

Special TaxFax

Report of the Commission on Taxation

The report of the Commission on Taxation was published on Monday 7 September. Running to some 550 pages with over 200 individual recommendations, the report offers an extremely comprehensive analysis of our taxation system in Ireland with far reaching recommendations on reform of existing taxes and the introduction of new ones. In this TaxFax we are bringing to members' attention the key recommendations contained in the report that we believe will be of most relevance to members. We will be providing further analysis and information to members through TaxFax, our website, more detailed technical briefings and nationwide presentations. We would welcome all feedback from members regarding the Commission's proposals and these can be provided directly to us or as a response to the comprehensive survey we will issue to members in the next number of days. Readers should please note that what follows is a summary of what the Commission has recommended – many of these proposals may not be implemented or if they are this may ultimately be done in a manner that differs from the Commission's suggested approach.

Commission's overall approach

The report makes clear that the Commission sees its recommendations as a complete package that will not result in any additional overall tax burden on the taxpayer base. It recommends that where any of its proposals would give rise to additional taxes on certain activities for taxpayers, this additional revenue should be used to reduce the level of tax imposed on employment and enterprise. The Commission also endorses a low rate tax policy but says this should be achieved by a broadening of the tax base with a removal of certain exemptions and tax expenditures and a capping of others. The report states that where it is recommending the removal of tax expenditures this should be subject to appropriate transitional measures. Head-line recommendations from the Commission's report includes proposals to introduce a recurring tax on residential property, a carbon tax, domestic water charges and taxing childrens' benefit.

Key proposals of relevance to the commercial sector include the zero-rating of stamp duty on shares, the removal of the remittance basis to taxation for individuals, the abolition of the patent exemption, the extension of the tax exemption for start up companies to unincorporated businesses and the replacement of capital allowances for plant and industrial buildings with a tax deduction for the accounting depreciation charge.

Key changes for business taxpayers

- » **Corporation tax exemption for start-up companies:** The exemption should be extended to businesses commencing in 2010 and 2011 (for two years and one year respectively) and not limited to 2009 start-ups. The exclusion of service companies should be removed. A new three year scheme should be introduced for unincorporated business start-ups. In addition, non-incorporated start-ups not qualifying for the new exemption because of thresholds should be given the option of spreading the payment of income tax over the first three years (1/3 of first year tax in year one; 2/3 of first year tax and 2/3 of second year tax payable in year two; 1/3 of second year tax and preliminary tax for the third year in year three). This is suggested as an alternative to having to come up with all the first year tax and preliminary tax for the second year in year two.
- » **Preliminary corporate tax – large companies:** The Report recognises the burden placed on large companies who cannot avail of the prior year basis to pay preliminary corporation tax. It recommends that this anomaly be removed on a phased basis to allow all companies avail of the look-back option.
- » **The business income tax base:** The Report recommends a far closer alignment of the business' accounting profits and its profits for tax purposes. The biggest consequence arising would be that capital allowances in respect of plant and qualifying buildings would be replaced by a tax deduction for the depreciation charge arising under standard accounting rules. Guidelines would be made available to small/unincorporated businesses. The rationale for this suggestion is simplification and a closer alignment between the period of tax write-off and the asset's useful economic life. The Report recommends a widening of the types of buildings that qualify for tax deduction to include, for example, call centres. Businesses would be allowed to transition to the new regime over a five year period. Importantly, the Report makes clear that existing special capital allowances regimes for specific activities or asset classes should not be replaced with the new proposed regime but should be preserved.
- » **Close company rules:** Abolition of professional services income surcharge and relaxation of passive income surcharge for close companies by raising the current €650 de minimus limit.

- » **Gains on disposal of trading assets:** The tax payable on such disposals should be reduced from the CGT rate of 25% to the CT rate of 12.5% – this is designed to leave the company with more funds to re-invest in the business.
- » **Balancing charges on disposals of buildings.** The Report recommends that, for future acquisitions, the exemption from a balancing charge that would otherwise arise when a building is disposed of after its “capital allowances” life be removed.
- » **Abolition of Patent Royalty Exemption:** The Report finds that resources would be better concentrated on the R & D credit scheme.
- » **Tax Credit for Research and Development (R & D):** Offset to be allowed for qualifying R & D credits against the corporate’s PRSI liability.
- » **Replacement of the Finance (No. 2) 2008 remittance basis of taxation:** The Report finds that the 2008 scheme is too narrow in that it excludes assignees from EEA territories and too broad in that it is not linked to specific skills. It recommends replacing this relief with a skills based regime linked to a list of “critical skills” that cannot be found in Ireland. The relief would be given from the assignee’s taxable income and would be capped at 25% of total income subject to an income ceiling of €250k (i.e. a maximum reduction of €62.5k). The relief could be claimed for a maximum of three years.
- » **Foreign tax credits on royalties:** The Report recommends that all trading companies should be entitled to unilateral credit relief and that an overall foreign pooling system should be introduced.
- » **Zero-rating of stamp duty on shares:** The Commission recommends that transactions in shares should be zero-rated for stamp duty purposes to support economic activity and sustain a capital market in Ireland. It is important to note that the recommendation is for zero-rating and not abolition.
- » **Share schemes and PRSI:** All share based remuneration should be liable to employer and employee PRSI and health levy. The Report recognises the significant administration difficulties that this would involve.
- » **Removal of income tax exemption from certain share schemes:** The report recommends that income tax exemption for approved share option schemes be withdrawn – its rationale is the **high** level of participation in unapproved option schemes. The relief for new shares purchased on issue by employees should also be removed – the rationale here is the low take-up rate.
- » **Retention and widening of income tax exemption for certain share schemes:** The income tax exemption for approved profit sharing schemes is to be retained. The exemption for Save As You Earn option schemes should be retained and widened.
- » **CGT changes:** The reintroduction of indexation relief for CGT purposes is recommended, as is rollover relief for CPO’s of farm land.
- » **Increased CGT charge on rezoning element of land disposals:** effectively an additional level of CGT would be charged on the excess of sale proceeds over the current use value of the land
- » **New recurring tax on land zoned for development:** The Report recognises the difficulties in implementing this proposal and the need to exclude key categories such as farmers who wish to continue farming the land – it suggest that control over the timing of the imposition of the tax should rest with the local authority.
- » **Abolition of farming stock reliefs.** The report finds it inequitable that only one sector of the economy should benefit from stock relief and that the original justification for the relief, high inflation, no longer obtains.
- » **Film relief and BES relief:** These reliefs are retained and it is recommended that the administrative complexity of BES be reduced.
- » **Business relief and agricultural relief for CAT:** For both business and agricultural reliefs the rate of relief to be reduced from 90% to 75% and a ceiling of €3m to be placed on the total amount of relief. In the case of agricultural relief, a condition of the relief should be that the land is operated as a farm for six years after the transfer. The reliefs should be amalgamated subject to deeming leasing out of farm land in the period prior to transfer as a qualifying activity.
- » **CGT Retirement relief:** Assets qualifying for family retirement relief for CGT purposes to be capped at €3m. Where assets transferred exceed €3m only that part of the gain attributable to the excess to be charged to tax. Non-family CGT retirement relief to be unchanged.
- » Capital allowances for **childcare facilities** to be discontinued.
- » Otherwise exempt **charitable and sporting bodies** should pay CGT on the disposal of development land.
- » **Grants:** All grants to meet revenue expenditure should be treated as taxable income and capital allowances should

be granted on a net of grant basis. However, this should not apply to employment related grants until favourable employment market conditions apply.

- » **Changes to commercial rates:** Vacancy relief to be modified to ensure it is not restricted to properties vacant at the time of striking the rate, the rate of relief to be within a 50 % to 100 % band and to be time-bound. The report recommends that a number of properties currently outside the rates base should be brought within it including: B & B's/guesthouses with four or more bedrooms, self-catering apartments and holiday homes operated by hotels, farm buildings owned by a body corporate and State-owned properties – with part-rating for third-level/professional institutions and community halls hosting commercial activities.

Key changes for individual taxpayers

- » **A new annual residential property tax:** The tax should be charged on the owner of the property on a self assessment basis and by reference to the property's open market value using valuation bands. The Report does not suggest a rate for this tax.

A personal tax credit of €75 should be given to householders who get a professional valuation done. There are very few exclusions provided in the Report and guest houses and B & B's not liable to commercial rates are included. Vacant houses are also included but builders' stock is excluded. However an exemption should apply for those who paid stamp duty on the house in the prior seven years. A low income waiver and deferral option for cash-poor taxpayers with valuable houses to be provided. The €200 levy on second homes should be removed. The tax should be administered by Revenue and have a number of payment options. By 2014 the revenue should devolve to local authorities. The introduction of the new tax should be accompanied by a zero-rating of stamp duty for principal private residences. Stamp duty on residential investment property should be at a rate that is competitive vis a vis other EU members.

- » **Introduce domestic water charges:** This should be done on a metered basis and incentives to be provided to consumers to install meters at an early stage. A flat fee system should operate pending the meter installation. Waivers to be provided for low income consumers.
- » **Residence rules:** Very significant changes are suggested to the basis of taxation of individuals. Implementation of these changes must be done in a manner that protects our international competitiveness and our ability to attract key skills and talent (and the need to attract mobile international talent is highlighted in the Report). The Report expresses

concern about potential manipulation of our current residence rules and recommends that they be widened to include tests such as centre of vital economic interests and permanent home. The Report finds that the remittance basis afforded to Irish resident and non-domiciled individuals is anachronistic, inequitable and should be removed – in effect it suggests that domicile status should not have a bearing on income tax status. The report recognises the significance of these suggestions by stating that they should have a three to five year lead in time before the change takes effect.

- » **High Earners' Restriction:** Currently the high earners restriction applies in full to individuals earning €500k or more and on a graduated basis on incomes from €250k to €500k. The Report recommends that it apply in full to incomes of €250,000 or greater and on a graduated basis from €200k to €250k.
- » **Children's benefit** to be taxed with a credit to be provided to protect the lower paid.
- » **Rate of tax on dividend income:** The rate of tax on dividends received by Irish resident individuals to be reduced to the rate applicable to deposit interest. Relevant dividends are those on ordinary shares in trading and investment companies located in the EU and EEA. The report notes that safeguards should be included to ensure that the provision operates as intended.
- » **Abolition of Stamp Duty on ATM/Credit Cards**
- » **VRT** to be phased out over ten years and replaced with road usage taxes: The report recommends that VRT be replaced on a phased basis with increased fuel charges and road pricing. This is a very long term recommendation by the Commission and the Report recognises the complexities involved. For the short term, the report suggests a new VRT scrappage scheme be considered.
- » **PRSI and Social Welfare:** The Report calls for a separate, comprehensive review of PRSI and finds the current system bears some characteristics of a tax as opposed to a social insurance scheme. It finds the current system to be unwieldy and with many anomalies and this places a large admin burden on employers. The Report states that a similar base should apply for employee and self-employed PRSI with a single rate – this means that employees would be liable to PRSI on unearned income. The employer PRSI ceiling should not be reinstated and the employee ceiling should be removed – the Report recognises the need to safeguard the marginal rate of personal tax at competitive levels and says this change should be done on a phased basis. PRSI relief to be available to the self employed on pension contributions and trading losses to be deducted

for PRSI purposes subject to the payment of a minimum PRSI contribution. The Report suggests that when the economy recovers the health levy should be integrated into the income tax system. The National Training Fund levy should also be abolished.

All social welfare payments to be subject to taxation but maternity benefit to be excluded from tax – ultimately the tax should be collected at source by the Department of Family and Social Affairs.

- » **Employee tax credit:** The denial of this credit to the self-employed and proprietary directors and possible justifications for this are discussed at some length in the Report (including references to changing the tax payment rules for the self-employed and the rules for Case I and Schedule E deductions). The Report's recommendation is that an earned income tax credit should be made available to all active income earners including the self-employed and proprietary directors (and not restricted to employees only).
- » **Single system for taxing income:** The Report recommends that in an ideal world the various parallel systems to collect tax on income (income tax, PRSI, levies) should be incorporated into one system but recognises now is not the time to do this because of the impact on headline tax rates and the incentive to work. The Report discussed a third income tax rate in abstract terms but does not advocate a third higher rate. It notes that a three rate income tax structure has merit but should have regard to the need to keep tax on labour low and marginal rates competitive.
- » **Medical insurance relief** to be limited to the cost of standard insurance schemes (e.g. VHI Plan B).
- » **Termination payments:** A cap of €200k to apply to tax free ex-gratia payments. SCSB and top-slicing relief rules should be simplified. A €200k cap should also apply to foreign service exempt termination payments.
- » Stamp Duty and Capital Gains Tax relief for **disposal of a site to a child** to be abolished.
- » **Tax relief for donations** to be subject to a €500,000 cap and a standard rating of the relief. The mechanics of the relief to be more closely aligned for PAYE and self employed taxpayers. Relief to be removed from the list of reliefs restricted for high earners. The current €250 floor to be reduced to €100.
- » Restrict **mortgage interest relief** to first time buyers. Rent relief and rent a room relief to be abolished.
- » **Up skilling relief:** Retraining costs incurred by the unemployed to be tax deductible against the prior six years' earnings.

- » **Artists' exemption** to be abolished: Consideration should be given to a system of income averaging.
- » **Sportsperson's relief** to be retained but curtailed: The total repayment should be capped at €350k and based on a period of ten continuous years as opposed to the ten "best" years. Currently active sportspersons retiring in the next six years should not be subject to these restrictions.
- » Tax relief on **service charges** to be abolished.
- » **Forestry exemption** retained.
- » A **wealth tax** and progressive rates of CAT and CGT were considered but are not recommended.
- » **Oireachtas members' expenses:** The treatment of these expenses should be aligned with that of employees generally including operating a vouched basis. The tax relief for Ministers who need to maintain a second home in Dublin should be capped and the current flat rate alternative for hotel/guest house accommodation removed.

Retirement provisions

- » A €200,000 cap to be placed on tax free **lump sums** – with the balance to be taxed at the standard rate.
- » There should be a correlation between the standard fund threshold (€5.4m) and the €150k earnings limit.
- » The **ARF** option should be extended to defined contribution occupational pension schemes
- » The Commission recommends a radical change to **relief for pension contributions** but says that the proposals should be considered for implementation in a more stable economic environment. Relief at the taxpayer's marginal rate would be replaced by a matching exchequer contribution of €1 for every €1.60 contributed by the taxpayer. This is equivalent to relief at a 38 % rate – 30 % hybrid income tax rate and 8 % for PRSI and levies. The relief would be administered at source by the pension scheme. It should be available to anyone with relevant earnings, even if they are outside the tax net. One of the consequences of this approach would be that the relief from employers' PRSI for employee pension contributions would go.

To encourage people to start pension provision a "kick-start" matching rate of €1 to €1 contributed would apply for the first five years of pension provision. The Commission also suggests that there should be an automatic enrolment of employees in pension schemes/PRSA's by their employers with an option to opt out a later date as a means to widen pension coverage. This proposal, and the consequent additional tax cost arising, appears

to have dissuaded the Commission from recommending relief at the top marginal rate for all, which is given some consideration in the Report. However, the report also recognises the need to examine the exchequer cost of non-funded schemes in the public sector. Some recognition is also given in the report to the fact the tax relief for pensions is largely tax deferred.

- » A new **SSIA type long-term savings product** aimed at low to middle income earners is recommended. For every €2 saved by the taxpayer the State would contribute €1. Members of defined benefit schemes would be excluded. Minimum and maximum savings levels would be set. Pre-retirement access could be allowed for events such as house purchase and illness but would result in a claw back of the state contribution. The returns on savings would be taxable.

Introduction of Carbon Tax

- » The tax should not apply to EU Emission Trading Scheme (ETS) participants. The tax is to be based on a standardised measurement of the CO₂ content in the particular fuel, by reference to international norms. It should not apply to fuel exported as it is linked to consumption in Ireland. The tax should be linked to the carbon price under the ETS but subject to a floor. It should be collected as early as possible in the supply chain but with accommodations for small suppliers with slow turnover. In addition, a threshold for small suppliers, below which they will not have to operate the tax, is suggested. The tax should be revenue neutral with a particular focus on protection from fuel poverty and of business competitiveness.

Tax Administration measures

- » **Appeals process:** The Report states that taxpayers should have the same level of access to the decisions of the Appeal Commissioners as Revenue and calls for the timely publication of all Appeal Commissioner rulings. It also notes the significant increase in the level of civil penalties that can be imposed and recommends the introduction of a low-cost Appeals mechanism.

The other recommendations of the Revenue Powers Group and Law Reform Commission Report regarding the appeals system should be implemented. These include extending the remit of the Appeal Commissioners to penalty categorisation, application of interest, Revenue's right to seek information and the conduct of audits.

- » **Interest on underpaid tax:** The Report notes the wide gap between the rates of interest on overpaid and underpaid

tax and the punitive element in the underpaid rate – it recommends the rate should be linked to commercial market rates.

- » **Reducing red tape:** The Report calls on Revenue to observe some key principles to reduce red tape including: minimising circular payments; streamlining applications for clearance certificates; extend self-assessment to exemption entitlements without the need for third party certification.

Specific recommendations include:

Dividend Withholding Tax (DWT): Exemption claims by foreign parent companies should not require third party certification

Interest and royalties: Exemption from withholding tax to apply on self-assessment basis

Relevant Contracts Tax (RCT): Significant reduction in the 35% rate – it should be aligned as closely as possible to the effective rate of tax payable by the sub-contractor.

In RCT “no loss of revenue” scenarios Revenue should be given discretion regarding the imposition of interest and penalties.

Professional Services Withholding Taxes (PSWT): A clearance system to allow gross payments should be introduced.

- » **E-filing:** Where taxpayers are using tax expenditures that require cost-benefit monitoring they should be required to e-file.

Tax Avoidance

- » The Report states that tax avoidance offends equity. But it also states that every taxpayer has the right to organise their affairs in a way that minimises their tax liability. It states that specific avoidance schemes should be countered with specific anti-avoidance provisions. It also notes that rushed or poorly drafted law can “open up loopholes”. It notes the uncertainty for business inherent in aspects of s811 and recommends an overall review of the GAAR including the introduction of a time limit for Revenue to make a decision on a point at issue.

Other tax expenditures

To be retained:

The Commission has certainly lived up to its terms of reference to examine all tax expenditures to determine those that are justifiable on a cost/benefit basis. The zeal with which it undertook this task is evidenced by the fact that not even the tax relief for veterans of the War of Independence escaped the microscope (happily this

venerable group has not lost its relief). The Commission identified 245 measures and then determined that 130 were benchmark tax system measures with the remaining 115 properly classed as tax expenditures. The list of tax expenditures/exemptions that the Commission recommends are retained include:

- » The CGT exemption on disposal of the principal private residence.
- » One parent family tax credit (but allocated to principal carer only)
- » Home carer tax credit
- » Relief for contributions to permanent health benefit schemes
- » Cost of employing carer for incapacitated individual (but standard rated)
- » Tax credit for donation of heritage items (but limited to 50% of value of item)
- » CGT exemption for works of art loaned for public display (but limited to gain arising for period of loan)
- » Deduction for capital expenditure on scientific research
- » Income tax relief for farm land leasing
- » Accelerated capital allowances for energy efficient equipment
- » Relief for investment in renewable energy generation
- » Tonnage tax scheme
- » Stamp duty relief for land transfers to young trained farmers
- » BIK exemption schemes for travel passes, bikes and personal security assets and services
- » Scholarships exemption
- » Relief for third level and training course fees
- » Exemption for statutory redundancy
- » Compensation for loss of future earnings
- » Income tax relief for long-term unemployed and double deduction for payroll costs
- » Exemption for income of credit unions

- » Annual exemption for credit union dividends on special share term accounts
- » Age tax credit
- » Age exemption and marginal relief
- » Relief for payments made under deeds of covenant
- » Relief for lottery profits
- » Stamp duty consanguinity relief

To be removed:

The list of tax expenditures/exemptions that the Commission recommends are removed include:

- » Exemption for childcare service providers
- » BIK exemption for employer provided childcare
- » Dependent relative tax credit (and the associated CGT relief on PPR but retain the linked mortgage interest relief)
- » Relief for expenditure on heritage buildings and gardens
- » Tax relief for purchase of milk quota
- » Investment allowance for plant used in a mine and exploration expenditure
- » Favourable tax treatment of individual venture capital fund managers
- » Relief for trade union subscriptions
- » Seafarer allowance

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