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December 2006

Tax

Budget 07

What's the bottom line?

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This publication contains a summary of the main features of Budget 2007.

Budget Commentary

The Minister for Finance, Mr Brian Cowen T.D., delivered his third Budget speech to the Dail on the 6 December 2006. As in previous years there has been much speculation as to what the Minister would do in this his last Budget before the present Government seeks re-election.

Looking back over the last three Budgets, it is interesting to compare the projected General Government Balance at the time of the Budget with the final outturn. The figures are as follows:

	2004 €m	**2005** €m	**2006** €m
Budget Projection	(1,038)	318	1,295
Outturn	1,356	439	3,980
Surplus over Budget Day projection	2,394	122	2,685
The tax receipts in this period were:			
Projected	33,236	37,750	41,925
Outturn	35,700	39,310	45,452
Additional tax receipts	2,464	1,560	3,527

In summary over the last three years the Government has collected €7,549m in taxes over that projected at the time of the Budget and this has contributed to a surplus of €5,199m over the Budget projection.

While one may argue over the accuracy of the Budget arithmetic, it is clear that Ireland Inc has expanded over the past three years. Further evidence of this can be seen from details published by the Central Statistics Office. In the period September to November, 2003 there were a total of 1,914,800 people in the workforce of which 85,900 were unemployed. By August 2006 this had grown to 2,178,200 of which 104,800 were unemployed. These figures show that the workforce has increased by 13.75% but unemployment has remained relatively low.

In 2003, some 199,500 (or 10.91%) were employed in the Construction sector. This had grown to 277,800 (or 13.4%) by August this year. This is growth of 39.24% compared with an overall increase in employment of 11.79%. The Construction sector must be congratulated in achieving such growth. However, with the ending of the property incentives and the completion of many of the major infrastructural projects over the coming years, the question must be asked as to whether the Government is considering the potential impact any slow down in this sector will have on the economy.

The Government is projecting a surplus of €2,276m on the back of tax receipts of 49,075m. The Minister has announced a reduction in the top rate of tax by 1% and increases in tax credits which will help employees. However, these are in addition to increases of 10% in wages over the next 27 months as agreed in the national wage agreement. This will result in increases in net wages considerably in excess of the current rate of inflation. It is to be hoped that any additional inflation arising from this increased spending power is matched with an increase in productivity if Ireland Inc is to remain competitive in the international community.

The substantial increase in the old age pension adds considerably to our Social Welfare costs. This is a socially responsible action at a time when Ireland is doing well as all should share in the country's prosperity. It disappointing that the Government has not introduced any further measures to encourage people to invest in their own pensions so that, as our population ages, people are less dependent on the value of the State pension.

Overall, the Budget delivered what had been predicted in the media. There was some welcome extension to the BES and Seed Capital Schemes including increases in the amounts which can be raised. Some changes are also proposed in relation to the R&D credit scheme. The Minister acknowledged the importance of the small and medium size business in Ireland's future prosperity. At a time when the economy is doing well, it is debatable if enough is being done to adequately encourage this sector.

Capital Tax

Stamp Duty

Any purchaser awaiting the much anticipated reduction of stamp duty on residential property will be disappointed with Budget 2007. The Minister clearly recognised that any cuts could only lead to higher property prices. He did however provide relief for such purchasers with the abolition of stamp duty on mortgage deeds, the maximum saving being €630.

Stamp duty on mortgage deeds

In line with the Minister's objective of supporting those purchasing homes and simplifying the compliance burden, the obligation to stamp a mortgage deed is being abolished for mortgage deeds executed on or after December 7, 2006. The charge to stamp duty generally arose in respect of mortgages over €254,000 which was calculated at rates varying from .05% to 0.1% with a maximum duty of €630.

Stamp duty on exemption for sporting bodies

As a measure to recognise the role of sport in Irish society, a new stamp duty exemption will be introduced for sporting bodies acquiring land for the purposes of promoting sport or games. The exemption details will be included in the Finance Bill but will apply in respect of bodies which are already entitled to income tax and capital gains tax exemptions.

Stamp duty relief for young trained farmers

The relief available on the transfer of land to qualified farmers will be simplified in the Finance Bill. The proposed amendments will make it easier for such individuals to meet the educational requirements outlined in the relief.

Stamp duty for farm consolidation

The stamp duty relief for exchange of farmland between two farmers introduced in 2005 to encourage the consolidation of small farming units will be extended under the Finance Bill provisions (subject to EU approval). The effect of the changes will be to extend the relief to 2009 and to enable the relief to be claimed by both parties where only one is consolidating his holding. Up until this change, both parties must be consolidating their holding in order to qualify.

Capital Gains Tax

Retirement relief

Retirement relief applies to disposals by individuals over 55 years, of business and farming assets which have been owned and used by them for 10 years prior to the disposal. A number of measures have been introduced to encourage early transfer of such assets to the younger generation.

The exempt threshold has been increased by €250,000 to €750,000 in respect of the disposal of any qualifying assets after January 1, 2007 where the conditions of the relief are satisfied. This threshold was last reviewed in 2003.

In addition, generally where land has been leased prior to the disposal, the relief was not available. The relief is now being extended to such land provided the letting was no longer than 5 years, the land had been held and used by the individual for 10 years prior to the letting and the land is being disposed of by the person leasing the land. The extension of the relief only applies in the context of farming land and not business assets generally.

Capital Acquisitions Tax

Agricultural relief

Rising house prices would have denied the availability of agricultural relief in the past for certain individuals. Therefore, to counteract this effect and in an attempt to encourage the early transfer of land to the next generation, the Minister announced changes to agricultural relief available in respect of gifts/inheritances of agricultural property to persons who qualify as farmers. The farmer test is an asset based test where 80% of the assets are represented by agricultural property. Ordinarily, debt is not taken into account in determining the test.

The relief will be changed in the Finance Bill to the effect that the net value of an individuals private residence after deduction of debt will be used in determining the farmer test.

Domestic Business

The Budget announcements include a number of positive measures for Irish businesses including enhancements to the Business Expansion and Seed Capital Schemes and an extension to the corporate tax relief for investment in renewable energy projects as well as measures designed to support small to medium enterprises and farmers.

However, these measures do not go far enough to encourage increased investment in smaller Irish companies and while some administrative burdens may be diminished, this Budget fails to capture the imagination of Ireland's entrepreneurial minds.

Business Expansion Scheme (BES) and Seed Capital Scheme (SCS)
The Minister announced an extension to the BES and SCS as well as significant increases in the thresholds for the company and individual investors.

The BES was due to expire on December 31, 2006 but is now being extended for an additional seven years to December 31, 2013. It is proposed that the limit which a company can raise under BES be increased to from €1m to €2m, subject to a maximum of €1.5m which can be raised in any 12 month period. It is proposed that the annual limit which an investor can obtain tax relief be increased from €31,750 per individual investor to €150,000.

The SCS is also to be extended from December 31, 2006 to December 31, 2013. The company limit for SCS will also increase to €2m, subject to a maximum of €1.5m which can be raised in any 12 month period. The investor limit for the SCS is to be increased to €100,000 under the Budget proposals.

These amendments are subject to the approval of the European Commission and further technical amendments will be put forward in the Finance Bill.

The increases in investor and investment limits are significant and are broadly in line with the recommendations put forward by the Small Business Forum in their report issued in April 2006. These

increases are likely to encourage additional investment in small Irish companies. However, the increase in the company limit from €1m to €2m is inadequate in the context of Irish economic growth over the last number of years.

Investment in renewable energy

Corporate tax relief is available to companies who invest in renewable energy projects including solar power, windpower, hypropower and biomass. To date, the number of companies availing of this relief has been limited as relief at the corporate tax rate of 12.5% is not a sufficient incentive. A welcome amendment in this Budget is that the expiry date for this relief has been extended from December 31, 2006 to December 31, 2011.

However, it is disappointing that the Minister did not respond to industry submissions which suggested the expansion of this relief to encourage investment by individuals in renewable energy projects.

Small to Medium Sized Enterprises

The Minister announced a package of measures which are designed to reduce the administrative burden for small to medium sized enterprises ('SMEs') on a day to day basis. In introducing these measures, the Minister made particular reference to the role that these enterprises play in employment and growth in the Irish economy and the recommendations put forward by the Small Business Forum.

These measures include:

- An increase in the small company threshold for preliminary corporation tax payment purposes from €50,000 to €150,000.
- New start-up companies will not be required to pay preliminary tax in respect of their first accounting period where their expected corporation tax liability for that period is expected to be less than €150,000.
- An increase in the annual VAT cash accounting threshold for small firms from €635,000 to €1 million from March 1, 2007.
- An increase in the small business VAT registration turnover thresholds from €27,500 per annum for services and €55,000 per year for goods to €35,000 and €70,000 respectively with effect from March 1, 2007.
- A reduction in the number of VAT returns to be required by smaller companies from six to three where the annual VAT liability is between €3,001 and €14,400 and two where the annual VAT liability is €3,000 or less.

- An increase in the transaction threshold which triggers the requirement for a tax clearance certificate from €6,500 to €10,000 for public sector contracts.

Farmer taxation

A number of positive measures have been introduced for the farming sector including:

- Extension of stamp duty relief for exchanges of farmland between two farmers.
- Amendments to the stamp duty relief for young trained farmers.
- An increase in the farmer's VAT flat rate addition from 4.8% to 5.2% with effect from January 1, 2007. This increase will not apply to VAT charged on the supply of livestock, live greyhounds and the hire of horses.
- An extension to the existing general stock relief for farmers and special incentive stock relief for certain young trained farmers for a further two years until December 31, 2008, subject to clearance from the EU Commission.
- A new exemption of €20,000 per annum from January 1, 2007 in respect of leases of farmland in excess of 10 years in duration, subject to clearance from the EU Commission.
- Amendments to the scheme of capital allowances for milk quotas.
- Amendments to CGT Retirement Relief to apply the relief in the event that the farmland has been leased prior to disposal.
- Amendments to CAT Agricultural Relief to allow for borrowings in relation to a principal private residence to be offset against the value of that residence for the purposes of the 80% agricultural assets test.

looking out for you

Financial Services

Recognising the importance of the international financial services sector in Ireland, The Taoiseach recently launched "Building on Success", a Government strategy that sets out a framework for the future development of the international financial services industry in Ireland. The strategy recognises the need to focus on growing this key sector and ensuring that we have the right mix of policies to support its development. A key focus at all times for the industry is to strengthen Ireland's position as a location for international financial services. A tax regime that facilitates all aspects of financial services is fundamental to achieving this objective.

While the Building on Success strategy is a welcome reaffirmation by the Government of its commitment to the financial services industry, it is important that the strategy is followed through. One of the major indicators of whether this follow through is happening is to evaluate the changes proposed in Budget/ Finance Bill 2007 in relation to the financial services industry.

In the various submissions made by the financial services industry to the Authorities, there are a couple of key areas in respect of which change was sought:

- Creating efficiencies in the general tax system, particularly in the area of paying preliminary corporation tax.
- Enhancing foreign tax credits to include foreign tax on branch profits.
- Granting a tax deduction for interest on tier 1 capital in Irish based credit institutions, as is the case in other countries.
- Simplifying the rules in relation to recovery of capital.
- Participation exemption for foreign dividends earned by Irish holding companies.
- Eliminate withholding tax on interest paid to non EU/non treaty counties.

In line with previous years, if the changes sought are to be addressed, they will only feature in the detail of the Finance Bill. On that basis, we should not be too surprised that there is little in the Minister's Budget speech that will excite (or indeed frustrate) the financial services sector.

Proposals made in the Minister's speech that do have an effect on the industry include:

1. Revision of the basis on which companies will pay preliminary corporation tax, and
2. A new stamp duty relief for Stock Exchange members.

Revision of basis for making preliminary corporation tax payments

Currently a small company is entitled to make its preliminary corporation tax payment based on the lower of either 90% of its expected final liability for the current period, or 100% of the final liability for the previous period.

A small company is one that has a final corporate tax bill of €50,000 per annum or less. Effective December 6, 2006, the Minister proposes that the €50,000 threshold increases to €150,000. This will mean that many companies now have a lot more certainty in terms of their tax payment obligations. In particular it will save them from the time consuming and duplicity of making estimated calculations for preliminary tax purposes and then actual calculations 10 months later for tax return filing purposes.

In addition, start up companies with a final corporate tax liability for their first accounting period of €150,000 or less will only have to pay their tax when making their corporate tax return, thereby saving them the need to make preliminary tax payments in year one.

This is certainly a welcome change for many financial services companies who have been spending significant time and money on meeting their tax payment obligations (not always with the benefit of certainty) and have found it a very frustrating and inefficient process.

A welcome amendment in the Finance Bill would be to address the problem facing financial services companies in relation to foreign exchange movements, as this has a major impact on their profitability and ultimately their preliminary tax calculation.

New stamp duty relief for Stock Exchange members

The Minister is proposing to consider the introduction in the Finance Bill of a new stamp duty relief for members of stock exchanges which would consolidate and replace existing reliefs. It is hoped that the new relief for these stock market intermediaries will better reflect modern share dealing practices and full details will be set out in the Finance Bill.

The Minister also proposes a small change in the area of DIRT, whereby persons over 65 or those permanently incapacitated can

receive gross interest without having DIRT applied (previously they would need to seek a DIRT refund) providing they have notified their financial institution.

All in all, one can say that the Budget has not been an exciting one for financial services. On the positive side, at least there were no unwelcome surprises! It is impossible to stress the importance of certainty to the industry. Surprises such as the removal of the remittance basis in 2006 and increases in employer PRSI ceilings in prior years were bitter pills to swallow.

Post the Christmas celebrations, we have the Finance Bill to look forward to and hopefully Santa Cowen will have some welcome presents in his bag of goodies for the financial services industry.

Indirect Tax

VAT

Conference centres

The Minister made a welcome announcement in relation to VAT on conference expenditure. Presently VAT cannot be recovered in Ireland by delegates on conference related accommodation expenses, unlike the position with some of our European neighbours, where such VAT is recoverable. The details are to be announced in the Finance Bill.

This should help to level the playing field for Ireland Inc and help promote Ireland as a centre for international conferences. However it remains to be seen when the Finance Bill is published whether these measures have gone far enough.

Small businesses

Registration thresholds

The VAT registration turnover thresholds are being increased from March 1, 2007. Businesses engaged in selling services will not have to register for VAT if their turnover does not exceed €35,000 (previously €27,500) whereas businesses selling goods will enjoy a €70,000 threshold (previously €55,000).

This will be mainly helpful to start up businesses selling to the general public or to businesses which cannot recover VAT.

Cash flow and administration reduction measures

There is a welcome increase again from March 1, 2007 in the thresholds for accounting for VAT on the basis of cash received rather than on the basis of invoices raised. The limit is currently €635,000 and is being increased to €1,000,000.

This again should help small businesses to improve cash flow and reduce working capital. This allied to the fact that the frequency for lodging VAT returns for certain businesses is to be reduced will also help to ease the administrative VAT burden. For business with a yearly VAT liability of €3,000 or less, the option of filing half yearly returns will be available. For businesses with a liability between €3001 and €14,400, the option of filing four monthly returns will be available.

However it would have been more user friendly if all under say €15,000 liability could file on a half yearly basis rather than complicating it with a number of thresholds.

Farmers - VAT flat rate addition
This is being increased from 4.8% to 5.2% with effect from January 1, 2007. This is effectively a VAT subsidy paid to non VAT registered farmers when they sell their produce to compensate them for the VAT that they cannot recover on some of their inputs.

Normally the VAT rate on livestock increases in tandem with the flat rate addition and this has the effect of eroding some of the benefits of the flat rate addition as farmers pay more VAT when they buy their stock. The good news this time is that the VAT rate is remaining unchanged at 4.8% which should make the flat rate addition increase more valuable.

Sundry VAT changes
The VAT rate on car seats is to be reduced from 21% to 13.5% with effect from 01/05/2007

Excises/VRT
The excise duty on a packet of 20 cigarettes is increasing by 50 cents from midnight tonight. The excise duty on kerosene and LPG (home heating oils) is being abolished from January 1, 2007.

There is also some proposed changes to the VRT system for cars subject to public consultation to effectively reward those driving lower emission cars . No doubt this will be balanced by higher VRT on cars which are not environmental friendly

Individuals

This year's Budget has "something for everyone" characteristics.

In a Budget with as few surprises as this writer can remember – Budgets aren't clouded in as much secrecy as they used to be - the prime individual beneficiaries are the first home buying, working couple, with a mortgage of over €379,000! Typically, these couples will be better off by €3,240 per annum or €270 per month, as a result of the Budget changes. This is due to:

Increase in Personal Tax Credit	260
Increase in PAYE Credits	540
Increase in Mortgage Interest relief (maximum)	1,600
Benefit of increased Standard Rate Band	840
	3,240

If their combined taxable earnings exceed €68,000, they will also benefit from the fall in the top tax rate to 41%.

The 1% fall in the top rate of income tax has, as you'd expect, something of a sting in its tail. For those with income in excess of €100,000, there is a .5% increase to 2½ % in the Health Levy applicable to the excess. What the Minister gives, the Minister taketh away!

Full details of the proposed tax bands and tax credits can be obtained from our table of rates and allowances (see Appendix A).

A double hit is being incurred by the Exchequer under the rent a room relief where the room being rented is being occupied by the landlord's child or other relative who, in turn, is claiming rent relief (maximum benefit increased from €330 to €360 per annum). In the only anti-avoidance measure in this year's Budget, the rent a room relief will no longer be allowed where a tenant claiming rent relief is related to the landlord.

Those lucky enough to enjoy the benefit of "soft loans" from their employers will see their tax liability on the related benefit increase from 1 January 2007. The "specified rate" (which determines the taxable benefit when the rate charged by the employer is less) is being increased from 3.5% to 4.5% for home loans, and from 11% to 12% for other loans.

There are some welcome changes in the process of granting certain tax reliefs and exemptions which are to be welcomed. For example, individuals aged over 65 and permanently incapacitated individuals who are exempt from tax, will be able to claim their exemption from DIRT by notifying their bank of their exempt status. Until now, such individuals had to claim a refund from the Revenue.
A number of administrative procedures are also to be introduced to give a number of reliefs at source. For 2008, it is planned to move to automatic tax repayments for non refundable hospital expenses, the cost of prescribed drugs and certain tuition fees. The object is to avoid taxpayers having to make claims to the Revenue particularly for the less known tax reliefs.

In summary, for the individual taxpayer, the 2007 Budget has all the hallmarks of a pre-election one, with no real surprises, some positives and certainly no negatives.

Inward Investment

This is a clearly domestically focussed budget speech appealing to indigenous business.

Minister Cowen noted "Ireland has become one of the world's most enterprising economies to the benefit of all". He went on to say that he wanted to see that development continuing so that the people of this country can face with confidence an increasingly competitive global marketplace and noted that the State would encourage Irish businesses to work smarter, to pursue excellence and to invest in innovation and creativity for the future.

In this context, the Minister has announced refocused BES and Seed Capital schemes, reduced the administrative burden on small medium enterprises (SMEs) and enhanced the R&D credit regime.

With the exception of the changes to the R&D credit regimes, what is interesting is the absence of any announcement on facilitating inward investment. Notwithstanding that there has been lobbying for much enhanced R&D credit relief and replacement of the credit system with participation exemption for dividend income (given Ireland is in breach of EU law), these issues have not been dealt with in any significant manner.

In relation to R&D credits, industry and practitioners sought an extension of the base year for a minimum of 5 years (i.e. to 2011) with a choice of either 2003 or 2004 as the base. Certain companies incurred significant plant expenditure in 2003 and are therefore excluded from effectively claiming credit for several years

until the plant requires full refurbishment. To solve this issue, it was recommended that plant cost was treated as a separate pool of expenditure to all other costs and credit given for an increment in either pool; not a measure that has seen the light of day.

The new provisions allowing companies to sub-contract R&D to third parties up to a limit of 10% of qualifying R&D is to be welcomed but is unlikely to be sufficient to cover expenditure incurred by pharmaceutical companies on clinical trials, which is fundamental to new drug development.

In contrast to the countries that compete with Ireland for international investment, such as The Netherlands, which itself has proposed a number of new incentives to maintain its attractiveness as a location for management of intellectual property, treasury functions, the current Budget has no consideration of or even reference to incentives for inward investment or the role that the multinationals play in the development of "one of the world's most enterprising economies".

The lack of a response or even an acknowledgement to the outcry over the abolition of the remittance basis last year is surprising given that Ireland is one of the most expensive locations as regards employee tax and social security costs out of a number of countries including Germany, UK, Luxembourg, France, US, The Netherlands and Belgium.

Given the continuous increase in the Irish cost base, the reduction in manufacturing jobs (both indigenous and multinational generated) and the strong global competition for business, the Minister's exclusive focus on encouraging the SME sector (while admirable of itself and long awaited) is regrettable. The economy is and will continue to be based on a dual strategy, strong and continued multinational investment and a growing indigenous sector, both of which require a dynamic economic strategy to enable them to compete in the marketplace. Sadly, there was no strategy for inward investment in the budget.

International tax

A number of recent budgets have included measures to assist in attracting international investment into Ireland, for example, the abolition of capital duty and the introduction of a participation exemption for certain share disposals. Aside from some amendments to the research and development tax credit regime (see above/below), this years Budget does not include any significant measures to enhance Ireland's attractiveness as a location for international investment.

Also expected amendments to the Irish corporation tax regime as a result of recent EU cases have not materialised. The ECJ decision, which was issued in late 2005, in the case of Marks & Spencer plc v Halsey has not been enacted into domestic law. Broadly in that case the ECJ decided that cross border loss relief claims between group companies established in EU countries should be allowed, in the circumstances where the subsidiary has exhausted all possibilities available in its state of residence for offsetting the losses. It is assumed that amendments to the Irish group relief regime as a result of this case will be included in the Finance Bill in early 2007.

Also in an opinion issued by the Advocate General in the case of Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, the Advocate General indicated that the U.K. system of taxing companies on foreign dividend income is contrary to the freedom of establishment and free movement of capital principles of the EC Treaty and also, in some respects in past periods, contrary to the EC Parent-Subsidiary Directive. The Irish system is identical, whereby dividends received from another Irish resident company are tax exempt whereas dividends received from overseas resident companies are subject to tax at 25% with credit given for taxes paid. The Irish tax law will have to change and a choice will have to be made between an exemption system for dividends or taxation of dividends with tax credit relief. In our view, an exemption system would be more beneficial for inward investment. At this stage the Irish regime may not be amended until the final decision of the ECJ.

pointing you in the right direction

Appendix A - Personal Tax Tables

Rate bands	**2007**	**2006**
Standard tax rate	20%	20%
Single/Widowed	€34,000	€32,000
Married	€43,000	€41,000
Married (two incomes)	€68,000	€64,000
One Parent	€38,000	€36,000
Higher tax rate	41%	42%
In all Cases	Balance	Balance

Income tax credits	**2007**	**2006**
Personal credit	€	€
Single	1,760	1,630
Married	3,520	3,260
Widowed	1,760	1,630
PAYE credit	1,760	1,490
Widowed without dependent child	550	500
Widowed with dependent child		
1st Year following bereavement	3,750	3,100
2nd year following bereavement	3,250	2,600
3rd year following bereavement	2,750	2,100
4th year following bereavement	2,250	1,600
5th year following bereavement	1,750	1,100
One parent family	1,760	1,630
Dependent relative	80	80
Incapacitated child	3,000	1,500
Blind person		
Single	1,760	1,500
Married couple, both blind	3,520	3,000
Age credit		
Single/Widowed	275	250
Married	550	500
Carers credit	770	770

Income tax allowances	**2007**	**2006**
	€	€
Employed carer re Incapacitated individual (allowed at marginal rate)	50,000	50,000

Exemption limits	**2007**	**2006**
	€	€
Age exemption limits (65 years and over)		
Single/Widowed	19,000	17,000
Married	38,000	34,000

PRSI and levies	**2007**		**2006**		
	Rate	Ceiling	Rate	Ceiling	
Employer	%	€	%	€	
PRSI	7.80	18,512	7.80	18,512	
PRSI	10.05	No limit	10.05	No Limit	*
Training Fund Levy	0.70	No limit	0.70	No Limit	**
Employee	4.00	48,800	4.00	46,600	***
Self employed and proprietary directors	3.00	No limit	3.00	No limit	
Health levy - Lower Rate	2.00	100,100	2.00	No limit	****
- Higher Rate	2.50	over 100,100	N/A	N/A	

* applied to all income where earnings are in excess of €18,512

** applied irrespective of earnings

*** first €127 per week not liable to PRSI and not payable where income does not exceed €17,628 (2006 - €15,600)

**** not payable where income does not exceed €24,960 (2006 - €22,800)

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