

[15.2A.3] High Income Individuals' Restriction

- Finance Act 2010 Changes and Related Issues

1. Introduction

Chapter 2A of Part 15 of the Taxes Consolidation Act 1997 (TCA 1997) and associated Schedules 25B and 25C introduced, with effect from 1 January 2007, a measure to limit the use of certain tax reliefs and exemptions by high-income individuals. This measure is commonly known as the high earners restriction. Details of the application and operation of the restriction (as applied for the tax years 2007, 2008 and 2009), with various examples, are contained in Tax Instruction 15.2A.1.

Section 23 of the Finance Act 2010 has made significant changes to the application and operation of the restriction for the tax year 2010 and subsequent years. These changes should substantially increase the number of individuals who will be subject to the restriction for those years. This instruction:

- restates the circumstances in which the restriction applied for the years 2007, 2008 and 2009,
- outlines the changes made by section 23 of the Finance Act 2010, and
- highlights the need for all staff to be aware of the restriction when examining the tax affairs of high-income individuals, including in circumstances where the restriction has not been applied for the tax year 2007 or subsequent years.

2. Application of the restriction for the years 2007, 2008 and 2009

For the tax years 2007, 2008 and 2009, the restriction applied to an individual where the answer to **all** of the following 3 questions was YES:

- Was the individual's *Adjusted Income* for the year equal to or greater than the *Threshold Amount*?
- Was the aggregate of the *Specified Reliefs* actually used by the individual for the year equal to or greater than the *Threshold Amount*?
- Did the aggregate of the *Specified Reliefs* used by the individual for the year exceed **50 per cent** of the individual's *Adjusted Income* for the year?

Adjusted Income is calculated by firstly adding the total amount of the specified reliefs actually used by an individual for a tax year to his or her taxable income for that year and then deducting any "*ring-fenced income*" of the individual for the year. Ring-fenced income is income such as deposit interest etc. (see full list in paragraph 4.3 of Tax Instruction 15.2A.1), which is already chargeable to tax at a rate of 20 per cent or more.

The *Threshold Amount* that applied for the tax years 2007, 2008 and 2009 was, in general, €250,000. However, ring-fenced income served to reduce the threshold amount in certain circumstances – please refer to paragraph 4.3 of Tax Instruction 15.2A.1. For the tax years 2007, 2008 and 2009, the Threshold Amount applied to both the level of Adjusted Income that the individual had for the tax year and the level of Specified Reliefs actually used by him or her, for the purposes of deciding whether the restriction was applicable.

Specified Reliefs are the various reliefs and exemptions that are liable to be restricted. These are listed in Schedule 25B to the TCA 1997 (see summary in Appendix 1 of Tax Instruction 15.2A.1 also).

The purpose of the restriction for the tax years 2007, 2008 and 2009 was to ensure that individuals with an adjusted income of €500,000 or more (i.e. where the full restriction applied) would pay an effective rate of income tax of approximately 20 per cent on a combination of adjusted income and ring-fenced income. Where adjusted income was less than €500,000, a tapering approach applied a graduated introduction of the restriction, with the effective rate of tax increasing towards 20 per cent as adjusted income increased towards €500,000.

3. Finance Act 2010 Changes

The Finance Act 2010 introduced a number of changes to the high earners restriction which further restrict the use of certain tax reliefs and exemptions by high-income individuals. These changes, which apply from the tax year 2010, are as follows:

- the effective rate of income tax for high-income individuals who are fully subject to the restriction increases from 20 per cent to 30 per cent,
- the 30 per cent effective rate applies at adjusted income levels of €400,000 and above,
- a graduated application of the restriction, with the effective income tax rate rising towards 30 per cent, applies between adjusted income levels of €125,000 and €400,000.

Instead of the concept of a single “Threshold Amount” which applied in 2007, 2008 and 2009 to both the level of Adjusted Income and the level of Specified Reliefs actually used, separate thresholds apply from 2010 in respect of Adjusted Income and Specified Reliefs – these are known as “Income Threshold Amount” and “Relief Threshold Amount” respectively.

For the year 2010, and subsequent years, the restriction applies to an individual where the answer to **all** of the following 3 questions is YES:

- Is the individual's Adjusted Income for the year equal to or greater than the *Income Threshold Amount*?
- Is the aggregate of the Specified Reliefs actually used by the individual for the year equal to or greater than the *Relief Threshold Amount*?
- Does the aggregate of the Specified Reliefs used by the individual for the year exceed **20 per cent** of the individual's Adjusted Income for the year?

Adjusted Income for the year 2010 and subsequent years is calculated in the same manner as for previous years. Likewise, sources of "ring-fenced income" and the list of and calculation of Specified Reliefs are the same.

The *Income Threshold Amount* is, in general, €25,000. However, ring-fenced income serves to reduce the income threshold amount in certain circumstances in the same way as it reduced the Threshold Amount in 2007, 2008 and 2009. The *Relief Threshold Amount* is, however, set at €80,000. This is a fixed amount and is not reduced proportionately where the individual has ring-fenced income.

4. Examination of the tax affairs of high-income individuals

Staff, who are examining the tax affairs of high-income individuals, are reminded to be aware of the application of the restriction, including in circumstances where the restriction has not been applied for the tax year 2007 or subsequent years.

As a general rule of thumb, for the tax years 2007, 2008 and 2009, staff should consider whether the restriction is applicable where:

- **50 per cent** or more of a combination of the assessable income and exempt income of the individual (but excluding ring-fenced income) is being written off in tax reliefs and exemptions, where the amount of such combined income is €500,000 or more, or
- **€250,000** or more in tax reliefs and exemptions is being written off, where the combination of assessable income and exempt income (but excluding ring-fenced income) is less than €500,000.

Additionally, for the years 2007, 2008 and 2009, staff should be aware that both Adjusted Income and the Threshold Amount of €250,000 were reduced where a taxpayer had ring-fenced income (the reduction was a direct reduction in the case of the former and a proportionate reduction in the case of the latter). This reduction could be substantial where the amount of ring-fenced income was significant and, in exceptional circumstances, could have reduced the adjusted income and the threshold amount to Nil.

As a general rule of thumb, for the tax year 2010 and later years, staff should consider whether the restriction is applicable where:

- **20 per cent** or more of a combination of the assessable income and exempt income of the individual (but excluding ring-fenced income) is being written off in tax reliefs and exemptions, where the amount of such combined income is €400,000 or more, or
- **€80,000** or more in tax reliefs and exemptions is being written off, where the combination of assessable income and exempt income (but excluding ring-fenced income) is less than €400,000.

For the tax year 2010 and later years, ring-fenced income reduces the amount of Adjusted Income directly and reduces the Income Threshold Amount of €125,000 proportionately. It does not affect the Relief Threshold Amount of €80,000.

Finally, for all years, staff should also be aware that certain Specified Reliefs are deducted in arriving at the amount of assessable income. For example, “section 23 type” relief will have been deducted in arriving at the amount of rental income assessable under Schedule D, Case V (or may have reduced the amount assessable to Nil) while a double rent deduction will have been allowed in arriving at the amount of profits or losses, arising under Schedule D, Case I or Case II, in the case of trades and professions. In deciding whether the restriction is applicable, specified reliefs given in this manner also need to be taken into account.

5. Examples

Appendix 1 contains a number of examples which reflect the differences between the application of the restriction in:

- the tax year 2007, and
- the tax year 2010.

Appendix 1 - Examples

Example 1.

Mr. Brown has taxable income of €100,000 in both 2007 and 2010. He has no ring-fenced income and uses specified reliefs of €75,000 each year in connection with the receipt of a dividend, exempt under section 141 TCA 1997, which is paid out of income arising from a qualifying patent.

Year 2007: The restriction does not apply for 2007. Adjusted income of €175,000 (taxable income of €100,000 + specified reliefs of €75,000) is less than the Threshold Amount of €250,000. The use of specified reliefs of €75,000 is also less than the Threshold Amount of €250,000.

Year 2010: The restriction does not apply for 2010. While adjusted income of €175,000 (taxable income of €100,000 + specified reliefs of €75,000) is greater than the Income Threshold Amount of €125,000, the use of specified reliefs of €75,000 is less than the Relief Threshold Amount of €80,000.

Example 2.

Mr. Green has taxable income of €30,000 in both 2007 and 2010. He has no ring-fenced income and uses specified reliefs of €85,000 each year, which relates to relief under section 248 TCA 1997 for interest paid on a loan to acquire an interest in a company.

Year 2007: The restriction does not apply for 2007. Adjusted income of €15,000 (taxable income of €30,000 + specified reliefs of €85,000) is less than the Threshold Amount of €250,000. The use of specified reliefs of €85,000 is also less than the Threshold Amount of €250,000.

Year 2010: The restriction does not apply for 2010. While the use of specified reliefs of €85,000 is greater than the Relief Threshold Amount of €80,000, the adjusted income of €15,000 (taxable income of €30,000 + specified reliefs of €85,000) is less than the Income Threshold Amount of €125,000,

Example 3.

Ms. Frawley has exempt artist's income of €240,000 in both 2007 and 2010. She also has taxable income of €100,000 for each of those years. She has no ring-fenced income and does not avail of other specified reliefs.

Year 2007: The restriction does not apply for 2007. While adjusted income of €340,000 (same as for 2010 below) is greater than the Threshold Amount of €250,000, the use of specified reliefs (the artist's exemption) is less than the Threshold Amount of €250,000.

Year 2010: The restriction applies for 2010. Adjusted income of €340,000 is greater than the Income Threshold Amount of €125,000. The use of specified reliefs (artist's exemption) is greater than the Relief Threshold Amount of €80,000 and also greater than 20 per cent of the adjusted income (20% of €340,000 = €68,000). Calculation of the restriction, which results in recalculated taxable income of €260,000, is as follows:

Adjusted Income	€		Recalculated Taxable Income	€
T - Taxable Income	100,000		T - Taxable Income	100,000
S - Specified Reliefs	240,000		S - Specified Reliefs	240,000
R - Ring fenced Income	(0,00)		Y – greater of €80,000 and 20% of Adjusted Income	(80,000)
Adjusted Income	340,000			
<i>20% of Adj. Income</i>	<i>68,000</i>		Recalculated Taxable Income	260,000

NB: The restricted amount of “excess relief” of €160,000 arising in 2010 is carried forward to 2011 and allowed under section 485F TCA 1997. It will be a specified relief to the extent that it is used in 2011 (or subsequent years).

Example 4.

Ms. Giles has exempt artist's income of €240,000 in both 2007 and 2010. She also has taxable income of €300,000 for each of those years. She has no ring-fenced income but uses €25,000 in BES relief each year. Therefore, specified reliefs used are €265,000 (€240,000 + €25,000).

Year 2007: The restriction does not apply for 2007. Adjusted income is €565,000 (same as for 2010 below). However, the use of specified reliefs of €265,000 is less than 50 per cent of the adjusted income (i.e. €282,500).

Year 2010: The restriction applies for 2010. Adjusted income is greater than the Income Threshold Amount of €125,000. The use of specified reliefs is greater than the Relief Threshold Amount of €80,000 and also greater than 20 per cent of the adjusted income. Calculation of the restriction, which results in recalculated taxable income of €452,000, is as follows:

Adjusted Income	€		Recalculated Taxable Income	€
T - Taxable Income	300,000		T - Taxable Income	300,000
S - Specified Reliefs	265,000		S - Specified Reliefs	265,000
R - Ring fenced Income	(0,00)		Y – greater of €80,000 and 20% of Adjusted Income	
Adjusted Income	565,000			(113,000)
<i>20% of Adj. Income</i>	<i>113,000</i>		Recalculated Taxable Income	452,000

NB: The restricted amount of “excess relief” of €152,000 arising in 2010 is carried forward to 2011 and allowed under section 485F TCA 1997. It will be a specified relief to the extent that it is used in 2011 (or subsequent years).

Example 5.

Mr. Tuohy has taxable income in both 2007 and 2010 of €300,000, of which €160,000 is deposit interest subject to DIRT. He uses specified reliefs each year of €150,000 (being double rent deduction in relation to a premises in a designated area).

Year 2007: The restriction does not apply for 2007. Adjusted income is €290,000 (same as for 2010 below) but the use of specified reliefs of €150,000 is less than the Threshold Amount of €161,111. The **Threshold Amount** of €161,111 is calculated as follows:

$$\begin{array}{l} 250,000 \times \frac{290,000}{450,000} \text{ (i.e. Adjusted Income)} \\ 450,000 \text{ (i.e. Adjusted Income plus ring-fenced income)} \end{array}$$

Year 2010: The restriction applies for 2010. Adjusted income of €290,000 is greater than the Income Threshold Amount of €80,555 (see below). The use of specified reliefs is greater than the Relief Threshold Amount of €80,000 and also greater than 20 per cent of the adjusted income (20% of €290,000 = €58,000). Calculation of the restriction, which results in recalculated taxable income of €370,000, is as follows:

Adjusted Income	€		Recalculated Taxable Income	€
T - Taxable Income	300,000		T - Taxable Income	300,000
S - Specified Reliefs	150,000		S - Specified Reliefs	150,000
R - Ring fenced Income	<u>(160,000)</u>		Y – greater of €80,000 and	<u>(80,000)</u>
Adjusted Income	290,000		20% of Adjusted Income	
<i>20% of Adj. Income</i>	<i>58,000</i>		Recalculated Taxable Income	370,000

The **Income Threshold Amount** is €80,555 and is calculated as follows:

$$\begin{array}{l} 125,000 \times \frac{290,000}{450,000} \text{ (i.e. Adjusted Income)} \\ 450,000 \text{ (i.e. Adjusted Income plus ring-fenced income)} \end{array}$$

NB: The restricted amount of “excess relief” of €70,000 arising in 2010 is carried forward to 2011 and allowed under section 485F TCA 1997. It will be a specified relief to the extent that it is used in 2011 (or subsequent years).

Example 6.

Mr. Walsh has taxable income of €100,000 in both 2007 and 2010, which includes ring-fenced income of €10,000. He uses Case V capital allowances of €300,000 in each of those years and also uses €25,000 in BES relief. Therefore, specified reliefs used are €25,000.

Year 2007: The restriction applies for 2007. Adjusted income of €415,000 (see below) is greater than the Threshold Amount of €244,118 (see below). The use of specified reliefs of €25,000 is greater than the Threshold Amount of €244,118 and also greater than 50 per cent of the adjusted income (i.e. 207,500). Calculation of the restriction, which results in recalculated taxable income of €180,882, is as follows:

Adjusted Income	€		Recalculated Taxable Income	€
T - Taxable Income	100,000		T - Taxable Income	100,000
S - Specified Reliefs	325,000		S - Specified Reliefs	325,000
R - Ring fenced Income	<u>(10,000)</u>		Y – greater of €244,118 and	<u>(244,118)</u>
Adjusted Income	415,000		50% of Adjusted Income	
<i>50% of Adj. Income</i>	<i>207,500</i>		Recalculated Taxable Income	180,882

The **Threshold Amount** of €244,118 is calculated as follows:

$$250,000 \times \frac{415,000}{425,000} \text{ (i.e. Adjusted Income)}$$

425,000 (i.e. Adjusted Income plus ring-fenced income)

NB: The restricted amount of “excess relief” of €80,882 arising in 2007 is carried forward to 2008 and allowed under section 485F TCA 1997. It is a specified relief to the extent that it is used in 2008 (or subsequent years).

Year 2010: The restriction applies for 2010. Adjusted income of €415,000 is greater than the Income Threshold Amount of €125,000¹. The use of specified reliefs is greater than the Relief Threshold Amount of €80,000 and also greater than 20 per cent of the adjusted income (i.e. €83,000). Calculation of the restriction, which results in recalculated taxable income of €342,000, is as follows:

Adjusted Income	€		Recalculated Taxable Income	€
T - Taxable Income	100,000		T - Taxable Income	100,000
S - Specified Reliefs	325,000		S - Specified Reliefs	325,000
R - Ring fenced Income	<u>(10,000)</u>		Y – greater of €80,000 and	
Adjusted Income	415,000		20% of Adjusted Income	<u>(83,000)</u>
<i>20% of Adj. Income</i>	<i>83,000</i>		Recalculated Taxable Income	342,000

NB: The restricted amount of “excess relief” of €42,000 arising in 2010 is carried forward to 2011 and allowed under section 485F TCA 1997. It will be a specified relief to the extent that it is used in 2011 (or subsequent years).

¹ There is no need to adjust this amount where the Adjusted Income is €400,000 or more.