TSG 11/06

TAX STRATEGY GROUP

Capital and Savings Taxation Issues

1. Introduction and context

1.1 Scope of this paper

This paper covers a range of Capital Taxes, including Capital Gains Tax (CGT), Capital Acquisitions Tax (CAT), certain Stamp Duties (those covering financial cards and financial instruments), and taxes on savings (DIRT and exit taxes). It sets out the current position for each of the main areas and examines issues that have been raised, or are likely to arise, in the context of the Budget/Finance Bill 2012, including proposals in the Programme for Government and the Memorandum of Understanding with the EU/ECB/IMF.

Stamp Duty on property is covered in a separate paper on the Taxation of Property to be considered by the TSG at a later meeting.

1.2 Programme for National Government

The Programme for National Government: Government for National Recovery 2011-2016 sets out guiding principles for economic and fiscal policy for the lifetime of the Government. The Programme commits the Government to a deficit reduction strategy which does not undermine short-term recovery or investment for long-term growth.

1.3 Memorandum of Understanding with the EU/ECB/IMF

The Memorandum of Understanding with the EU/ECB/IMF (MoU) states that the Government will provide a draft budget for 2012 aiming to further reduce the general Government deficit including the detailed presentation of consolidation measures totalling €3.6 billion including, inter alia, "a reform of capital gains tax and [capital] acquisitions tax".

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 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.

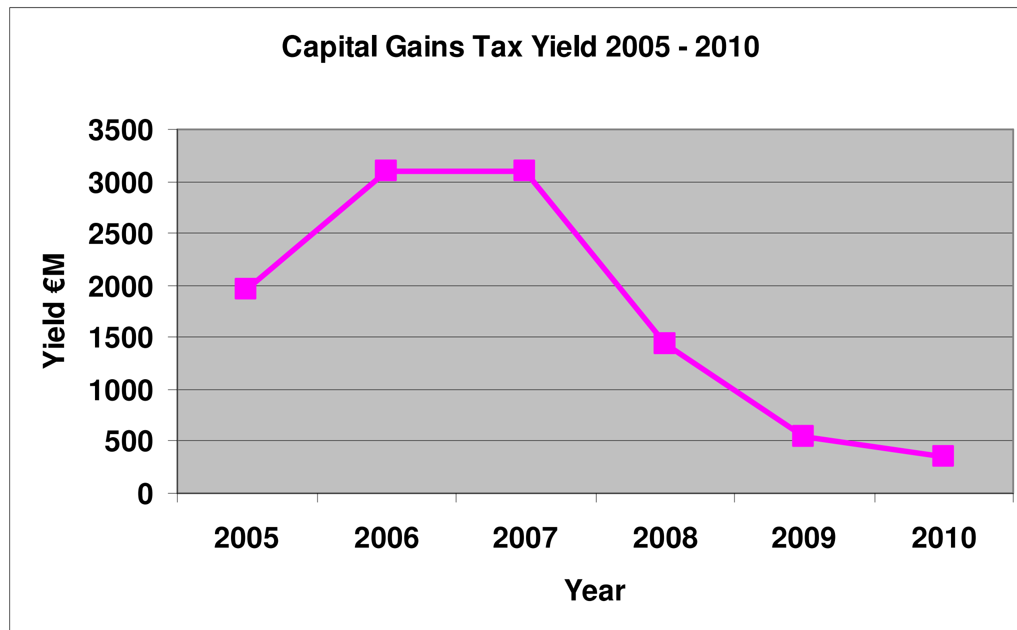
2.2 Evolution of CGT

- **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.

2.3 CGT Yield

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



The CGT yield in 2010 was €347 m, down from €542 m in 2009 – a fall of €195m (37%). The main payment date for CGT is in December. The 2010 yield is only 11% of the CGT yield in its peak year of 2007 (€3.105 billion).

The recent drop in the CGT yield can be attributed 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 an 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 to 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 relief applies to assets valued up to €750,000. Where the disposal is made to a child or favourite niece/nephew, there is no monetary limit to the relief.

- Remittance basis
  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.

2.5 Capital Gains Tax measures in Budget/Finance Act 2011

Given the short time period for the enactment of Finance Act 2011 no Capital Gains Tax measures were contained in that Act.

2.6 Capital Gains Tax measures in Finance (No. 3) Act 2011

Finance (No. 3) Act transposed the provisions of the Civil Partnership and Certain Rights and Obligations of Cohabitants Act 2010 (the "Civil Partnership Act") into tax law. In Capital Gains Tax, this involved extending the "no gain/no loss" treatment of transfers between spouses, and between separated and divorced spouses under maintenance agreements, to transfers between registered civil partners, separating civil partners, and former opposite sex cohabitants under a maintenance agreement.

2.7 Possible Capital Gains Tax issues - Budget/Finance Act 2012

As outlined above, the MoU provides for reform of Capital Gains Tax in Budget 2012. The MoU does not identify any specific measures to be introduced. However, a number of possibilities can be identified for consideration:

(i) Increase CGT yield by increasing the rate

- Increase rate from the existing 25% level
- Align the CGT rate with the minimum Income Tax rate for high earners
- 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
- Abolish/amend retirement 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)

(i) Options for increasing CGT rates

A number of options can be identified for increasing the yield from CGT by increasing rates. The rate has increased twice since late 2008:

- Budget 2009: rate increased from 20% to 22%
- Supplementary Budget 2009: rate increased from 22% to 25%

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, an increase in the CGT rate could have a behavioural impact in that it could deter taxpayers from disposing of assets.

In addition, consideration should be given to whether to vary the current gap between the capital taxes rates (CAT and CGT) of 25% and the standard Income Tax rate of 20%. It may be appropriate to reflect any change to the CGT rate in the CAT rate and possibly also the DIRT rate.

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

- <u>Increase CGT rate for higher rate income tax payers</u>
  The current 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>Align the CGT rate with the minimum Income Tax rate for high earners</u>
  The CGT rate could be aligned with the minimum Income Tax rate for high earners e.g. 30%. If done in conjunction with CAT and DIRT, it would mean that the same minimum rate would apply to all forms of income.

- <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 deter a disposal of an asset at an appropriate time even though it had not been held for a long period.

- Apply higher rates to larger gains
  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 25%, the next €50,000 at 30%, and the balance at 35%.

- Re-introduce a higher CGT rate for disposals of development land
  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.] The previous Government introduced an 80% windfall rate of tax on 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%; or 50%, which is double the current standard rate of CGT).

(ii) Abolition/amendment of reliefs/exemptions

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

- Abolition or amendment of principal private residence relief
  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 the unlikelihood of a considerable yield from this source, and the forthcoming introduction of a property tax, it may not be worthwhile at this point to pursue what is likely to be an unpopular measure.

- Abolition or amendment of retirement relief
  The value of retirement relief has increased considerably in recent years. Disposals of business assets within a family are fully relieved, while the amount of consideration relieved for disposals outside the family has increased in stages from IR£250,000 (=€317,434) in 1995 to its current

rate of €750,000 in 2007. Given the decrease in the value of business assets since then there may be grounds for adjusting retirement relief. It should also be borne in mind that if CGT and CAT are payable on the same event (such as a disposal of business property by parents to children, where retirement relief could be claimed) any CGT paid by the person making the disposal can be taken as a credit against the beneficiary's CAT liability. Options which could be considered include:

- Imposing a cap on retirement relief in intra-family transfers
- Reducing the amount of retirement relief on transfers outside the family (for example, from €750,000 to €500,000)
- Considering the interaction of CGT retirement relief with tax free lump sums taken on retirement (i.e., allow an individual to claim either CGT retirement relief on business assets or income tax relief on lump sums but not both reliefs).

- Amendment of loss relief

  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, 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. However, given the requirement to increase the CGT yield under the MoU, the opportunity for increasing reliefs and exemptions is limited.

- 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 25%. The tax-free thresholds are adjusted annually in line with movements in the Consumer Price Index (CPI). However, no CPI adjustment was made in 2011 because the thresholds had been reduced in December 2010 and a further CPI adjustment would have led to a situation where there would have been three sets of thresholds within one month. The group thresholds are set out below.

CAT Group tax-free thresholds

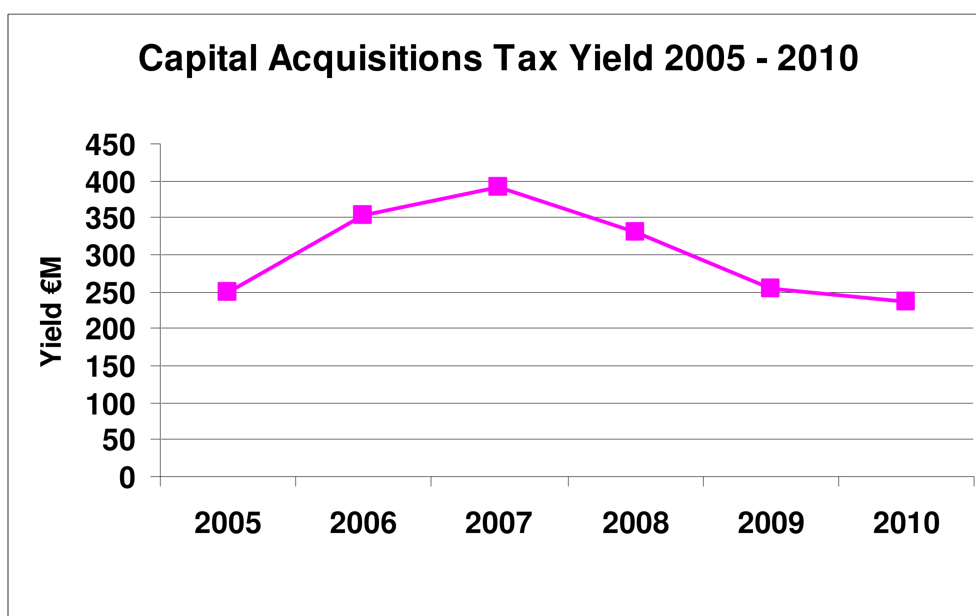
Group	Relationship to Disponer	Group Thresholds 01/01/2010 – 07/12/2010	Group Thresholds 08/12/2010 Onwards
A	Son/Daughter*	€414,799	€332,084
B	Parent/Brother/Sister/Niece/Nephew/ Grandchild	€41,481	€33,208
C	Relations other than Group A or B	€20,740	€16,604

* 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. In the interim, the thresholds had fallen by c. 4% in January 2010 in line with the fall in the CPI. The tax-free thresholds are currently 39% below their peak levels in early 2009.

The CAT yield so far this year has been negligible as Finance Act 2011 introduced a single payment date of 30 September for all gifts or inheritances taken on or before 31 August. As the CAT yield arises mainly from inheritances /gifts, any reduction in the yield can be mainly attributable to decreasing asset values, particularly the decline in property values. Unlike CGT and Stamp Duty, the number of CAT transactions has not suffered a significant decline (the reduction in the number of CAT returns filed in 2010 is attributable to the introduction of a single payment and filing date for CAT).

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



The CAT yield was €236.5m in 2010 (down €19.12m or 7.5% from the yield of €255.6m for 2009). The projected CAT yield for 2011 is €250m, this is some 5.5% higher than the 2010 outturn.

Given the likely continuation of the decline in asset values, or at best, maintenance of current asset values, there is little chance of an improvement in the CAT yield in the short to medium term as the tax is currently structured.

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.
- 1990 – Group tax free thresholds linked to CPI – Group A threshold is IR£150,000, 7.5 times the Group B threshold (IR£20,000) and 15 times the Group C threshold (IR£10,000).
- 1985 – gifts/inheritances between spouses exempted from CAT.
- 1994 - CAT payable at 20% on first IR£10,000 above tax-free threshold, 30% on next IR£30,000 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 – from IR£192,900 to IR£300,000 (€380,921); Group B – from IR£25,720 to IR£30,000 (€38,092); and Group C – from IR£12,860 to IR£15,000 (€19,046). The Group A threshold is now 10 times the Group B threshold and 20 times the Group A 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 in 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.

3.3 CAT Reliefs/Exemptions

The main CAT reliefs and exemptions are as follows:

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

- <u>Spouses, Registered Civil Partners and former co-habiting spouses</u>
  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.

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

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

- <u>CGT/CAT "same event" relief</u>
  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 Capital Acquisitions Tax measures in Budget/Finance Act 2011

The group tax-free thresholds were reduced by 20%, the pay and file date for CAT was brought forward from 31 October to 30 September, and an anti-avoidance provision was introduced to prevent abuse of agricultural relief and business property relief.

3.5 Capital Acquisitions Tax measures in Finance (No. 3) Act 2011

Finance (No. 3) Act transposed the provisions of the Civil Partnership and Certain Rights and Obligations of Cohabitants Act 2010 (the "Civil Partnership Act") into tax law. In Capital Acquisitions Tax, this involved extending the exemption for gifts and inheritances between spouses to gifts/inheritances between registered civil partners, separating civil partners, and former opposite sex cohabitants under a maintenance agreement.

3.6 Possible Capital Acquisition Tax issues - Budget/Finance Act 2012

As outlined above, the MoU provides for reform of Capital Acquisitions Tax in Budget 2012. The MoU does not identify any specific measures to be introduced. However, a number of possibilities can be identified for consideration:

(i) Increase CAT yield by increasing the rate

- Increase the current single rate of 25%
- Align the CAT rate with the minimum Income Tax rate for high earners
- 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

- <u>Increase the current single CAT rate of 25%</u>

  The CAT rate has increased twice 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%

  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 2012; in particular, the commitment in the MoU to reform CAT and 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.

- <u>Align the CGT rate with the minimum Income Tax rate for high earners</u>
  As noted in the CGT section, consideration should be given to whether to align the rate with the minimum Income Tax rate of the "horizontal measure" (30%) or vary the current gap between the capital taxes rates (CAT and CGT) of 25% and the standard Income Tax rate of 20%. It may be appropriate to reflect any change to the CAT rate in the CGT rate and possibly also the DIRT rate.

- <u>Re-introducing "slicing"</u>
  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, 25% on the first €100,000 gifted/inherited over the threshold and a higher rate on greater amounts).

(ii) Options for broadening the CAT base

- <u>Reduce tax-free thresholds</u>
  The CPI is projected to rise by 1% in 2011. This would lead to a minor rise in the current tax-free thresholds. There may be a case for breaking the link with the CPI as the asset which is most likely to pass by inheritance, property, is still falling in value while the CPI is projected to increase.

  Consideration could also be given to further reducing the tax-free thresholds (for example, Group A to €350,000; Group B to €35,000; and Group C to €17,500).

  The Group A threshold is currently ten times the Group B threshold and 20 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 reducing the differential, perhaps to the 7.5 times/15 times ratio which applied between 1989 and 1999.

- 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 proportional (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

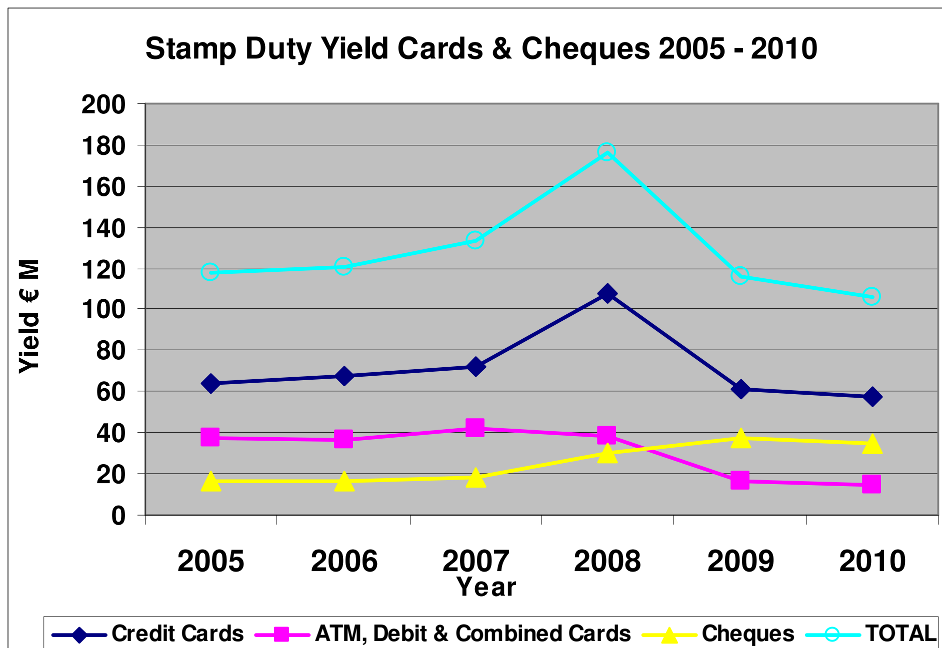
each year in arrears, or on the date the account is closed. The Duty on credit cards is not apportioned – for example, if a credit card account is closed on 2 April, the full Stamp Duty for the year is chargeable. The Stamp Duty on ATM and debit cards is charged on relevant accounts at 31 December each 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.

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. As noted earlier, it is proposed that no Stamp Duty will be charged on ATM/debit cards attached to "Basic Payment Accounts", which are being introduced to encourage financial inclusion. 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.

Recently, there have been some initial discussions at EU and IMF/G20 levels on the merits of introducing a Financial Transactions Tax (FTT) or Financial Activities Tax (FAT) which could cover financial transactions undertaken by individuals and businesses. While this is at a very early stage and will have to be considered at EU Working Group level, there may be implications at some stage for Ireland's Stamp Duty on financial cards and instruments regime.

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 six months to 30 June 2011 was €53 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. Legislation is forthcoming on a new insurance compensation levy to pay for the bailout 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 €17m in the six months ending 30 June 2011. 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 a tax relief at source for health insurance policy holders aged 50 and over – this is paid by Revenue to the health insurance companies. The scheme is intended to be Exchequer neutral (the amount of levy collected is intended to equal the tax relief paid out). The levy is currently €205 per adult and €66 per 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 which will replace the current temporary scheme.

The current "interim" scheme was originally scheduled to expire on 31 December 2011. The Department of Health has recently sought an extension of this scheme for a further year pending the introduction of full risk equalisation. The Department of Finance has agreed to this but has made clear that it does not feel that the tax system is the appropriate long term mechanism to provide for risk equalisation in the health insurance sector.

This health insurance levy yielded €196.9 million in 2009 (in respect of seven months of renewals) and yielded €317 million in 2010. It is payable on 25 September in 2011 so there has been no yield from this source in 2011 to date.

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 an 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 at a rate of 0.6% on pension fund assets as of 30 June in each year. The levy is intended to yield €470 m. The first payment of the levy is due on 25 September 2011.

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.

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
2006	406
2007	609
2008	419
2009	209
2010	187

The yield in the six months to 30 June 2010 was €100 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; factors also noted for the decreased yield for CGT and, to a lesser extent, CAT. 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. Stamp Duty on Share transfers – issue for consideration

Consideration might be given to reducing/eliminating Stamp Duty on share sales, as recommended by the Commission on Taxation. This change would also be in line with EU intentions on this issue which aim to eliminate all Government charges on shares as a means of encouraging the free flow of capital and investments between Member States. 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 €180m, based on 2010 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 27% where interest is paid or credited at least once annually (most bank accounts) and 30% where it is paid less frequently. A 30% rate of exit tax applies to life assurance and funds products.

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 in the rate from 20% to 23%[1]
- Supplementary Budget 2009: increase in the rate from 23% to 25%[2]

Budget 2011 saw the DIRT rate increase from 25% to 27%[3].

5.2 Evolution of DIRT

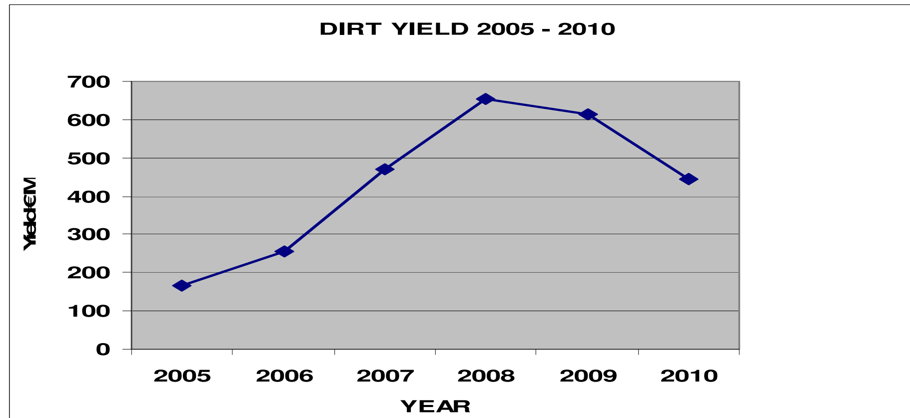
- 1986 – DIRT introduced at 35% (pegged to the standard rate of income tax)
- 1994 - DIRT becomes a final liability tax (see above).
- 2007 - Finance Act 2007 introduced a new scheme to allow the operation of DIRT free savings accounts for two groups: (a) account holders aged over 65 years of age whose 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 - Rate of DIRT increased from 20% to 23% for all payments, including deemed payments made on or after 1 January 2009.
  Rate of tax increased from 23% to 25% for all payments, including deemed payments made on or after 8 April 2009.

[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.

- 2011 – 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).

5.3 Net Yield from DIRT

The graph shows the yield from DIRT since 2005:



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 at 25% for 2010, there was a reduction in the yield of slightly more than 28% (down from €614 m to €445 m). The current rates of 27% and 30% came into effect on 1 January 2011.

Given the current 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.

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. However, it is possible that no additional yield would result from such a move.

In line with the similar proposals in the CGT and CAT sections above, the standard DIRT rate could be aligned with the minimum Income Tax rate for high earners, i.e., 30%. If done in conjunction with CGT and CAT, it would mean that the same minimum rate would apply to all forms of income.

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
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