Budget 2013

Bridging The Gap

O'Hanlon Tax Limited

Introduction

Budget 2013 was published by Minister for Finance Michael Noonan TD on 05 December 2012 (see the Minister's Statement here). The Government is aiming to effect an adjustment of €3.5bn in the economy, and has opted to increase taxes by circa €1.25bn, and make expenditure cuts of circa €2.25bn. The Minister for Public Expenditure and Reform Mr Brendan Howlin, TD outlined the provisions for reducing expenditure (see the Minister's Statement here) and signalled that the timing of future Budgets may change so that they are published earlier in the year.

A review of the main taxation issues announced in the Budget is set out below.

Local Property Tax

Some of the tax changes announced in Budget 2013 were signalled in advance, such as the new Local Property Tax "LPT", and a detailed analysis of the new Local Property Tax is provided in a separate flyer available here.

PRSI

The Minister is increasing the minimum level of annual PRSI contribution from the self-employed from €253 to €500 and abolishing the weekly allowance for employees. The effective increase is €264 per annum.

Unearned income (such as rental income, investment income etc) for PAYE taxpayers will become subject to PRSI from 2014. Up to 2014 unearned income of a PAYE taxpayer is not subject to PRSI.

Capital Taxes

There were a few changes announced by the Minister in the area of capital taxes in relation to rates and thresholds. There were no announcements made in regard to reforms of the core existing reliefs for CAT and CGT but measures may be contained in the Finance Bill.

Capital Acquisitions Tax

The Minister announced an increase in the rate of capital acquisitions tax. The rate has increased from 30% to 33% for gifts or inheritances taken after 05 December 2012. See OHT's CAT Rate Table here.

The tax free thresholds for capital acquisitions tax have been reduced by 10%. The class (a) threshold will be reduced from €250,000 to €225,000, the class (b) threshold will be reduced from €33,500 to €30,150 and the class (c) threshold will be reduced from €16,750 to €15,075. These reduced thresholds apply to gifts or inheritances taken after 05 December 2012.

Capital Gains Tax

In addition to the CGT change announced in regard to farm restructuring (discussed below in the Farm Measures section), the Minister announced an increase in the rate of CGT. The rate has increased from 30% to 33% for transactions that take place after 05 December 2012. See OHT's CGT Rate Table here.

Deposit Interest Retention Tax "DIRT"

The rates of DIRT that applies to deposit interest, and the rates of exit taxes that apply to life assurance policies and investment funds are being increased. For annual payment or payments made more frequently the rates are increasing from 30% to 33%. For payments made on a less frequent basis (i.e. greater than annually) the rate increases from 33% to 36%.

Carried Interest Provisions

A carried interest is the share in profits received by a fund manager for managing a relevant investment. The Minister announced that a review of provisions relating to this area would be carried out to try and ensure that the legislative arrangements *"work as intended".*

The explanation given for the review is that the Government is trying to help companies involved in innovation activities to get access to investment from venture capital funds.

Income Tax

The rates, bands or relief for income tax were left unchanged. From 01 July 2013, Maternity Benefit will be treated as taxable income but will continue to be exempt from the USC.

The standard rates of USC will now apply to those aged 70 years of age and over earning €60,000 and over, and medical card holders (PAYE/self-employed income earners) earning €60,000 and over with effect from 01 January 2013.

There will also be an increase from (12.5% to 13.5%) in the specified interest rate used in calculating the taxable benefit from preferential loans, other than home loans. The specified rate used to calculate the taxable benefit from preferential home loans is to decrease from 5.0% to 4.0%.

Income Tax Reliefs

The current Film Tax Relief Scheme is being extended to 2020, however, the Minister indicated that the scheme would be moving to a tax credit model in 2016.

Charitable donations made in 2013 and subsequent tax years will be relieved from income tax at a rate of 31% rather than at the marginal rate.

As expected, mortgage interest relief has not been extended to those purchasing a property in 2013 but incentives have been provided to some purchasers in the form of an exemption from the Local Property Tax.

From 01 January 2013, Top Slicing Relief will no longer be available on ex-gratia lump sums in respect of termination and severance payments where the taxable amount (after applying the basic/increased exemption or SCSB) is €200,000 or over.

SMEs & The Ten Point Plan

A Ten Point Tax Reform Plan has been introduced which includes measures aimed at assisting the Small and Medium Enterprise "SME" sector.

The following is a summary of the proposed measures which the Minister indicates are to help cashflow (a more detailed analysis of some of these measures is set out below):

1. Reforming the 3 Year Corporation Tax Relief for Start Up Companies to allow unused credits to be carried forward to help create jobs.

2. Amending the Close Company Surcharge by increasing the de minimis level to €2,000 to reduce the administrative burden.

3. Increasing the amount of expenditure eligible for the R&D Tax Credit on a full volume basis (without reference to the 2003 base year) to €200,000 to encourage innovation.

4. Increasing the VAT cash receipts basis accounting threshold from €1m to €1.25m.

5. Extending the Foreign Earnings Deduction for work related travel to Algeria, Democratic Republic of Congo, Egypt, Ghana, Kenya, Nigeria, Senegal & Tanzania to help boost demand for Irish goods and services abroad.

6. Extending the Employment and Investment Incentive scheme to 2020 to help companies access funding.

7. Extending the standard rate and Young Trained Farmers rate of stock relief, and amendments to the definition of registered partnerships for stock relief, to give a targeted assistance to the farming sector.

8. Introducing a Capital Gains Tax relief for Farmers for land restructuring to give a targeted assistance to the farming sector.

9. Reviewing the 'carried interest' provision in the tax code to help small businesses to access funding.

10. Announcing a joint Revenue and Department of Finance public consultation to identify ways to ease the administrative burden.

Other measures include a rebate on diesel (with effect from 01 July 2013) and the PlusOne initiative, which is intended to encourage employers to hire individuals who are long-term unemployed. This will replace the Revenue Job Assist and the Employer PRSI Incentive schemes.

It was also indicated that there will be other SME sector provisions complementing the above taxation provisions with a focus on the provision of credit to SMEs, specifically:

"Given the fragile state of the public finances, the individual measures are modest. However I believe that the combination of the measures will have a significant beneficial impact."

—Michael Noonan TD,

Minister for Finance.

- Approval to the Credit Review Office to extend the team of available reviewers so that SMEs seeking assistance from the CRO receive a considered and timely response to their application;
- The publication by the CRO of specific guidance for SMEs on accessing credit from banks.
- The National Pensions Reserve Fund (NPRF) is also developing a range of support funds to provide equity, finance and restructuring and recovery investment to the SME sector .

Motor Tax

Motor Tax rates across all categories will increase with effect from 1 January 2013. For a table detailing the new motor tax rates click here**.**

Pensions

It was announced that from January 2014, tax relief on pension contributions will only apply to pension schemes that deliver income of up to €60,000 per annum. In general (once the condition that the income from the pension is less than €60,000 is met) tax relief on pension contributions will continue at the marginal rate of tax.

It is not clear how the income from a pension fund which is many years from maturity is to be established but further details should be available once the Finance Bill is published.

It was also announced that the Pension Levy (which is currently applied to pension funds) will not be renewed after 2014.

A new provision will be made in Finance Bill 2013 for persons with Additional Voluntary Contributions (AVCs) to withdraw up to 30% of their value. Any amounts withdrawn will be subject to tax at the individual's marginal rate as marginal rate relief was provided on the contributions initially. The option will be available for a 3 year period from the passing of Finance Bill 2013.

It is also anticipated that changes will be put in place (in 2014) to vary the maximum allowable pension fund at retirement for tax purposes (the Standard Fund Threshold which is currently set at €2.3million).

Farming Measures

There were a number of measures introduced in Budget 2013 in relation to the agri-food sector.

Stock Relief for Farmers and Young Trained Farmers

Stock relief provides a deduction of 25% to farmers for the increase in their stock from the beginning of the period to the end of the period (100% of stock increase is given to young trained farmers). This relief was due to end on 31 December 2012 but it has been extended to 2015.

Farming Partnerships – Stock Relief

Qualifying farming partnerships benefit from a 50% deduction for the increase in their stock in a given year. A qualifying partnership was defined as a *"milk production partnership".* The relief is due to be extended to other forms of farming partnerships such as beef partnerships.

CGT on Disposal of Agricultural Land

Relief from capital gains tax on the disposal of agricultural lands will be available where the disposal is for the purpose of farm restructuring. The proceeds of sale of the land must be reinvested for the same purpose.

The relief applies for the period 01 January 2013 to 31 December 2015. The sale and reinvestment must occur within 24 months of each other, e.g. if land is sold on 30 June 2013 the proceeds of sale must be reinvested before 30 June 2015.

VAT – Flat Rate Farmers

The rate of flat rate addition for farmers is being reduced from 5.2% to 4.8%.

Non VAT registered farmers can charge the flat rate addition on their sales and do not have to pay this amount over to Revenue. If the person buying goods is VAT registered and is acting in the course of business then he can claim an input credit for the flat rate VAT paid to the farmer. It is aimed at compensating the farmer for VAT incurred on his purchases.

Corporation Tax

The Minister announced changes to corporation tax, many of which have been dealt with in the SME Provisions section.

Corporation Tax Rate

The Minister reiterated the Government's commitment to the 12.5% corporation tax rate, as is becoming a Budget tradition at this stage

Research & Development

The amount of initial investment for R&D tax credit purposes will be increased from €100,000 to €200,000. Prior to Finance Act 2012, a tax credit for R&D expenditure was referenced to a 2003 base. FA 12 provided that a 25% credit for the first €100,000 of expenditure could be claimed without reference to the 2003 base amount. This initial expenditure level will now be increased to €200,000.

3 Year Relief for Start Up Companies

The 3 year relief for start up companies was introduced to provide relief from corporation tax and capital gains tax for companies in the first 3 years of trading. Any unused relief in the first 3 years can be carried forward to subsequent years, subject to a limit equal to the amount of the eligible employer's PRSI for that year.

Close Company Surcharge

A surcharge of 15% applies to 50% of the distributable income retained in close companies from professional services activities, and to 100% of the distributable estate and investment income (with a 20% rate applying where the level of investment income retained exceeds the company's distributions). The provisions of the surcharge are being amended so that the de minimus amount of income that must be retained in the company for the surcharge to take effect increase from €635 to €2,000.

Value Added Tax "VAT"

A significant announcement in the Budget was the increase in the threshold for operating the cash receipts basis for VAT. Where the turnover of a business is less than €1m VAT can be operated on a cash receipts basis rather than on an invoice basis, i.e. VAT is paid over to Revenue when payment is received, and not when the invoice issues, giving a cash flow advantage. The threshold of €1m is being increased to €1.25m.

Property & Tax

Real Estate Investment Trusts (REITs)

REITs are popular investment vehicles in other jurisdictions such as the US, and the UK, and in Budget 2013 the Minister for Finance announced that legislation would be introduced in Ireland to provide for the establishment of REITs, and the leaflet published (click here) outlines a proposal which is similar to the UK REIT structure .

A REIT is a listed company which is used to hold rental investment properties. REITs are designed as general investment vehicles so provisions will be included in the legislation to ensure that no one person or group of connected persons can control the REIT. The aim of a REIT is to facilitate investment in properties in three ways:-

- Risk diversification – the REIT enables the investor to take a stake in a wide property portfolio to spread the investment risk.
- Simplified taxation – the REIT mirrors the tax that would arise if the taxpayer invested directly in the property, so the REIT is largely tax transparent and the double layer of tax that can arise with a traditional property investment company is eliminated.
- Ease of investment – the investor can invest in a small way by buying a few REIT shares, so the initial investment does not have to be large (and no borrowing is required); and it is easy to realise the investment by selling the REIT shares (which will not impact on the underlying property portfolio).

"Our current levels of expenditure are no more sustainable than the property bubble that once sustained them."

Brendan Howlin TD

Minister for Public Expenditure and Reform

How is a REIT taxed?

- The REIT is exempt from corporation tax on qualifying income and gains
- The REIT has to distribute the majority of its profits to investors each year
- The investors pay tax each year on the profits flowing through the REIT

Property Investment Incentives

The Minister noted that regeneration is needed in some cities and has indicated that proposals for a targeted incentive will be considered to improve certain areas identified in the Budget as in need of regeneration.

The aviation sector has been identified as having potential for growth, and the Minister proposes that accelerated capital allowances, available over 7 years, will be introduced to encourage the construction of hangers and ancillary facilities. The investment "window" will be 5 years from the introduction of the scheme.

It is not clear who is the target investor for these new incentives. Traditionally such incentives took the form of capital allowances or "section 23" type relief which allowed a high income taxpayer a deduction for the capital cost of a building. However the high earners restriction limits the use of such reliefs and the Minister noted in his speech that he sees *"greater fairness in the tax system [by] reducing the ..reliefs that can be availed of by income earners to shelter income..."*

Conclusion

Income tax rates, credits and bands have remained unchanged, with the Minister increasing the tax take from income by extending PRSI to all unearned income (in 2014), increasing the minimum PRSI contribution, and making up a substantial part of his tax target by the new Local Property Tax.

It is not clear what the final effect of the measures announced in Budget 2013 will be and we will have to wait until the publication of the draft legislation to get a full picture of the tax regime that will apply in 2013. It is likely that there will be additional changes made as the legislation is enacted, as traditionally anti-avoidance measures are incorporated in the early stages of the Finance Bill.

Caveat: *These notes are intended as a general guide to Budget 2013 only. Finance Bill 2013 has not yet been published and the proposals may change substantially before Finance Act 2013 is enacted. Formal tax advice should be obtained before any steps are taken that may have a tax effect.*

O'Hanlon Tax Limited, 6 City Gate, Lower Bridge Street, Dublin 8 Tel: 01 604 0280 Fax: 01 604 0281 Eml: info@ohanlontax.ie