TSG 10.13

Tax Incentives Expenditure

This paper on Tax Incentives Expenditures is divided into three sections:

Section 1 – Property Based Schemes Legacy Reliefs
Section 2 – Limerick Regeneration
Section 3 – Review of Tax Expenditures Budget 2011

Section 1 – Property Based Schemes Legacy Reliefs

Background

1. The Programme for Government states the following "*We will eliminate unnecessary tax reliefs and ensure that those relief schemes which are closed to new entrants will be eliminated during the lifetime of the Government where possible*". The only scheme still open to new entrants is the Mid-Shannon Corridor Tourism Infrastructure Scheme. New entrants have until 31 May 2012 to submit project applications for approval in principle. Expenditure on approved projects under this scheme that is incurred before 31 May 2015 can qualify for capital allowances. The scheme for palliative care units has not been commenced[1].

2. The Commission on Taxation did not examine the property-based tax incentive schemes that are closed to new entrants. However, because of the nature of these reliefs, they will continue to impose costs on the Exchequer for the duration of the "legacy" of these schemes. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXX

XXXXXXXXXXXXXXXXXXXX

3. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

Operational Difference between Commercial and Residential Schemes

4. Because there are significant differences in the operation of tax relief between the commercial and residential schemes separate tables have been set out hereunder in relation to the 'non-cost' elements of the schemes.

   a) ANNEX 1 contains the commercial schemes,
   b) ANNEX 2 contains the residential schemes, and
   c) ANNEX 3 contains composite cost to the Exchequer figures for both commercial and residential relief.

---
[1] When the Commencement Order is made the commencement date will be made retrospective to 13 March 2008.

5. The termination dates which differ across schemes are the dates by which the construction or refurbishment work on a building has to be carried out if the expenditure that is attributable to that work is to qualify for tax relief.
   - Where a building is not completed by the termination date the expenditure attributable to any construction or refurbishment work that takes place after this date cannot qualify for tax relief.
   - There are no set dates by which a person has to acquire a tax incentive property in order for tax relief to start to be claimed.
   - Tax relief can only start to be claimed after a building has been completed and the building leased or owner-occupied for the purposes required by the particular scheme.
   - Once a building has been leased or owner-occupied and is in use for the required purpose, tax relief can be claimed over varying periods.
   - In addition, the rate at which the available tax relief can be used up depends on the particular taxpayer having sufficient taxable income in any year to absorb the relief.
   - Any unused relief (with the exception of that for residential owner-occupier relief) can be carried forward indefinitely until it has been absorbed.
   - Thus, it is not possible to provide an indication of the final year in which tax relief under these schemes will be claimed as the start year for relief can vary from building to building and the relief period applicable likewise can vary within some of the schemes and between different taxpayers.

Scenarios for consideration

6. A number of scenarios are being explored to end, phase out or delay the use of property based capital allowances, section 23 relief and double rent allowances going forward suggest themselves. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX.

7. It is extremely difficult to assess how much additional tax inflows to the public purse could result in the short to medium term from any of these proposals. In some cases, where those affected have sufficient income, there may be an increase in the tax take. In other, loss-making situations, no net increase in tax is likely to accrue to the Exchequer, though the time in the future at which tax may be payable, will be brought closer.

8. While most of the reliefs, which are the subject of these proposals, have been terminated by now, the Exchequer effects will be felt for some considerable time to come. In the case of capital allowances, these affects arise from unused capital allowances carried forward, capital allowances not yet given and in some cases in respect of properties constructed but not yet sold resulting in entitlement to capital allowances not yet crystallising. The ongoing effects of section 23 type relief arise from losses carried forward but not yet set against Case V income as well as properties still under construction.

   The 4 scenarios being explored are as follows:

Scenario 1. End Incentive Reliefs:

9. This scenario would involve the following:
   - Any unused capital allowances carried forward beyond 2010 to be lost.
   - No further annual allowances to be given beyond 2010.
   - No new capital allowances to be given beyond 2010.
   - All section 23 losses carried forward beyond 2010 to be lost.
   - No new section 23 relief, which arises after 31 December 2010, to be given.

- All losses carried forward beyond 2010 attributable to double rent allowance to be lost.
- No double rent allowance to be allowed in chargeable periods beyond 2010.

Scenario 2. Phase Out Incentive Reliefs Over 4 Years:

10. This scenario involves a phased reduction in the amount of unused capital allowances carried forward or yet to be given to a percentage of what might otherwise have been available. The proposal involves a reduction to 75% in 2011, 50% in 2012, 25% in 2013 and zero thereafter. Any unused capital allowances carried forward into 2014 and onwards and any capital allowances which might otherwise have been given in 2014 and subsequent years are permanently lost.

11 The mechanism by which the relief is withdrawn is similar to that set out in the bullet points in Option 1. For example, a section 23 loss of €100,000 carried forward into the tax year 2011 is automatically reduced to €75,000 under the 75% limit. Similarly, a 15% year 4 capital allowance in respect of expenditure on the construction of a hotel, which is to be given in 2011, will be correspondingly reduced. Any unused capital allowances carried forward from 2010 into 2011 are reduced to 75%.

12 The double rent allowance must be similarly restricted. In reality this allowance comprises 2 elements; the amount of rent actually paid and another notional amount equal to the rent paid. The restriction can only apply to this notional amount. The relief is given as an additional deduction equal in amount to the rent.

13 The scenariol is as follows:

- The additional deduction is reduced to 75% for 2011, 50% for 2012 and so on.
- Losses carried forward attributable to double rent allowances must be deemed to comprise equal amounts in respect of rent actually paid and the additional allowance already given. The loss carried forward to 2011 should, therefore, be reduced by 12.5%. The appropriate reduction for losses carried forward to 2012 is 25% and so on, culminating in 50% in 2014. This means that in 2014 and any subsequent year, the only amount allowed as a deduction, whether carried forward or in respect of that year, is the amount actually paid in rent.

Scenario 3. Extend Period of Reliefs out to Max. of 25 Years

14 This scenario involves a further slowing down of the rate at which capital allowances, section 23 relief and double rent allowance is to be given to a period not greater than 25 years. This is the longest period currently allowed for industrial buildings allowances purposes (in non-incentive areas or sectors). For buildings already constructed and in use, the period is 25 years less the length of time for which the relief has already been given. It should be noted that under this option, the full amount of the relief to which the taxpayer is entitled, will be given, albeit over a considerably longer period of time.

15 For <u>section 23 relief</u>, the proposals are as follows:

- At end of each year, the remaining tax-life of each section 23 property (25 years less the period since the first use of the property) as well as amount of section 23 relief still extant in respect of that property to be calculated. The second figure divided by the first sets the upper limit on section 23 relief available for use in that year.
- The order of set-off of relief against Case V income to be set out. Older buildings before newer ones.

- Sale of property before end of holding period (10 years) results in clawback of relief already given (current situation) and transfer of relief to second owner to be set off over balance of 25 year period.
- Sale of property after end of holding period results in no clawback and continued availability of section 23 relief against Case V income, subject to limit imposed at first bullet point above.
- After end of the tax-life of property (25 years) all limits cease and any remaining section 23 relief is available immediately in full against Case V income.
- High earners restriction takes precedence over these proposed limits.

16 The proposal for capital allowances is, in many ways, analogous to that proposed for section 23 relief. The simplest way to deal with the double rent allowance under this option is to disallow it. The lessee will still be entitled in these circumstances to a deduction of an amount equal to the rent actually paid but no more.

17 The details are as follows:
- The remaining tax-life of the building is calculated as in bullet point regarding section 23 relief.
- Capital allowances are given and carried forward, either as unused capital allowances in exactly the same way as currently.
- At the end of each year, the amount of such unused capital allowances, together with any allowances to be given in that year, are calculated in respect of each building. This figure, divided by the remaining tax-life of the building is the upper limit of such allowances, which can be used to reduce taxable income.
- Other restrictions (high earners restriction, limits on sideways use of capital allowances etc) take precedence over limit imposed under this proposal.
- At end of the tax-life of building, any unused capital allowances may be set against income without restriction.
- Balancing charges and clawback of relief already given in the event of a sale before the end of the holding period should be computed as at present.
- High earners and other restrictions to take precedence over this limitation.

Scenario 4. – Do Nothing

18 As already stated the impact of the horizontal measure in restricting the amount of relief in any one year has had the effect of spreading the cost to the Exchequer over a longer period, by reducing the impact each year going forward. Reports from Revenue Commissioners indicate that the restriction as introduced worked as intended. The changes introduced in Budget and Finance Act 2010 has further curtailed the amount of tax relief that can be claimed by individuals in any one year.

Conclusion

19 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX These are being examined in advance of the Budget.

20 There are a number of key and very complex issues which require consideration in relation to the legacy aspect of the reliefs currently available:

- The annexes provide a list of the various schemes indicating the wide range of start dates, termination dates and the writing down periods. It also provides information on the type of relief available to both commercial and residential purchasers.

- Each Scheme has its own <u>unique</u> criteria, qualifying period and capital allowances regime.
- These factors complicate reaching a definitive position for <u>all</u> schemes

21 The writing down period is also complex for the following reasons:

- XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXX
- XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXX
- XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
- The restriction of reliefs, or horizontal measure, introduced in 2007, is having an impact on those taxpayers that claim a total amount of reliefs above €250,000 per annum. The measure has increased the effective rate for the tax payers concerned to 20% for those affected by the full restriction, by reducing the amount of relief allowed by 50%. This had the effect of increasing the writing down period of the relief. On the other hand it could be argued that this has reduced the tax foregone by the Exchequer each year.
- <u>It is therefore not possible to state the final year by which tax relief under any scheme will be claimed. Once construction is completed and the building is sold (owner occupier) or leased only then can tax relief be claimed.</u>
- Qualifying expenditure is written off at various rates depending on the type of relief being claimed.
- Unused relief (with the exception of residential owner-occupier) can be carried forward indefinitely until used up.
- Finally, given the overhang in the property market of completed, not yet completed properties and unsold it is difficult to quantify the potential impact on the Exchequer in the coming years should theses properties be sold.
- XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXX

<u>Section 2 – Limerick Regeneration</u>

22 Arising from the publication of the Phase One Implementation Plan for the Limerick regeneration programme the Government agreed to the following on 15 June 2010:

(2) agreed to endorse the approach set out for the delivery of key physical, social, and economic infrastructure projects in the Moyross, Southill, Ballinacurra Weston and St. Mary's Park areas, over the period June 2010 to December 2014, as set out in Section 3 of the memorandum;

(5) agreed that a proposal for a new tax incentive scheme, centred around economic, employment, and social regeneration aspects of the Implementation Plan, to stimulate the

delivery of necessary private investment and enterprise development for Limerick Regeneration would require to be developed so that the specific terms can be assessed and State Aid issues considered; and to ask the Inter-Departmental Group, established to explore opportunities to incentivise private sector investment, to draw up proposals for such a scheme for consideration while considering other options to support enterprise development;.

Comment

23 Arising from the Government decision of 15 June 2010, the Dept. of Finance has been in contact with the Dept. of Environment and informed them that if anything in relation to the Limerick Project is to be included in 2011 Finance Bill detailed preparation would need to begin immediately...