for single individuals and from €40,000 to €36,000 for married couples). The yield from such a change is likely to be negligible but it could give rise to much resentment.

The Tax Strategy Group may wish to discuss.

Capital and Savings Taxation Policy
September 2012