Irish Life

Budget 2012

This update provides commentary and summary of the main changes announced in the Budget on Monday 5th and Tuesday 6th December 2011.
This is not a customer document and is intended for financial advisors only.

Grinch Time

Commentary by Pat O'Sullivan – Head of Investment Strategy

Recent Budgets – and the 2012 budget is no exception – is like a serial re-run of the Jim Carrey movie, 'How the Grinch Stole Christmas'. Significant expenditure cuts and higher tax burdens do little to engender the Christmas spirit but the Ministers for Finance and Public Expenditure have little choice but to rein in the fiscal deficit and get control of the public debt mountain. However, it does appear that the Grinch will be a feature of Christmases in Ireland for a few more years to come.

Pensions

From a pension's perspective, Budget 2012 was reasonably positive as the marginal tax reliefs were left unchanged. However, the Minister did state that the incentives will have to be reformed and there will be consultation on this over the coming year to arrive at a workable solution.

The Minister also acknowledged the fact that the pension's sector is making a sizeable contribution of about €750m in 2012 to fund the government's Jobs' Initiative. Other measures affecting pensions can be found later in this document.

Commercial property

The Budget has made significant efforts to help stimulate the commercial property market in Ireland. The measures include:

- Stamp duty for commercial property transfers will be reduced from the current top rate of 6% to a flat rate of 2%.
- Introduction of a Capital Gains Tax incentive for property purchased between now and the end of 2013. If the property is bought during this period and held for 7 years, no CGT is applicable.
- No legislated introduction of a retrospective ban on upward only rent reviews.

These measures should help stimulate activity in the Irish commercial property market. This would be a very welcome development as the level of uncertainty surrounding the issue of upward only rent reviews effectively stalled transactional activity in the investment sector of the Irish market for the last 12 months

In terms of the residential mortgage market, the Minister did increase the mortgage interest rate relief in 2012, but stated that it will no longer be available after the end of 2012 and will be fully abolished from 2018 on. The Minister said that he will be making a formal announcement shortly on measures to help those in mortgage arrears but gave no specific indications as to what they might be in the Budget.

Taxation measures

The Minister maintained the governments pledge not to raise income taxes. Instead, the vast bulk of the tax increases were focused on indirect taxes, such as the increase in the VAT rate by 2%. This is estimated to raise €670 million in a full year, which accounts for the vast bulk of revenue raising measures in the Budget. Given the fact that the majority of the revenue adjustments in the previous Budgets have been achieved through direct taxation (income taxes), focusing on indirect taxation is the lesser of two evils. When one considers that the marginal rate of tax on income is 52% for PAYE workers and 55% for the self-employed, it would be hard to justify significantly higher income taxes.

Higher income taxes will only result in a disincentive to work and thus hinder future job creation and ultimately lead to lower revenues for the government. As the Minister stated in his budget speech, 'The OECD have concluded that Ireland has the most progressive tax system of the EU members of its organization and Revenue records show that the top 5 per cent of income earners pay 44 per cent of income tax. When the marginal rates of tax are very high jobs are lost.' When the OECD talks of us having the most progressive tax system, it means that those who earn more pay more in taxes. One of the problems of the Irish income tax system is that these marginal rates hit at very low levels of income and this is a situation that does need to be rectified going forward. Overall, the income tax base is still too narrow and needs to be widened.

Fiscal outlook

In constructing the Budget for 2012 the key objective was to ensure that Ireland returns to a sustainable level of growth, while attempting to minimise the cost of that objective. The current government has inherited a huge fiscal problem. As John Fitzgerald of the ESRI stated in a recent paper*, ‘Over the last two decades, when the debt burden was low, the objective should have been to use the annual Budget to maintain the level of economic activity as close as possible to the growth in potential output and not to exceed it. Over the period 2003 to 2007 this should have involved a progressive tightening of fiscal policy to reduce excess demand in the economy. Instead the opposite happened with the consequences that we know today.’

The government is targeting a General Government Deficit of 8.6% of GDP in 2012 or €13.7 billion. The government has earmarked another €8.6 billion of fiscal adjustments over the period 2013-2015 in order to get the deficit under control and convince international investors of our fiscal probity. By 2015, the government is forecasting that the deficit will have fallen to 2.9% of GDP. These forecasts look taxing (no pun intended) and given the state of the international economy the risk is that these forecasts could be missed which could lead to even more austerity than planned.

However, Ireland has made considerable progress in terms of fiscal retrenchment and this has resulted in government bond yields falling quite significantly over the second half of this year. Irish government 10-year yields fell from over 14% to currently stand at a little over 8%. Realistically, Irish government bond yields would need to fall below 6% to enable us to exit the bailout programme and return to the international debt markets. The government hopes to be able to do this by 2013. However, this will require further significant fiscal adjustments and a reasonably benign global economy.

Pat O’Sullivan
Head of Investment Strategy

* Presentation to the ERSI / FFS Budget Perspectives Conference, by Prof. John Fitzgerald

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Budget 2012 – Advisory Services Update

As you are aware Budget 2012 was announced over 5th and 6th December 2011. The first day dealt with savings to be gained by changes in the public spending, while the Minister published amendments to the capital taxes on day two. No changes were made to Income Tax rates, bands and credits however changes were made to indirect taxes such as CAT, CGT and Exit Tax which will be of interest to all in the life and pensions industry.

Below are the key points:

- No change to Income tax relief on pension contributions.
- Minimum imputed distribution requirement of 5% to apply to vested PRSAs. On ARFs and vested PRSAs rate to increase to 6% only were funds are in excess of €2million.
- Employer PRSI relief for employee contributions has been removed.
- The Capital Acquisitions Tax rate increased to 30% with the Group A threshold reduced to €250,000.
- An increase in the Exit Tax rate to 33% on life assurance policies and investment funds.
- Changes have been made to Retirement Relief from CGT.

What follows in this document is a summary and factsheet from Advisory Services on the various changes that were announced.

LIFE, SAVINGS & INVESTMENTS OVERVIEW

Tax on Savings - Deposit Interest Retention Tax (DIRT) and Exit Taxes on Life Assurance Policies and Investment Funds

The rate of tax applied to deposit interest, and also the rates of exit tax applying to life assurance policies and investment funds, is being increased by 3 percentage points in each case and will now be 30% for payments made annually or more frequently and 33% for payments made less frequently than annually.

The increased rates will apply to payments, including deemed payments, made on or after 1 January 2012.

Capital Acquisitions Tax

The current rate of capital acquisitions tax of 25% is being increased to 30%. This increase applies immediately for gifts or inheritances taken after 6 December 2011.

In an additional change to the CAT rules the current Group A tax-free threshold for inheritances or gifts for children is being reduced from €332,084 to €250,000.

This change applies for gifts or inheritances taken after 6 December 2011.

Capital Gains Tax

An increased rate of 30% applies in respect of disposals made after 6 December 2011.

A new incentive relief from CGT is being introduced. For properties bought between Budget night and the end of 2013, where the property is held for more than seven years, the gains accrued in that period will not attract CGT.

This relief will be available after 6 December 2011.

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Farmer Taxation

The Minister announced the following proposed changes to Retirement Relief from Capital Gains Tax in an effort to incentivise the timely transfer of farm assets.

For intra-family transfers, full retirement relief from Capital Gains Tax will still be available, subject to normal conditions, for individuals aged 55 to 66. However, where the individual transferring the assets is aged over 66 years an upper limit of €3m on retirement relief for business and farming assets disposed of within the family is introduced.
The current unlimited amount applies for a transitional period of two years for individuals currently aged 66 or who reach that age before 31 December 2013.

Where assets are transferred outside the family the current upper limit of €750,000 will be maintained for individuals aged between 55 and 66 years. This limit for business and farming assets transferred outside the family is reduced from €750,000 to €500,000 for individuals aged over 66 years.
The current upper limit of €750,000 applies for a transitional period of two years for individuals currently aged 66 or who reach that age before 31 December 2013.

We await full details of these changes in the Finance Bill.

PENSIONS OVERVIEW

Marginal Rate Income Tax Relief for Pension Contributions

The marginal rate income tax relief available for an individual making pension contributions remains unchanged. Relief continues to be limited at 15% to 40% of relevant earnings based on age, subject to an earnings cap of €115,000.

Approved Retirement Funds and Vested-PRSAs Minimum Distribution

There is no change to the 5% minimum income requirement currently being paid from ARFs for 2011.

From 2012, the minimum imputed distribution of 5% each year is to apply to vested-PRSAs. Vested-PRSAs are PRSAs where the customer has taken his retirement lump sum and the balance remained in the PRSA. Where an individual holds more than one PRSA the deemed distribution will apply to the aggregate of the assets in all of that individual’s PRSAs once any one of them is vested.

The minimum imputed distribution applies on ARFs from the year in which the customer turns 61. There is no minimum imputed distribution requirement on AMRFs. We will have to wait for the Finance Bill for exact details, but it would be sensible if similar allowances were applied to vested-PRSAs.

Approved Retirement Funds and Vested-PRSAs in excess of €2 million

For 2012 and future years, the minimum imputed distribution which applies to the value of assets in an ARF or vested-PRSA is being increased from 5% to 6% where the value is in excess of €2 million (or, where an individual has more than one, where the aggregate value exceeds €2 million). It is not clear from what has been published if this 6% rate will apply to the whole of an ARF or vested-PRSA where the value is over €2 million, or if a 5% requirement applies to the first €2 million with 6% applying to the excess.

In considering the impact of this change, it is worth remembering that the standard fund threshold remains unchanged at €2.3 million. Few customers will have in excess of €2 million in an ARF or vested-PRSA. 5% will remain the minimum imputed distribution for the vast majority of ARF customers.

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Approved Retirement Funds and Vested-PRSAs Taxation on Death

The rate of tax is to be increased from 20% to 30% where following the death of a ARF holder, the value of the ARF is paid to children aged over 21.

Details of when this change will apply will be published in the Finance Bill. It follows from the legislation as it stands currently that any changes made to the treatment of an ARF on death will automatically also apply to a vested-PRSA on death.

Employer PRSI on pension contributions

The current relief of 50% of employer PRSI for employee contributions to occupational pension schemes and other pension arrangements is being removed from 1 January 2012. The change will be legislated for in the Social Welfare Bill.

Future Changes to Pensions?

The Minister acknowledged in his speech that due to changes made over the past year, the pension sector is making a sizeable contribution. No changes have been made to the standard fund threshold of €2.3 million, or to the maximum tax free lump sum of €200,000. It was indicated by the Minister that pension incentives will be reviewed in the next year to make the system sustainable over the long term, and that the Department of Finance and the Revenue Commissioners will work with the various stakeholders to develop a solution.

OTHER ITEMS OF INTEREST

Universal Social Charge (USC)

The lower exemption threshold for the USC has been increased from €4,004 to €10,036, a change which, the Minister stated, would benefit nearly 330,000 people.
A change in the calculation of the USC with a move to a cumulative system was also announced.

Mortgage Interest Relief

For first time buyers who took out their first mortgage in the period 2004 to 2008 Mortgage Interest Relief is increased to 30%.

For those who wish to buy a home in 2012 the following rates were announced :

- First time buyers will get mortgage interest relief at a rate of 25% ; and
- Non-first time buyers will benefit from relief at 15%

Mortgage interest relief will no longer be available to house purchasers who purchase after the end of 2012 and will be fully abolished from 2018.

Stamp Duty - Transfers of non-residential property

A single rate of Stamp Duty for non-residential properties of 2% in respect of instruments executed after 6 December 2011.
It was also announced that the existing Consanguinity Relief from Stamp Duty on transfers of non-residential properties is to be retained for intra-family transfers until the end of 2014. This Relief will, however, be abolished after 1 January 2015.

Stamp Duty on Residential property will remain the same.

Income Tax, PRSI and other information

Standard Rate Bands	No Change
Single / Widowed	
No dependant children	€32,800
With dependant children	€36,800
Married – one income	€41,800
Married – two incomes	€65,600
Max transferable between spouses	*(€41,800)*

Income Tax Credits	No Change
Personal	
Single	€1,650
Married	€3,300
PAYE / Employer Credit	€1,650
Incapacitated child	€3,300
Blind Person – single	€1,650
- married (both blind)	€3,300

Income Exemption Limits	No Change
Single / Widowed (aged 65+)	€18,000
Married (aged 65+)	€36,000

PRSI Rates	A1	S1
Employee All Income (earnings less than €352pw exempt)	**4%** First €127 pw exempt	**4%** On all Income
Employer All income	10.75%	Nil

Universal Social Charge	Employee	Self Employed
Income up to €10,036	2%	2%
Between €10,036 and €16,016	4%	4%
Between €16,016 and €100,000	7%	7%
Income in excess of €100,000	7%	10%

Full medical card holders and over 70s	Employee	Self Employed
Income up to €10,036	2%	2%
Between €10,036 and €100,000	4%	4%
Income in excess of €100,000	4%	7%

The USC exemption threshold has been increased to €10,036. This levy is paid on gross income, before the deduction of capital allowances or pension contributions.
It does not apply to social welfare payments, including contributory and non – contributory social welfare pensions.

Savings and Investment Tax	2012	2011
DIRT	30%	27%
Life Assurance Policies	33%	30%
Wrapper Products	53%	50%

Social Welfare Benefits

Social Welfare Benefits	Weekly 2012	Weekly 2011
State Pension (Contributory + Transition)		
Personal Rate	€230.30	€230.30
Personal + Adult dependant (over 66)	€436.60	€436.60
Widow / Widowers Contributory Pension (under 66)	€193.50	€193.50
State Pension (Non-Contributory)		
Personal Rate	€219.00	€219.00
Personal + Adult dependant (under 66)	€363.70	€363.70
Widow/ Widowers Non Contributory Pension	€188.00	€188.00
Invalidity Pension		
Personal Rate (under 65)	€193.50	€193.50
Personal (under 66)+ Adult dependant	€331.60	€331.60
Jobseekers / Illness Benefit		
Personal Rate	€188.00	€188.00
Personal + Adult dependant	€312.80	€312.80
Jobseeker's Allowance		
18 to 21 years of age		
Personal Rate	€100.00	€100.00
Personal + Adult dependant	€200.00	€200.00
22 to 24 years of age		
Personal Rate	€144.00	€144.00
Personal + Adult dependant	€268.80	€268.80
Over 25 years of age		
Personal Rate	€188.00	€188.00
Personal + Adult dependant	€312.80	€312.80
Disability Allowance		
18 to 21 years of age		
Personal Rate	**€100.00**	€188.00
Personal + Adult dependant	**€200.00**	€312.80
22 to 24 years of age		
Personal Rate	**€144.00**	€188.00
Personal + Adult dependant	**€268.80**	€312.80
Over 25 years of age		
Personal Rate	**€188.00**	€188.00
Personal + Adult dependant	**€312.80**	€312.80

The main Social Welfare payment rates have stayed the same. However there are a number of changes to the rules for certain benefits that affect who is eligible to receive payments and the calculations of those payments. (See www.welfare.ie)

Increase for each dependant child	€29.80	€29.80

Child Benefit (Children's Allowance)	2012	2011
First and second child	€140.00	€140.00
Third child	**€148.00**	€167.00
Fourth and subsequent child	**€160.00**	€177.00

The higher rates of child benefit for third and subsequent children will be phased out over two years.