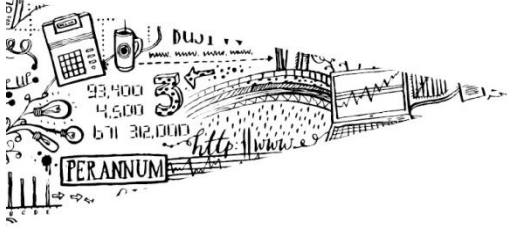


Tax alert Ireland

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Finance Bill 2012

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The Minister for Finance Michael Noonan TD published the Finance Bill 2012 earlier today.

The Minister has positioned the Bill as "*a further step towards economic recovery and regaining our fiscal autonomy*". This next step on Ireland's journey involves giving effect to the signalled revenue raising measures announced in his December Budget speech and setting out the detail of various measures designed to protect and create employment. These stimulus measures are to be welcomed and should be positive in enhancing Ireland's competitive position as a destination for investment from home and abroad.

Of particular note is the introduction of the Special Assignee Relief Programme (SARP) which will assist in reducing the cost to employers of bringing skilled individuals to Ireland via a partial income tax exemption for the assignee. Taken together with our corporate tax regime, including the 12.5% tax rate, the SARP further enhances Ireland's competitive position in attracting and retaining projects involving highly skilled employees - it is anticipated to assist in creating further high-value local employment in key sectors.

There are a number of targeted technical improvements aimed at simplifying the tax treatment of complex financial transactions thus enhancing Ireland's attractiveness as a location for international financial services activity and assist in meeting the target of creating 10,000 jobs in this sector by 2016. Finance Bill 2012 also contains further improvements to the R&D tax credit regime as signalled in the Budget. Specific provision is also made for granting a tax deduction for foreign taxes in computing profits for Irish tax purposes on certain royalty and interest income.

The Minister acknowledges that the country's limited resources must be applied where there is the best employment potential and therefore a return for that investment of public money. It is clear that significant efforts have been made to target those resources to key sectors of the economy.

Ernst & Young welcomes these efforts and will continue to work with the relevant Government departments and other stakeholders to bring forward other suggestions for improving Ireland's international competitiveness and economic recovery.

This alert summarises the main provisions of Finance Bill 2012 published today. The Bill now proceeds to Committee and Report stages, where additional amendments may be tabled. Further developments will be closely monitored and additional tax alerts will issue on certain aspects of the Bill.

Stimulus measures

Special Assignee Relief Programme (SARP)

The Finance Bill sets out the detail of the Special Assignee Relief Programme. The relief reduces the Irish income tax liability of individuals who are transferred into Ireland to work for an associated company. The new SARP relief is only available where the transfer commences in 2012, 2013 or 2014 and replaces the limited remittance basis available to non-Irish domiciled individuals on employment income up to 31 December 2011. Unlike the old remittance basis, it is not a condition of the relief that income is not brought into Ireland.

In summary, the relief is a welcome development as it will help to reduce the costs for the employers assigning key employees and executives from abroad to Ireland. An expansion of the proposals tailored to the specific need of the SME sector would be welcome.

To qualify for the relief the employee must work in Ireland for a minimum of 12 months and must have been non-Irish resident for at least 5 tax years immediately prior to the year of arrival in Ireland. The individual must also have worked for at least 12 months for their foreign based employer prior to their arrival in Ireland and performed the duties for that employer outside Ireland. Upon arrival in Ireland, the individual must work predominantly in Ireland and cannot work abroad for more than 30 days in a year.

To qualify for the relief an individual must earn a salary of at least €75,000. The relief operates by granting an exemption from income tax on 30% of employment income between €75,000 and €500,000. The relief can be claimed for the duration of the assignment up to a maximum of five years.

The relief can be granted under the PAYE system once a claim is made and approved by the Revenue Commissioners. To retain the relief the affected employee must file a tax return for the relevant tax year by 31 October of the following year.

For an employee to qualify their employer must be incorporated and resident in a country with which Ireland has a double tax treaty. It is disappointing that the new provision, as drafted, does not provide relief for employees of Irish indigenous companies, who do not have associated companies abroad, despite the Minister making reference to such companies in his Budget speech.

Foreign Earnings Deduction (FED)

As promised in the Budget, the Finance Bill introduces a Foreign Earnings Deduction (FED) as an incentive for companies expanding into Brazil, Russia, India, China and South Africa (the BRICS countries) through assigning Irish based employees to those markets. The relief provides a reduction in the Irish income tax liability for the individual reducing any tax equalisation costs for the company.

The relief will operate for three tax years ending in the 2014 tax year. The explanatory memorandum to the Bill states that extension of the scheme beyond the BRICS countries is not favoured until the scheme has been

operating for some time, which suggests that the scheme may be extended beyond 2014.

The relief operates by way of a deduction against employment income for employees who spend at least 60 qualifying days in a year in a BRICS country. To count as a qualifying day it must be a day which is one of at least 10 consecutive days throughout which the individual is working in the BRICS countries.

The maximum deduction against employment income is €35,000 per annum, which is the equivalent of a maximum tax saving of €14,350 for a higher rate taxpayer. Where the individual is also entitled to a claim a credit for foreign tax paid on the same income, the amount of the deduction must be reduced by the amount of the income generating the foreign tax credit. Benefits-in-kind, termination payments, and restrictive covenants are excluded in calculating the amount of the deduction, however, the amount of the deduction itself is offset against total employment income less allowable employee pension contributions for the year. The employment income can be from an Irish employment or from a foreign-sourced employment.

Employees claiming the FED relief are not entitled to claim relief under the Special Assignee Relief Programme (SARP), or relief under the Research and Development credit provisions introduced by the Bill.

Enhancing Research and Development

The Finance Bill introduces a number of enhancements to the R&D regime as follows:

- a volume basis of relief for the first €100K of R&D spend in each period,
- improving the cap on allowable outsourced activity to allow for the greater of either the existing caps or €100K.
- provision for certain companies to pass on their R&D tax credits to qualifying key R&D employees. These employees could use the credit to obtain refunds of their income tax (not USC or PRSI). The relief is capped such that the effective income tax rate payable by these key R&D employees cannot be less than 23%.

The scope for passing on relief to key R&D employees as currently drafted is quite narrow. Ernst & Young plans to engage with the relevant Government departments to propose widening this arrangement.

The Bill also makes provision for a number of technical changes including:

- a welcome form of reorganisation relief allowing excess credits to move between companies on certain intra-group trade transfers,
- exempting a clawback of credits for certain intra-group transfers of R&D buildings.
- provision for interest and penalties for erroneous claims.

A more detailed Ernst & Young Tax Alert will issue in the coming days on these changes to the R&D regime.

Corporation tax measures

The Bill further extends the existing 'start-up' 3 year corporation tax relief to new companies which commence a trade by 31 December 2014.

In a move that codifies the recent UK case, *FCE Bank plc v HMRC*, provision is made to extend the definition of a group for the purposes of surrendering trading losses for tax purposes. The effect of this rule is to move towards an ability to trace the 75% required group relationship on a global basis. The application of these rules to each situation will need to be carefully considered. This provision will be effective in respect of accounting periods ending on or after 1 January 2012.

Specific provision is made for securing a corporate tax deduction for foreign withholding tax suffered on certain royalty and interest income not otherwise qualifying for double tax relief or unilateral credit relief. The provision applies on income received after 1 January 2012.

The Bill also extends the categories of foreign dividends received by Irish companies which can qualify for the 12.5% tax rate. At present dividends sourced out of the trading profits of subsidiaries resident in an EU Member State or country with which Ireland has a double tax treaty, are liable to corporation tax at the 12.5% rate rather than 25%. This will be extended to dividends sourced from the trading profits of subsidiaries resident in a territory that has ratified the Convention on Mutual Assistance in Tax Matters. This would include countries such as Argentina and Brazil. The measure will apply to dividends received on or after 1 January 2012.

In a technical adjustment Irish branches of non-resident companies will now be obliged to deduct withholding tax on overseas interest payments.

Financial services

In his Budget Speech, the Minister stated his intention to introduce a package of measures to support the continued success of the Irish financial services industry. Overall, while we believe that there is more that can be done with this objective in mind eg. the introduction of a foreign dividend exemption and the broadening of relief from interest withholding tax for treasury companies on payments to related parties in non-tax treaty countries, several of the measures proposed by the Bill are very positive steps.

In addition to several other general measures highlighted elsewhere in this Alert which will be beneficial to the financial services industry (such as changes to SARP, R&D tax credit, foreign earnings deduction, group relief for losses, taxation of foreign source dividend income, other stamp duty changes), the Bill proposes several specific measures, summarised below.

Asset management

The measures proposed by the Bill in relation to the asset management industry include:

- the implementation of facilitating legislation for UCITS IV cross-border mergers/amalgamations and reconstructions (including master/feeder structures) plus associated stamp duty exemptions and rollover of gains for Irish unitholders.
- the extension of simplification measures to the non-Irish resident declaration process to include intermediaries and fund migrations to Ireland.
- stamp duty exemptions for exempt unit trusts.

Corporate treasury

The Bill contains a welcome measure in relation to the tax-deductibility of certain interest paid by cash pooling operations to non-EU/non-tax treaty jurisdictions which may have been regarded as putting Ireland at a competitive disincentive when it came to multinationals deciding where to locate such operations (although it remains to be seen how the proposed measure operates in practice).

Islamic finance

The Bill includes other facilitating measures which are designed to increase Ireland's attractiveness as a location for Islamic Finance (allowing, in particular, for a broadening of income which a finance company within the regime may receive).

Aircraft leasing

The proposed extension of credit relief for foreign tax withheld on lease payments from non-tax treaty countries in respect of equipment (including planes and engines) should prove beneficial to the Irish aircraft leasing sector, as well as to other big-ticket lessors.

Insurance

The Bill proposes the expansion of exemptions from exit tax on investments in life policies to include investment by certain pension funds bringing the exemptions broadly into line with those available for investment funds.

Capital markets

Certain amendments have been proposed to the residual charge to income tax on Irish publicly listed debt.

Green IFSC

The Bill proposes additional measures aimed at supporting the well-publicised 'Green IFSC' initiative, including the broadening of the definition of 'carbon offsets' within the Section 110 regime with an associated stamp duty exemption in respect of such assets.

Individual Taxation

Share based remuneration

The Bill contains a number of provisions in relation to share based remuneration. These include:

- permitting employers to satisfy any income tax and Universal Social Charge (USC) liability arising in respect of share awards by withholding sufficient shares to meet the income tax and USC liability due under PAYE. This reflects similar provisions which already exist in the US and the UK and which are incorporated in the rules of many share schemes implemented by FDI companies operating in Ireland today.
- requiring USC due on share option gains to be paid within 30 days of the date of exercise of the options (as is currently the case for income tax).
- permitting income levy or USC previously paid in respect of forfeitable share awards to be repaid where the shares are subsequently forfeited.
- an amendment to the provisions introduced in 2001 relating to the deferral of income tax liabilities on certain 'underwater' shares acquired under options exercised prior to 6 February 2003. The Bill provides that half the amount of the gain arising in any year

from the sale of the shares must be paid towards the outstanding tax liability until such time as it is fully discharged.

Property tax incentive reliefs

The Bill makes changes to the existing legislation in relation to property tax incentive reliefs.

The most significant of these changes is to effectively repeal proposals to limit Section 23 relief and other property capital allowances against all sources of Irish rental income. This will be a welcome change as the restrictions were viewed by many, including the current Minister for Finance, as unworkable and likely to have done significant and potentially long-term damage to the property market.

The Bill confirms the surcharge announced on Budget Day effective from 1 January 2012 on individuals availing of these reliefs with gross incomes of €100,000 or more. The surcharge will apply at a rate of 5%, paid as a higher rate of USC, on the amount of income sheltered by property reliefs in a given year. Residential owner-occupier relief is unaffected by these changes.

Other provisions are included in the Bill to correct unintended issues arising from the interaction of Section 23 type relief and capital allowances balancing charges with the High Earners Income Restriction.

The Bill also contains measures announced in Budget 2012 providing that investors in certain property or area-based tax incentive schemes will no longer be able to use any capital allowances beyond the tax life of the particular building or structure. Where the tax life of a building has already ended or ends at any time up to the end of 2014, then the loss of these unused capital allowances will only take place for chargeable periods ending in 2015 and subsequently.

Retirement benefits

The Bill gives effect to a number of the provisions announced in Budget 2012 in the area of retirement benefits, but also makes a number of detailed changes to Approved Retirement Funds (ARFs) and Personal Retirement Savings Accounts (PRSAs). A more detailed alert will follow.

Other business taxation measures

Emissions trading

The tax treatment of acquisitions, disposals and surrenders of emissions allowances under the EU Emissions Trading Scheme (ETS) has been clarified. Such treatment had been a matter of debate for some time within the affected industries.

The Finance Bill provides that a tax deduction will be given to trading companies for expenditure incurred on the purchase of emissions allowances in accordance with the accounting treatment.

Where the company disposes of allowances purchased for the purpose of a trade the consideration received will be regarded as a trading receipt. However, with effect from 8 February, capital gains tax will apply to the sale of surplus allowances granted free of charge under the ETS.

Groups will need to manage their 'intra-group' EU allowances transactions carefully to ensure that such transactions do not result in adverse tax rate mismatches.

Relevant contracts tax (RCT)

The Bill contains a number of measures in relation to relevant contracts tax, i.e. withholding tax applicable to certain payments made by principal contractors to sub-contractors involved in construction, meat processing or forestry operations. Commencing in 2012 the administration of the system moved to an electronic platform (e-RCT). The Bill includes a number of measures in relation to the move to the new e-RCT regime.

Measures are also included to extend the definition of a principal contractor to include a person carrying out the installation, alteration or repair in or on any building or structure of systems of telecommunications. In addition the scope of construction operations has been extended to include the alteration or repair in any building or structure of systems of heating, lighting, air-conditioning, soundproofing, ventilation, power supply, drainage, sanitation, water supply, or burglar or fire protection.

Capital taxes

New capital gains tax (CGT) relief on property

The Bill provides details of the new CGT incentive for property purchased between midnight on 6 December 2011 and the end of 2013. Provided a property acquired between 7 December 2011 and the end of 2013 is held for 7 years, the proportion of the gain as 7 years relates to the entire period of ownership shall be exempt. For example, on a disposal of property after ownership for 7 years, the full gain would be exempt. If the property was held for 20 years, 7/20ths of the gain would be exempt.

The relief applies to property in any EEA State in compliance with EU law. An apparent drafting error seems to exclude property in Ireland! No doubt this will be corrected in the next stage of the Bill.

Capital acquisitions tax (CAT) (gift and inheritance tax) - pay and file

The payment and filing date for CAT has been pushed back from 30 September to 31 October. This amendment applies on and from 8 February 2012.

Stamp duty-self assessment

The Finance Bill provides for a full move to self assessment for stamp duty. This legislation is subject to Ministerial Order. On the passing of the Ministerial Order, stamp duty returns will be required to be submitted within 30 days of execution.

Other consequential changes mean that those reliefs currently requiring adjudication will no longer require same, such as associated companies relief.

The Finance Bill introduces a number of exemptions from stamp duty in relation to financial services transactions to further strengthen Ireland's position in the financial services market. These include:

- provision for relief from stamp duty in respect of the reconstruction or amalgamation of unit trusts and offshore funds.
- the extension of the exemption in respect of the transfer of units in a unit trust to other unit trusts.
- the extension of the provision of the stamp duty relief in respect of fund reorganisations.

The Bill also provides for a new exemption in respect of the merger and cross border merger of companies.

The Bill also provides for a new exemption in respect of the transfer of property held for the benefit of a pension scheme or charity in certain circumstances. This exemption is effective from 8 February.

Indirect taxation

VAT on bakery products

A welcome measure has been introduced which seeks to modernise the Revenue's definition of bread. This confirms that products such as bagels, wraps, naan bread and pitta bread and other bread type products containing specified amounts of any dried fruit, vegetables, herbs or spices will be subject to VAT at the zero rate. However, other bakery products such as croissants, danishes or brioche will remain outside the definition of bread on the basis that their ingredients include higher levels of sugar and fat.

Revenue powers and administration

The Finance Bill proposes some significant changes to tax administration. A more detailed alert will issue in due course, but in summary, for 2013 onwards taxpayers will be required to compute and declare their own tax liabilities (albeit with the possible assistance of Revenue calculators) rather than merely submitting returns of income and gains. The ability to 'self-correct' these tax returns will be put on a statutory footing. Also the imposition of further restrictions on when taxpayers can 'express doubt' (and so mitigate any possible penalties and interest by bringing any matter in a return to Revenue's attention) will make it more important than ever to ensure that tax returns are technically robust at the time of filing and that any doubts are genuine. Many of the other amendments merely remove obsolete provisions and simplify the tax code.

In the past few years there have been some legal challenges (with mixed success) to the manner in which assessments have been raised and the timing thereof. The new rules are no doubt drafted with these challenges in mind. It appears they are intended to make it easier for Revenue to initiate enquiries and raise assessments outside the normal 4 year time limit in certain situations of suspected 'tax avoidance'. It remains to be seen if there are sufficient safeguards to prevent Revenue engaging in intrusive 'fishing expeditions' outside the intended scope of this amendment.

The Bill also extends the requirement in the tax code to maintain books and records for 6 years to liquidators of companies that have been wound up and to the last directors of companies that have been dissolved.

In an attempt to clamp down on the use of 'phoenix' businesses and late payment of taxes, a new power will be given to the Collector General to enable him to require any person carrying on a business to give security or further security as he considers appropriate for the payment of specified fiduciary taxes, i.e. PAYE, Relevant Contracts Tax, USC and VAT. Security may be requested where the person was involved in the management of a business that had defaulted in the payment of taxes or where the current business has not paid such taxes within 30 days of their due dates. Given that the person must desist from engaging in business until the security is provided or face penalties, it will be extremely important that affected taxpayers note the 30 day appeal deadline for disputing a request for security.

The Bill also provides Revenue with a new power to obtain information and documents from any persons (including professional advisers) where Revenue is investigating certain tax offences and an application is successfully made to a District Court judge for the relevant order. Given the wide range of potential tax offences this power may be used more widely than at first it might appear. Documents subject to legal professional privilege are exempt but in an interesting development, Revenue is empowered to seek a ruling from the District Court as to whether or not there is an entitlement to refuse to produce those documents on the grounds of legal professional privilege.

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