An Roinn Airgeadais
Department of Finance

Tax Strategy Group Capital & Savings Taxes-21/13

September 2021

Department of Finance
Prepared by Tax Division
www.gov.ie/finance

Contents

Introduction

This paper covers Capital Acquisitions Tax (CAT), Capital Gains Tax (CGT) and Deposit Interest Retention Tax (DIRT)/ Life Assurance Exit Tax (LAET) taxes

It briefly sets out the current position on each tax and examines potential options for change in the context of Budget 2022.

1 Capital Acquisitions Tax

Capital Acquisitions Tax (CAT) was first introduced in 1976 and includes gift tax, inheritance tax and discretionary trust tax. When introduced, it presented a significant change from the previous system of 'death duties' which imposed a tax on the estate of the deceased. In contrast, CAT is charged to the beneficiary of the inheritance or gift, on an amount over a particular tax-free threshold. This approach is aligned with the majority of OECD countries whereby 21 of the 24 OECD countries with an inheritance tax, levy the tax on the beneficiary. Only three OECD countries follow a different approach by taxing the estate of deceased donors (Denmark, the UK and the US). The overarching rationale for applying the tax on the beneficiary is to support equality of opportunity, encouraging redistribution of wealth across a larger number of beneficiaries, and promoting horizontal and vertical equity.

The Capital Acquisitions Tax Consolidation Act 2003 (CATCA) was introduced into law to consolidate CAT legislation, and has since been amended by subsequent Finance Acts. Under the current provisions, Capital Acquisitions Tax is payable on the total of all gifts and inheritances received since 5 December 1991. There are three tax-free thresholds depending on the relationship between the disponer and the beneficiary, with CAT applying on the amount over the thresholds.

There are many considerations in the design of an effective inheritance and gift tax regime. Wealth received through transfers from gifts or inheritances is notably different from income, as it is not earned or accumulated by the individual, but is received as a result of personal circumstances. In receiving unearned wealth in this way, inheritances and gifts can provide increased social mobility and opportunity for those who receive them. However, if concentrated amongst a few, they may perpetuate inequalities in these same areas. Recent research also indicates that the expectation of future inheritances can affect consumption and savings decisions of individuals, meaning that inheritances can have an impact across a lifecycle, and not just at the time the inheritance occurs[1].

The first section of this paper provides an overview of the CAT regime. It then provides a brief discussion on a number of policy options which the Tax Strategy Group may wish to consider.

1.1 Rates of Tax and Thresholds Available

The standard rate of CAT is 33% in respect of gifts and inheritances taken on or after 6th December 2012. There are three tax-free thresholds depending on the relationship between the disponer and the beneficiary, with CAT applying on the amount over the thresholds.

Group A threshold (€335,000) - Applies where the beneficiary is a child (including certain foster children) or minor child of a deceased child of the disponer. Parents also fall within this

[1] "Inheritances and inequality over the life cycle: what will they mean for younger generations?", institute of Fiscal Studies, Bourquin, Joyce and Sturrock, April 2021.

threshold where they take an absolute inheritance from a child. This threshold was last increased in 2019, from a previous value of €320,000.

Group B threshold (€32,500) - Applies where the beneficiary is a brother, sister, niece, nephew, or lineal ancestor or lineal descendant of the disponer. This threshold was last increased in 2016, from a previous value of €30,150.

Group C threshold (€16,250) - Applies in all other cases. This threshold was last increased in 2016, from a previous value of €15,075.

All gifts/inheritances received since 1991 from all disponers in the relevant group must be aggregated together when calculating the taxable value. The balance of the gift/inheritance above the threshold is taxable. Table 1 below sets out recent changes to CAT thresholds.

1.2 Recent CAT Group Threshold increases

Table 1 *Recent CAT Group Threshold Changes*

	From 2012	Budget 2016	Budget 2017	Budget 2019	Budget 2020
Group A	€225,000	€280,000	€310,000	€320,000	€335,000
Group B	€30,150		€32,500		
Group C	€15,075		€16,250		

1.3 CAT Yield 2011-2021

The CAT yield to the Exchequer for each year from 2011 to 2020 is shown in Table 2 below, together with the projected yield (P) for 2021. The CAT yield is taken from Revenue net receipts 2011-2020.

Table 2 *CAT Yield 2011-2020*

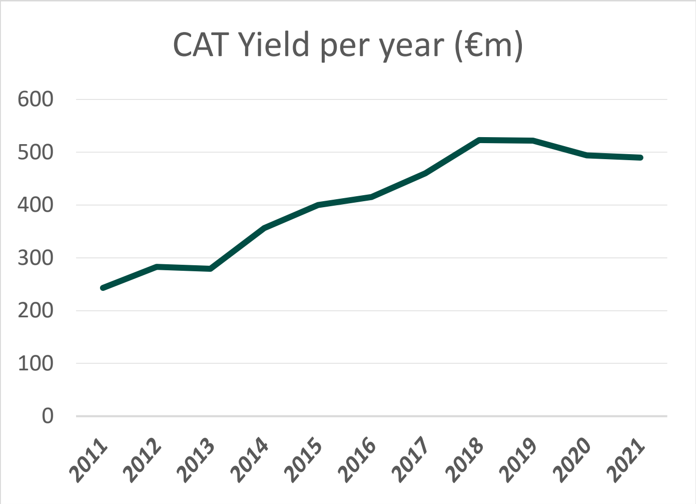
Year	Yield	% change
2011	€243m	+3%
2012	€283m	+16%
2013	€279m	-1%
2014	€356m	+28%
2015	€400m	+12%
2016	€415m	+4%
2017	€460m	+11%
2018	€523m	+14%
2019	€522m	+0.2%
2020	€505m	-3%

2021	*€490m**	*-3.0%*

Source: Revenue Commissioners

*Projected yield for 2021 is taken from draft Department of Finance Stability Programme Update April 2021.

Chart 1 *CAT Yield 2011-2020*



Source: Revenue Commissioners

1.3.1 CAT CASES & REVENUE BY THRESHOLD 2015-2020

Table 3 *CAT Cases & Revenue by Threshold 2015-2020*

	2015	2016	2017	2018	2019	2020
Group A Threshold	Cases: 6,735 Revenue: €156m	Cases: 5,283 Revenue: €156.1m	Cases: 6,722 Revenue: €167.4m	Cases: 6,794 Revenue: €201.6	Cases: 6,455 Revenue: €199.9m	Cases: 6,237 Revenue: €198m
Group B Threshold	Cases: 11,598 Revenue: €183.2m	Cases: 10,601 Revenue: €185m	Cases: 12,584 Revenue: €226.2m	Cases: 13,249 Revenue: €241.1m	Cases: 13,019 Revenue: €245.5m	Cases: 11,372 Revenue: €239m
Group C Threshold	Cases: 4,118 Revenue: €58.9m	Cases: 4,014 Revenue: €69.5m	Cases: 4,618 Revenue: €64.3m	Cases: 4,880 Revenue: €76.2m	Cases: 4,654 Revenue: €69.1m	Cases: 4,626 Revenue: €65m
Total	Cases: 22,451 Revenue: €398.1m	Cases: 19,898 Revenue: €411.4m	Cases: 23,924 Revenue: €457.9m	Cases: 24,923 Revenue: €518.9m	Cases: 24,128 Revenue: €514.5m	Cases: 22,235 Revenue: €502m

Source: Revenue Commissioners

Note: All revenue figures have been rounded to the nearest first decimal point and include combined inheritance and gift tax only.

1.4 Main CAT Reliefs and Exemptions

There are a number of valuable reliefs and exemptions available, including:

- **Agricultural Relief:** Qualifying farmers can avail of CAT Agricultural Relief, which reduces liability to CAT by 90%. The relief operates by reducing the market value of 'agricultural property' (including farmland, buildings, stock) by 90%, so that gift or inheritance tax is calculated on an amount - known as the 'agricultural value' - which is substantially less than the market value.

  To qualify for agricultural relief, 80% of the beneficiary's assets, after having received the gift/inheritance, must consist of qualifying agricultural assets. The beneficiary must also be an active farmer or lease the land to one. Agricultural Relief has been available for gift and inheritance tax since the introduction of Capital Acquisitions Tax in 1976.
- **Business Relief:** A relief from Capital Acquisitions Tax applies to gifts and inheritances of certain business property, subject to certain conditions. The relief amounts to a 90% reduction in respect of the taxable value of relevant business property. In order to qualify for this relief, the business concerned must not consist wholly or mainly of dealing in land, shares, securities, or currencies or making or holding investments.
- **Dwelling House Exemption:** Section 86 of the Capital Acquisitions Tax Consolidation Act 2003 provides for an exemption from Capital Acquisitions Tax on the inheritance (and in restricted cases the gift) of certain dwelling houses. Amendments were introduced in recent years with the aim of reinstating the original policy intention of the exemption. These included a change in Finance Act 2016 to considerably narrow its scope so that, with effect from 25 December 2016 the exemption no longer applies to gifts of dwelling houses unless the gift is made to a dependent relative of the donor. In Finance Act 2019, the conditions of the relief were further amended to ensure that all properties inherited from the same disponer are considered when assessing eligibility for the dwelling house exemption.
- **Small Gifts Exemption:** It is possible to receive gifts from the same person in any calendar year without having to pay CAT on these gifts. The gifts must have a combined total value of €3,000 or less in order to qualify for this exemption.

1.5 CAT Policy Options

1.5.1 REDUCE/INCREASE CAT RATE

The current rate of CAT is 33%, and this has been in place since 2012. Table 4 below provides details on the cost associated with a reduction in the CAT rate, as well as details on the corresponding yield from an increase in the CAT rate.

Table 4 *Cost of CAT Rate Changes*

		€ million/Full Year
Reduction in the CAT rate	From 33% to 32%	-13
	From 33% to 30%	-40
	From 33% to 28%	-66
	From 33% to 23%	-132
Increase in the CAT rate	From 33% to 34%	13
	From 33% to 36%	40
	From 33% to 38%	66
	From 33% to 43%	132

Source: Revenue Commissioners

1.5.2 OPTIONS FOR REDUCING/INCREASING GROUP THRESHOLDS

There are options to increase or decrease the CAT Group thresholds, or to move towards a single threshold for Groups A, B and C. However, policy over successive periods has been to maintain the Group A threshold higher than that of B or C in recognition of the importance of inheritance between parents and their children.

Increasing the Group B (currently €32,500) and C (currently €16,250) thresholds to bring them into line with the Group A threshold (currently €335,000) would be costly, estimated at approximately €222 million per annum. This is because a significant portion of the yield from gifts and inheritances arises from the Group B threshold, as illustrated in Table 3 above.

Analysis by Revenue indicates that the majority of CAT receipts is from inheritances. Receipts from inheritances were €430 million in 2020 from total CAT receipts of €505 million. Gifts at €71 million were the next largest, receipts from discretionary trusts were €3.5 million.

Estimated costs/yield from an increase/decrease to the CAT thresholds are provided below.

1.5.3 COST OF INCREASING THRESHOLDS

***Table 5** Group A Threshold*

Current Threshold	**Proposed new threshold**			
€335,000	€340,000	€350,000	€360,000	€400,000
Estimated full year cost (€)	-4m	-10m	-16m	-35m

Source: Revenue Commissioners

***Table 6** Group B Threshold*

Current Threshold	**Proposed new threshold**			
€32,500	€33,000	€34,000	€35,000	€335,000
Estimated full year cost (€)	-1m	-4m	-6m	-170m

Source: Revenue Commissioners

***Table 7** Group C Threshold*

Current Threshold	**Proposed new threshold**			
€16,250	€17,000	€18,000	€19,000	€335,000
Estimated full year cost (€)	-1m	-2m	-3m	-52m

Source: Revenue Commissioners

1.5.4 YIELD FROM DECREASING THRESHOLDS

***Table 8** Group A Threshold*

Current Threshold	**Proposed new threshold**			
€335,000	€250,000	€280,000	€330,000	€310,000
Estimated full year yield (€)	62m	40m	26m	18m

Source: Revenue Commissioners

Table 9 *Group B Threshold*

Current Threshold	**Proposed new threshold**		
€32,500	€31,000	€30,000	€25,000
Estimated full year yield (€)	4m	7m	20m

Source: Revenue Commissioners

Table 10 *Group C Threshold*

Current Threshold	**Proposed new threshold**		
€16,250	€15,000	€14,000	€13,000
Estimated full year yield (€)	1m	2m	3m

Source: Revenue Commissioners

1.5.5 REDUCE AGRICULTURAL AND BUSINESS PROPERTY RELIEF

Reducing the scale of Agricultural or Business relief would increase the yield from CAT. Reducing Agricultural relief from 90% to 80%, for example, would result in an estimated additional yield of €7 million for the full year. The estimated impact of reducing Business relief from 90% to 80% is an additional yield of €17 million for the full year.

However, such changes could have a negative impact on the development and growth of family businesses. In relation to Agriculture Relief, the 2014 Agri-Taxation Review recommended retaining this relief as a vital measure to ensure the ongoing viability of farming businesses that pass from one generation to another. Table 11 below provides further detail on the estimated yield which would result from reducing the scale of relief available.

Another recent perspective provided by the ESRI[2] suggests that the primary beneficiaries – of Business Relief in particular – are not those inheriting or being gifted small family farms or businesses, but far more substantial ones. They argue furthermore that given that there is strong evidence that inherited family-owned and -run firms are, on average, very poorly

[2] https://www.esri.ie/system/files/publications/BP202201.pdf

managed (Bloom and van Reenan, 2010), the goal of supporting the growth of and succession within family businesses should be weighed against the wider economic costs of discouraging the disposal of business assets to third parties.

Table 11 *Reduction to scale of Agricultural and Business relief.*

Relief	**Current Reduction %**	**Yield at 50% Reduction**	**Yield at 60% Reduction**	**Yield at 70% Reduction**	**Yield at 80% Reduction**
Agricultural	90	48m	31m	17m	7m
Business	90	76m	55m	35m	17m

Source: Revenue Commissioners

1.5.6 AMENDMENT OF CAT SMALL GIFT EXEMPTION

As set out above, it is possible to receive a gift up to the value of €3,000 from any person in a calendar year without having to pay CAT. It should be noted that there is no limit on the number of small gifts a person can take in a year from different donors. In response to the impact of the Covid pandemic, consideration could be given to increasing this limit, as discussed below.

The impact of Covid-19 on savings patterns has led to an increase in gross household savings, with deposits growing by 12.8% in 2020. A recent report by the Central Bank likened these savings to deferred spending, rather than precautionary savings, meaning that they may be spent in the future[3]. However, future spending patterns will depend on the speed of recovery from the pandemic, with households likely to adopt a cautious spending approach in a slower recovery scenario.

In order to stimulate the distribution of accumulated savings, consideration could be given to increasing the threshold of the CAT Small Gifts Exemption, in order to encourage *inter vivos* transfers of wealth. For instance, the threshold could be increased to €5,000, which would cost €1.1m per year (based on Revenue costing data, which does not account for behavioural changes). According to a recent ESRI report[4], if households run down these excess savings, this could support the economic recovery.

Costs associated with a change in the threshold of the Small Gifts Exemption are set out below.

[3] *Saving durinig the pandemic: Waiting out the storm?* Reamonn Lydon & Tara McIndoe-Calder, Vol. 2021 No.4, Centrl Bank of Ireland Economic Letter
[4] ESRI Spring 2021 Quarterly Economic Commentary https://www.esri.ie/system/files/publications/QEC2021SPR_0.pdf

Table 12 *Cost of Amendments to Small Gift Exemption*

Proposed Exemption Amount	Effect of Change - Yield/Cost	Estimated €m
€2,000	Yield	+0.5
€2,500	Yield	+0.3
€3,500	Cost	-0.3
€4,000	Cost	-0.5
€5,000	Cost	-1.1
€10,000	Cost	-3.7
€15,000	Cost	-6.3
€20,000	Cost	-9.0

Source: Revenue Commissioners

*Costing is based on number of gifts cases where CAT was payable i.e. where threshold and gift exemption amount was exceeded. It does not account for any behavioural changes, cases where threshold and gift exemption amount was not exceeded or cases where no return was required to be made.

1.5.7 TREATMENT OF INTEREST-FREE LOANS

CAT can apply in certain circumstances where a person is in receipt of an interest-free loan. Specifically, where a person receives an interest-free loan, the annual value of the loan is treated as a taxable gift in each year that the loan is in place. If the annual value of the loan is greater than €3,000 (the CAT small gifts exemption limit), then CAT may apply.

The value of the loan is determined in accordance with section 40 CATCA 2003 as “the best price obtainable in the open market” for the use of the loaned money. Revenue practice has been to accept the current best financial institution deposit interest rate as the best price obtainable in the open market at the end of each year. The value of the gift is therefore based on what it costs the disponer to make the loan, rather than on the actual benefit to the recipient of the loan, i.e. the cost of borrowing an equivalent amount on the open market.

This differs from the treatment of other gifts, such as a house or a car. In the case of the free use of a house, for example, the gift would be valued at what it would cost the beneficiary to rent an equivalent property on the open market. Similarly, the free use of a car would be valued based on comparable open market car rental rates.

The effect of this different treatment for interest free loans is particularly apparent in the current low interest rate environment. Given the extremely low deposit rates that have been available over the last number of years (consistently below 1% since 1994 and currently about 0.5% for fixed term deposits), only very significant loans (loans in excess of €600,000) would bring the annual value of an interest free loan above the €3,000 threshold of the small gift exemption. Were borrowing interest rates employed instead of deposit rates, then interest free personal loans in excess of €32,000 and interest free loans for mortgage purposes in excess of €89,000 would potentially attract an annual CAT liability.

In order to ensure consistent treatment across the CAT code, consideration may be given to changing the current practice to instead consider the value of the gift in relation to the benefit it awards/grants to the recipient.

To achieve this, it will be necessary to clarify the tax treatment to be used in calculating the value of an interest free loan, such that in the case of the free use of cash, the best price obtainable in the open market is the best borrowing interest rate for the same use.

1.5.8 CAT AGGREGATION PERIODS

Since 2001, Capital Acquisitions Tax has been payable on the total of all taxable gifts and inheritances received since 5 December 1991. A key objective of taxing wealth transfers in this way is to promote equal distribution of wealth and reduce inequality. One distinguishing feature of the Irish CAT regime is that each transfer is not treated as a standalone event. Instead, the accumulated value of gifts and inheritances over a specified period is considered in the assessment for tax. The rules for how these transfers are added together are the aggregation rules. The design of the Irish CAT regime, in this regard, differs from other OECD countries, as Ireland is the only OECD country to currently tax a ‘lifetime’ accumulation of wealth taken from gifts and inheritances. While this approach is attractive from an equity perspective, it must also be balanced against the administrative and compliance complexities which increase as a consequence.

Since the introduction of CAT in 1976, there have been periodic changes to the CAT aggregation rules, including changes to the duration of the lookback period within which the value of gifts and inheritances subject to CAT is accumulated. Table 13 below, shows the changes to aggregation periods since the introduction of Capital Acquisitions Tax in 1976. While there has not been a consistent aggregation period applied over the years, the longest previous aggregation period was for gifts and inheritances from 1982 to 1998, a period of 16 years. The current aggregation period of 30 years is clearly significantly longer than any period since the introduction of CAT. The most recent two amendments began from a starting point of a 10-year look back period, with a look back from 1998 to 1988 and a subsequent change to a look back from 2001 to 1991, the base year still in place in 2021.

Table 13 *Previous Aggregation Rules 1976-present*

Aggregation period	Applying to gifts/inheritances taken on or after	Legislation	Section	Inheritances from	Gifts from
Gifts: 5–15 years Inheritances : 0-10 years	Gifts taken on or after 28 February 1969 (no aggregation of inheritances before 28 February 1974)	CAT Act 1976	Schedule 2	1 April 1974	28 February 1974
Gifts/Inheritances: 2-16 years	26 March 1984	Finance Act 1984	S111, amending Schedule 2 CAT Act 1976	2 June 1982	2 June 1982
Gifts/Inheritances: 10-13 years	2 December 1998	Finance Act 1999	S201, amending Schedule 2 CAT Act 1976	2 December 1988	2 December 1988
Gifts/Inheritances: 10 – 30 years (current provision)	5 December 2001	Finance Act 2002	S121, amending Schedule 2 CAT Act 1976	5 December 1991	5 December 1991

1.5.8.1 Amendment of CAT aggregation rules

There are advantages to retaining a regime of taxing lifetime accumulations of wealth from both inheritances and gifts. This approach supports horizontal equity as individuals who receive the same amount of wealth pay the same amount of tax, regardless of whether they receive it through one large transfer, or through several smaller transfers over time. Vertical equity is also improved by such an approach as those who receive more wealth over their lifetime pay more tax than those who receive a smaller amount. By ensuring that all such transfers are included in the tax assessment, there are fewer opportunities for avoidance, and taxation is not influencing decisions on the timing of gifts.

However, the design of any tax regime frequently involves some tension between competing priorities of equity, efficiency and simplicity. Continuing to maintain a lifetime aggregation period presents some practical difficulties, which increase over time. The obligation to track accumulating wealth transfers over an extended period, and to meet reporting obligations, places increased compliance costs on beneficiaries. Alongside this, there are increased administration costs on Revenue. While self-assessment can minimise these costs, where audit or investigation is required, the administration costs are potentially high, as Revenue is required to investigate records over an extended period. It is possible that the current extended aggregation period places a disproportionate compliance burden on taxpayers to maintain records and report over a 30-year period, and similarly places a disproportionate administrative burden on Revenue.

1.5.8.2 Options to changing the aggregation periods

In considering any change to the aggregation periods, we should seek to minimise the impact on the progressivity and equity of our CAT regime,and avoid any unintended effects. Such impacts may include reducing the tax base, reducing CAT yield or introducing opportunities for avoidance.

As set out above, the current 30-year aggregation period is the longest since the introduction of CAT. Therefore, it may be timely to review CAT aggregation policy to ensure that the objectives of the tax are being supported, while also considering the compliance and administration burden which the current design imposes.

The following sets out some key considerations which should form part of the assessment on an appropriate aggregation period.

Over the years, since the introduction of CAT, there have been periodic changes to the CAT aggregation rules. These changes have not followed a particular consistent pattern. An option is to, again, implement a once-off legislative change to the aggregation period, with the intention of updating this at regular intervals in the future, depending on the policy decision at that time.

Alternatively, it may be preferable to set a rolling lookback period. An advantage of this is that it provides certainty to taxpayers and removes the requirement for further legislative change. However, a significant disadvantage to this approach is that it may incentivise tax-planning behaviour, as the timing of *inter vivos* transfers (gifts) could be arranged to optimise the use of tax-free thresholds. Such tax-planning behaviour would disproportionately benefit the wealthier, who are in a position to transfer assets during their lifetime. For a majority, the largest proportion of wealth is held in less liquid assets, such as the family home, or is required as security in retirement. For that reason, substantial *inter vivos* transfers of wealth are less likely. However, those with a greater excess of wealth, or more liquid assets, will be in a position to make transfers during their lifetime in order to minimise the tax burden on the beneficiary. Any change which may incentivise such tax planning behaviour, particularly where it limits the effectiveness of the distributive objective of CAT, should be pursued with caution and should be minimised as much as possible.

One means to minimise the effects of this change is to ensure that the aggregation period is not too short and approximates a reasonable lifetime exemption threshold, such as a 15-20 year period. This may help to minimise opportunities for tax planning.

The Tax Strategy Group may wish to consider these issues.

2 Capital Gains Tax

In general, Capital Gains Tax (CGT) is charged on the value of the capital gain made on the disposal of an asset. Disposals are not limited to sales of assets e.g. a gift of an asset counts as a disposal and may be liable to CGT if a gain is made, as may an exchange gain made on converting foreign currency. CGT was introduced in 1975, following the publication in 1974 of the White Paper on Capital Taxation. Prior to this, the only tax on capital in Ireland was estate tax.

2.1 CGT Yield

The CGT yield to the Exchequer for each year of the last 10 years is shown in Table 14 together with the provisional yield (p) for 2021. The projected yield for 2021 is taken from the Department of Finance's Stability Programme Update 2021. It is important to note however that these are receipts of CGT for individuals and some corporates in respect of gains on development land. Chargeable gains for corporates are included in the corporation tax receipts and cannot be presented separately.

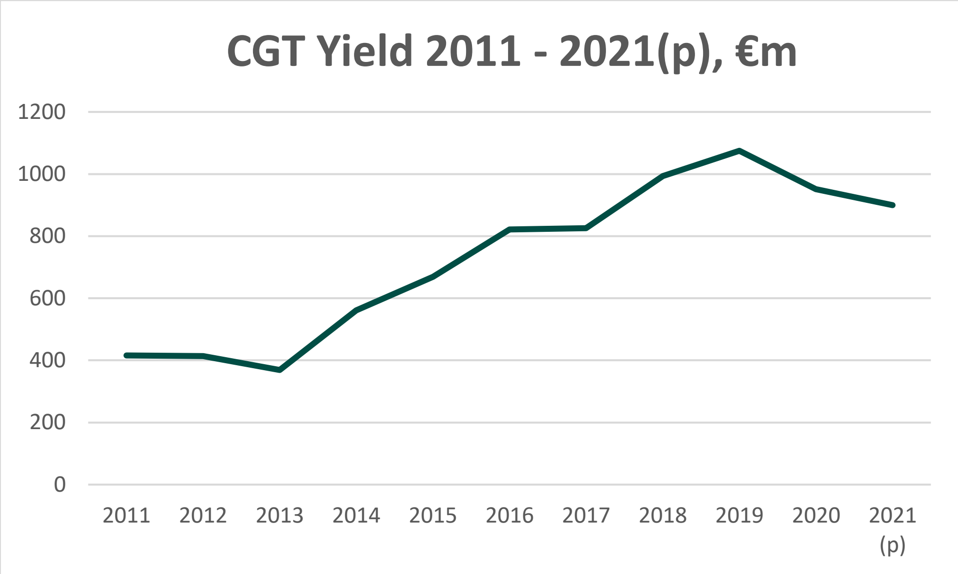
***Table 14** CGT Yield from 2011 to 2021**

Year	Yield	Percentage Annual Change
2011	€416m	
2012	€414m	-0.5%
2013	€369m	-10.9%
2014	€561m	+52.0%
2015	€669m	+19.3%
2016	€822m	+22.9%
2017	€826m	+0.5%
2018	€994m	+20.3%
2019	€1,075m	+8.1%
2020	€951m	-11.5%
2021	€900m (p)	-5.4%

Source: Department of Finance

** The 2021 figure is a provisional figure from the Stability Programme Update 2021*

Chart 2 *CGT Yield 2011 – 2021**



Source: Department of Finance

** The 2021 figure is a provisional figure from the Stability Programme Update 2021*

2.2 Rate of CGT

CGT was originally introduced at a rate of 26 per cent, approximately one third of the highest marginal personal income tax rate at the time. A review in 1978 increased the base rate on capital gains to 30 per cent and introduced reduced rates to reflect longer holding periods. Rates increased sharply in the early 1980s in response to the fiscal crisis before a single rate of CGT of 40 per cent was introduced in 1994. In a paper published in 2001, Moore McDowell, reflecting on the multiple rates, remarked that:

> *One argument often used to justify the higher taxation of short-term gains is that it discourages speculation… However, most economists, including myself, believe that in market economies, speculation plays a beneficial role in the efficient allocation of resources through time. The suppression of speculation through taxation therefore reduces the efficiency of the economy, lowers income, and damages prosperity*[5]*.*

In addition, in assessing why lower rates of CGT give rise to higher rather than lower revenues, MacDowell further noted that the greater rate of realization induced by the lower tax rate reflects the unlocking of capital, which under the higher tax rates would have remained in the original use. However he notes that this is a timing effect, with a decision to realize gains

[5] MacDowell, M. (2001) Capital gains taxation in Ireland
https://www.fraserinstitute.org/sites/default/files/IntlEvidenceNoCapitalGainsTaxSec3C.pdf

sooner and more frequently implies advancing the flow of tax receipts to the Exchequer rather than increasing its steady-state level. This implies a temporary rather than a permanent increase in revenues from a rate cut. It is argued though that this unlocking of capital has the additional effect of increasing the efficiency of the use of capital in the country, which may result in a permanent, or steady-state, increase in the yield of the tax.

The current rate of CGT has stood at 33% cent for disposals made from 6 December 2012. The rate of CGT increased four times since 2008 when it stood at 20%. The following sets out the most recent changes in the rate of CGT:

- On or before 14 October 2008 – 20%
- From 15 October 2008 to 7 April 2009 – 22%
- From 8 April 2009 to 6 December 2011 – 25%
- From 7 December 2011 to 5 December 2012 – 30%
- From 6 December 2012 to present – 33%

2.3 CGT Exemptions and Reliefs

Ireland's CGT regime includes a number of exemptions and reliefs. A brief overview of some of the main exemptions and reliefs is set out below.

2.3.1 ANNUAL EXEMPTION

The annual exemption provides an annual CGT exemption on the first €1,270 of gains arising on the disposal of assets in a calendar year by an individual.

2.3.2 TRANSFERS BETWEEN SPOUSES AND CIVIL PARTNERS UNDER A COURT ORDER

Disposal to spouses and civil partners, separated and divorcing spouses and civil partners and to former co-habitants under a court order are treated as being at a "no gain / no loss" and the recipient is treated as having acquired the asset at the same date and for the same value at which it was acquired originally by the disponer.

2.3.3 PRINCIPAL PRIVATE RESIDENCE RELIEF

The transfer or sale of an individual's principal private residence (PPR), including land of up to one acre around the residence, is exempt from CGT. The extent to which the CGT PPR relief applies depends on the particular facts and circumstances of each individual case.

Where the individual resides in their home for only part rather than the whole duration of ownership, the relief is apportioned accordingly on a pro rata basis. In addition, the final year of ownership is counted as a year of occupation.

A period of deemed occupation is also provided for in the situation where, due to the requirements of their employment, an owner is prevented from residing in the house for a period of up to four years provided certain conditions are met.

2.3.4 RELIEF FOR DISPOSAL OF CERTAIN BUILDINGS AND LAND

There is an exemption from CGT for land and buildings purchased between 7 December 2011 and 31 December 2014 where this property was subsequently disposed of after being held for between 4 and 7 years.

2.3.5 TRANSFER FROM A PARENT TO A CHILD

An exemption from CGT is available on the transfer of a site by a parent (or both parents simultaneously) to their child and the spouse or civil partner of that child to build a house which is the child's only or main residence. For the purposes of this exemption, a transfer includes a joint transfer by an individual, and their spouse or civil partner, to their child. The area of the site must not exceed 1 acre and the value of the site must not exceed €500,000.

2.3.6 RETIREMENT RELIEF

Business or farming assets are relieved from CGT where the person disposing of the asset(s) is aged 55 or over and both owned and used the asset(s) for the ten years prior to the disposal. While this relief is commonly referred to as Retirement Relief, it is not necessary to retire from the business or farming in order to qualify.

The operation of the relief differs between the disposal of a business or farm to a child and disposals to anyone other than to a child. The operation of the relief also differs between persons aged 55 to 65 years and persons aged 66 years and over.

For the purposes of the relief, child includes a stepchild or child of a civil partner, an adopted child, a child of a deceased child, a niece or nephew who has worked full time in the business or farm for at least five years, and a foster child of at least five years before the age of 18.

From 1st January 2014 if the person is between 55 and 65 years of age and the disposal is to a child, the full relief may be claimed. If the person is 66 years of age or older the relief is restricted to €3 million.

If the child disposes of the asset within 6 years, the relief will be withdrawn and they must pay the full amount of CGT on the original disposal and the subsequent disposal.

In the case of a disposal of a business or a farm to someone other than a child, the full relief may be claimed when the market value at the time of disposal does not exceed a threshold of €750,000 if the person is under 66 years of age. The threshold is €500,000 if the person is 66 years of age and older.

These thresholds are lifetime limits and if they are exceeded the relief is withdrawn and CGT is payable on the gains on all disposals. Marginal relief may apply to gains that exceed the thresholds limiting CGT to half of the difference between the sale price or market value and the threshold.

2.3.7 REVISED ENTREPRENEUR RELIEF

Section 597AA Taxes Consolidation Act 1997 provides that disposals of qualifying business assets (in most businesses but excluding those involving dealing in land or holding investments) by qualifying individuals are charged CGT at a rate of 10 per cent up to a lifetime limit of €1 million in chargeable gains. To qualify, among other conditions, an individual must own at least 5 per cent of the business and have spent a certain proportion of their time working in the business as a director or employee for three out of the previous five years, prior to disposal.

2.3.8 DISPOSAL OF BUSINESS TO A COMPANY

Where a non-corporate person (i.e., individual, trust, partnership) transfers a business (as a going concern) to a company, relief is given to the extent that the sale proceeds are taken by way of shares in the company. The relief provides a deferral of the tax payable on the amount of the consideration taken in the form of shares in the company, subject to a number of conditions being met. There is no requirement that the person making the transfer should have worked in the business.

2.3.9 FARM RESTRUCTURING RELIEF

Relief from CGT is available where an individual disposes of or exchanges farmland in order to consolidate an existing holding. To qualify for the relief, the first sale or purchase must occur between 1 January 2013 and 31 December 2022. The next sale or purchase must occur within 24 months of the first sale or purchase.

2.3.10 CGT CARRIED INTEREST PROVISION

Section 541C Taxes Consolidation Act 1997 provides for the taxation of carried interest. Carried interest is the proportion of an investment's gains that a venture capital manager takes as a return.

Carried interest is the share of profits received by an individual, partnership or company for managing the relevant investment based on a pre-agreed share ratio. Carried interest excludes profits attributable to investors by reference to an initial rate of return and it cannot exceed 20% of the total profits of the relevant investment.

For the purposes of CGT, carried interest is charged at 15 per cent where received by an individual or partnership and 12.5 per cent where received by a company.

2.4 Context for Amending CGT Regime

As with all taxes, CGT is subject to ongoing review, which involves the consideration and assessment of the rate of CGT and the relevant reliefs and exemptions. Depending on the policy aims, objectives and resources available, there are always options for amending the scope of the tax, including changing the rate of the tax, amending or abolishing existing reliefs and exemptions, or considering the introduction of new reliefs or exemptions.

In general, a narrow base for a tax regime with significant exemptions often requires a higher rate in order to generate an appropriate yield. A wider base may facilitate a lower headline rate of tax as it applies to a wider set of economic and commercial activities reducing the reliance on any one activity potentially maintaining a more sustainable yield.

2.4.1 ECONOMIC CONTEXT FOR BUDGET 2022

Against the backdrop of Budget 2022, the Departments of Finance's Stability Programme Update (SPU) published in April sets out the economic context for any policy discussion on this topic, with some of the most relevant points captured below.

Modified Domestic Demand (MDD), which is a more useful indicator of economic conditions in Ireland, is projected to increase by 2½ per cent this year. As public health containment measures are phased out, MDD should accelerate further next year, with a MDD growth rate of 7½ per cent projected, in part reflecting a 'catch-up' period.

From a policy perspective, it appears that a reallocation of firms and workers across the economy will be necessary as the business model of some firms will no longer be viable while, on the other side of the equation, new firms in expanding areas will emerge.

In smoothing this transition from the pre- to the post-pandemic economy, the SPU notes the Government has no role in propping-up firms whose business model is no longer viable but must maintain the necessary conditions that promote firm-creation and market dynamism.

Finally, the SPU highlights Ireland's changing demographic profile over the coming decades, with the current four persons of working age for each person aged 65 and over to decrease to just over two persons by 2050.

2.4.2 INTERNATIONAL COMPETITIVENESS

To the extent that businesses take into account the rate of capital taxes, there is a suggestion that businesses may move to or establish and develop in locations where there is a more favourable CGT treatment in order to take advantage of this. Clearly, the rate of CGT is not the only reason that businesses factor into location decisions, but it needs to be considered.

In any comparison, there is a need to understand and take into account the specific details of various CGT systems in different jurisdictions in order to carry out a fair comparison. This includes examining special rates, and reliefs and exemptions, rather than focusing solely on the applicable headline CGT rate. Headline rates are not always directly comparable in making a decision on whether to amend rates. For example, some jurisdictions operate different CGT rates for individuals and businesses and often the latter is the same as the corporate tax rate. There is often a link between individual CGT rates and personal income tax rates and the rate can be higher depending on the rate of income tax applying in the particular country. As a result there is a diversity of such rates across a number of comparable countries. Table 15 below therefore seeks to assess Ireland's individual rate of CGT against selected euro area countries plus the UK, Denmark and Norway.

Table 15: *Headline Rates of CGT for Individuals, Selected Euro area plus UK, Denmark and Norway*

State	**Individual, CGT Rate %**
Austria	27.5
Belgium	In general exempted (except in some specific cases)
Denmark	Subject to normal PIT rate
Finland	30 (34 on income exceeding €30,000 annually)
France	30, plus exceptional income tax for high earners at 4%
Germany	25, plus solidarity surcharge
Ireland	33
Italy	subject to the normal PIT rate
Latvia	20
Lithuania	20
Luxembourg	subject to the normal PIT rate
Netherlands	NA
Norway	subject to the normal PIT rate
Slovak Rep	19
Slovenia	27.5
Spain	Residents – 26 Non-residents - 19
Sweden	30
UK	< £12,300 – exempt; basic rate band up to £37,500 – 10; higher rate - 20. UK residential property and carried interest -28 (higher rate) and 18 (basic rate).

Source: PwC Worldwide Tax Summaries, May 2021

It is also important to highlight that any change to the rate of CGT in Ireland would not only affect CGT receipts but also corporate tax receipts from corporate gains (with the exception of development land) which are not possible to identify separately. In looking at CGT rates internationally, it is important to look at the trends in rates as well as the static rates. It is for this reason a brief summary of current thinking in the UK and US in relation to CGT is set out below.

2.4.2.1 UK

CGT Rates

The United Kingdom has two marginal rates of CGT, 20 per cent and 28 per cent. The 28 per cent rate applies to gains from residential property (excluding a person's home) and the 20 per cent rate applies to gains from all other chargeable assets. In the case of cross-border activity and investment between Ireland and Northern Ireland, CGT may be payable either in Ireland or the UK and the relevant taxation regime and rates will apply.

In July 2020, the UK Government commissioned the Office of Tax Simplification to examine CGT, with its first of two reports published on 11 November 2020 on the policy design and principles underpinning the tax[6]. The second report due next year will examine key technical and administrative issues. The recommendations in this report include a closer alignment between CGT rates and income tax rates. The current rates of CGT in the UK are lower than standard income tax rates. The report notes the argument that this divergence can be justified as rewarding risk taking and promoting enterprise, however it also highlights the need to have a full understanding of the economic social and fiscal costs and benefits, when diverging from neutrality.

It is argued in the report that any change to the rates would have a significant behavioural effect, including an impact on people's willingness to dispose of assets and trigger a tax charge, increasing the extent to which CGT has a 'lock in' effect. Other issues pertaining to a change in rate highlighted include that it is inappropriate to tax the part of a gain that has arisen (perhaps over many years) merely because of inflation; the increased incentive for taxpayers to hold assets through companies, as corporation tax is charged at a lower rate than the higher or additional rates of Income Tax; and the potential need to consider a greater degree of flexibility in the use of capital losses in some situations.

2.4.2.2 US

The Biden administration has signalled its intention to roughly double the top rate of federal tax on capital gains and dividends. For those earning more than $1m per year, levies on capital income would be brought into line with the top rate on wage income, which is expected to increase from 37 per cent to 39.6 per cent.

2.4.3 POLICY CONSIDERATION AND APPROACHES FOR AMENDING CGT

Before getting into the specific policy issues arising in relation to the current CGT system, it is important to provide some context in terms of the broad policy approaches and considerations for the design/review of any CGT system. This context, set out below, is based on a report published by the OECD on the taxation of CGT of individuals[7]. It examined a number of considerations in the design/review of any CGT system:

- Securing tax revenues
- Efficiency considerations including 'lock-in' effects
- Contribute to horizontal and vertical equity
- Encourage savings and promote enterprise

[6] OTS (2020) Capital Gains Tax Review: Simplifying by design

[7] OECD (2006) Taxation of Capital Gains of Individuals: Policy Considerations and Approaches

- Contain taxpayer compliance and tax administration cost
- Possible capital gains tax effects on risk-taking
- Possible CGT effects on the cost of capital and corporate financial policy

2.4.3.1 Securing tax revenues

Without a personal income tax system with a broad-based taxation of capital gains or a separate CGT, individuals could be expected to engage in tax arbitrage to convert taxable income into exempt capital gains. Imposing tax on capital gains acts as a disincentive to characterize or convert taxable ordinary earned income and investment income such as interest, dividends or rents into tax-exempt capital gains. It should be noted though that CGT may not completely eliminate tax arbitrage due to tax rate differentials across different income types and capital gains.

2.4.3.2 Efficiency considerations including 'lock-in' effects

Efficiency considerations are central to policy decisions over whether and how to tax capital gains. Ireland and most other countries tax capital gains on a realization basis i.e. when the asset is disposed of rather than on accrual basis. There are clear advantages to this approach as it avoids problems with trying to value the capital gains on assets of investors at current market values as well as potential liquidity problems for taxpayers with insufficient cash-flow to cover the tax burden.

Nevertheless, the realization basis is not without its flaws due to the deferral of tax on capital gains until disposal. This approach encourages the disposal of loss-making assets to obtain current tax relief on loss deductions, while also encouraging investors to hold onto assets with accumulated gains to defer tax liability on them, thereby 'locking-in' resources.

This 'lock-in' can be negative when it distorts the allocation of productive capital and constrains finance for profitable investments. The severity of this 'lock-in' is also impacted by the availability of information on investment opportunities and the openness of capital markets, with greater information and more open capital markets reducing the impact of this 'lock-in'.

The OECD note that in addressing lock-in, many countries have in place 'rollover' provisions that in certain cases provide for deferral of capital gains tax beyond the year in which a capital gains asset is transferred or disposed of. While in some cases such relief may reduce certain lock-in incentives and improve efficiency. In general, rollover relief deepens rather than mitigates lock-in effects by extending deferral opportunities.

2.4.3.3 Contribute to horizontal and vertical equity

The main consideration by Ireland in introducing CGT in 1974 was to strengthen tax equity between those earning primarily ordinary income and those making capital gains. The OECD report notes the experience of member states prior to the implementation a CGT system. The exclusion of CGT violated the principle of horizontal equity but also vertical equity as those with capital income usually have a greater ability to pay taxes and convert or receive income as capital.

2.4.3.4 Encourage savings and promote enterprise

The OECD noted that promotion of household savings and enterprise is a central policy consideration guiding the treatment of capital gains. Preferential treatment of long-term gains aims to encourage long-term savings, encourage patient capital investment and help compensate for a lack of inflation indexing.

2.4.3.5 Contain taxpayer compliance and tax administration costs

Policy makers are sensitive to the administrative burden of any taxation including CGT thereby favouring a realization-based approach over an accruals based approach. The use of an annual tax-exempt allowance is one option used to minimise compliance and administrative costs of collecting CGT on small occasional capital gains.

2.4.3.6 Possible capital gains tax effects on risk-taking

The OECD report notes the work of economists including Stiglitz on analysing tax distortions to individual portfolio allocation between safe and risky-assets that find that CGT may impact on risk-taking. An important distinction raised here is that while the ‘popular’ view tends to be that CGT negatively impacts risk-taking, symmetric tax treatment of capital gains and capital losses may encourage the amount of risk-taking in the economy, in effect by providing a risk subsidy.

2.4.3.7 Possible capital gains tax effects on the cost of capital and corporate financial policy

In addition to CGT influencing the allocation of wealth between safe and risky assets, different personal tax rates on interest, dividends and capital gains may also impact decisions. A lower rate of CGT to that on dividends may influence a firms decision to reinvest profits rather than distribute. CGT may also influence a firms financial policy by affecting the relative cost of alternative sources of finance (debt, retained earnings and new share issue). The OECD note that relatively high effective tax rates on capital gains and dividends may exacerbate a tax distortion favouring debt finance over equity. This could be a concern if corporate debt/asset ratios are relatively high, raising the possibility of instability in financial markets.

2.4.4 COSTINGS FOR POSSIBLE CHANGES TO THE CGT RATE

The cost/gain from a change in the rate of CGT is set out below in Table 16.

Table 16: *Cost of Increasing/Decreasing the Headline Irish CGT Rate*

	Change in Rate	**Full Year Exchequer (Cost)/Gain** **€ million**
Reduction in the CGT rate	From 33% to 32%	(33)
	From 33% to 31%	(66)
	From 33% to 28%	(164)
Increase in the CGT rate	From 33% to 38%	164
	From 33% to 35%	66
	From 33% to 34%	33

Source: Revenue Commissioners Ready Reckoner, November 2020

In terms of the cost of changing the headline rate of CGT, each 1% reduction / increase in the headline rate of CGT is estimated to be €33 million, assuming no behavioural change. A 5% reduction in the CGT rate in a single Budget would have an Exchequer impact of €164 million, assuming no behavioural change.

It is worth noting that any change in the headline CGT rate would also have an impact on overall corporation tax receipts from businesses paying tax on capital gains as part of their corporation tax. However, as previously indicated, it is not possible to present separate estimates for this.

The funding of any change is also a key consideration. There may be a need for trade-offs in any rate change.

2.4.5 CHANGING THE CGT RATE

It is likely that there is no specific rate of CGT that is the most appropriate for the Irish economy. Indeed, there is no analysis that indicates the most appropriate CGT rate to adopt. Ultimately, as with many taxes, the rate is one of judgement taking into account the above policy considerations and approaches.

In considering whether to make any change in the rate there are a number of possibilities. The CGT rate could be increased, decreased or differential rates of CGT could be introduced (i.e. two separate CGT rates). Any changes in the rate could be combined with changes to certain CGT reliefs and exemptions, in particular if there were to be a reduction in the current rate.

The Exchequer cost of any reduction is set out in section 2.4.4. The straight-line cost could be offset by compensatory adjustments through restricting or abolishing exemptions and reliefs set out in section 2.3.

2.5 Policy Options regarding Revised CGT Entrepreneur Relief

2.5.1 BACKGROUND

Section 2.3.7 briefly sets out the detail of this relief. An external review by Indecon Consultants of the Revised CGT Entrepreneur Relief was published as part of the Budget 2020 documentation. A number of possible modifications, amendments and potential improvements were suggested in respect of the relief, both through the public consultation exercise as well as the Indecon evaluation. These were as follows:

- Reduction in the headline rate of CGT of 33 per cent
- Increase in the lifetime limit of €1 million (to €10 million - €15 million)
- Amendment or removal of the requirement for an individual to own at least 5 per cent of share capital in the company
- Amendment of the requirement for an individual to spend at least 50% of their working time in the company over three of the five years preceding the disposal
- Change to the definition of qualifying companies and corporate structure
- Inclusion of passive investors within the scope of CGT Entrepreneur Relief
- Consideration of the interaction between CGT Entrepreneur Relief and Retirement relief

While the thinking behind this relief is to encourage entrepreneurial activity, there is an argument that it is not really achieving this objective because of its broad based approach. For instance, the relief has:

- benefited businesses which were in operation prior to its introduction;
- benefited the sellers of a range of specific services businesses whose owners are unlikely to need a CGT relief for the sale of such businesses;
- benefited individuals of an average age of 52 years old, becoming in effect an early retirement scheme; and,
- while reinvestment of the proceeds of a sale is not a requirement of the relief, it has been shown that individuals who benefit from the relief are, for the most part, not likely to reinvest the proceeds of a sale in a new business activity

In addition research in the UK indicated that its equivalent relief, did not incentivise entrepreneurial activity. The IFS research indicated that, in the UK, owner-managers of small companies enjoy significant tax savings by retaining income in their companies, often for long periods and until liquidation, in order to access the relief. No evidence was found that tax-motivated retention of profits translates into more investment in business capital. The decision by the UK Chancellor of the Exchequer in his 2020 Budget to reduce the lifetime limit on the UK's equivalent entrepreneur relief scheme from £10 million to £1 million undermined the argument that the UK is more competitive than Ireland in terms of this CGT relief. It also undermined the argument in favour of an increase in the domestic lifetime limit to €10 million or €15 million.

It should also be noted that the ESRI question the merits of the relief in its Budget Perspectives 2022 Paper 1 (May 2021).

The relief was maintained in Budget 2021 with a minor amendment made to the shareholding aspect so that an individual who has owned at least five per cent of the shares in the company for a continuous period of any three years prior to disposal may qualify. Prior to this change it was necessary to hold the shares for three years in the five years immediately preceding the disposal.

2.5.2 POSSIBLE CHANGES TO ENTRPRENEUR RELIEF

Angel Investors

The Department of Enterprise Trade and Employment (DETE) has sought changes to incentivise investment in businesses from external 'angel' investors. It proposes achieving this by removing the current working time requirement – where an individual must spend at least 50 per cent of their working time in the company over three of the five years preceding the disposal. It has further sought an accompanying change to either the current lifetime threshold of €1 million or, preferably, through the change in the CGT rate applying for gains in excess of the lifetime threshold.

This is based on the argument that there should be tax incentives to promote investing in assets linked to job creation in Ireland (such as equity in Irish SMEs) over and above assets which are far less linked to growing jobs in the community (such as real estate and international stock market portfolios). It is argued that a better CGT outcome would motivate investors away from passive asset speculation to active business investment.

Reinvestment

Another option for amendment put forward by DETE is to retain the relief as is, while amending the current lifetime threshold to a 'per venture' threshold. It is argued that this would ensure that the relief can be utilized by serial entrepreneurs and that utilization of the lifetime threshold in one venture will not prove to be a disincentive to locating a second venture in Ireland.

DETE argues that by allowing serial entrepreneurs to benefit from subsequent ventures, this will dramatically reduce deadweight and speaks to all of the original objectives of the scheme, in that it retains the incentive for entrepreneurs to locate businesses in Ireland, improves competition in capital taxation and incentivizes those ‘winners’ to reinvest in Irish businesses rather than passive investments.

2.5.3 COST

The latest published cost for CGT Entrepreneur Relief from the Revenue Commissioners is €92.4 million for 2018.

Revenue has no information from tax returns on possible lifetime disposals by entrepreneurs and so is unable to provide costings on issues put forward above.

2.6 Policy Options for Amending CGT element of Employment and Investment Incentive (EII) Scheme

2.6.1 BACKGROUND

The Employment and Investment Incentive (EII) scheme is a tax relief, which aims to encourage individuals to provide equity, based finance to trading companies. Tax relief can be claimed for investments when certain conditions are met. For shares issued after 8 October 2019, the relief is available in full in the year of the investment, provided those shares are held for at least four years. EII is available to qualifying individuals who make qualifying investments. The maximum investment on which you can claim relief in a year is:

- €150,000 in respect of the years up to and including 2019
- €500,000 in respect of the years after 2019, subject to those shares being held for a minimum period of 7 years

  or

- €250,000 in respect of the years after 2019 where those shares are held for a minimum period of 4 years only.

For the purposes of computing an individual’s liability to CGT, the purchase price of the shares is considered to be the cost before deduction of the tax relief. In general, should the purchase price exceed the consideration received on the sale of the shares a ‘no gain/no loss’ position will arise for the purposes of CGT.

2.6.2 ISSUE

CGT Treatment

The 2018 Indecon review commissioned by the Department of Finance in relation to the EII scheme gave the recommendation *"that capital gains secured on all subsequent sales of shares are treated as capital gains rather than the current approach to tax any such gains at income tax rates."* It was stated in this review that this would incentivise genuine investors in enterprise and would remove a perceived competitive disadvantage compared to the UK. It was noted however, that the change should not apply to cases where a connected party is the investor. Indecon also indicated its support of the wider anti-avoidance restrictions to prevent capital gains tax applying to disguised profit distributions for non-EII investments.

The current approach to the disposal of shares acquired under the EII scheme is to apply capital gains tax rules where the shares are disposed of on foot of an arm's length, 3rd party transaction, with gains arising on foot of any other type of transaction being taxed at income tax rates.

Losses

As part of the recent public consultation run by the Department of Finance on the EII Scheme, the issue of loss relief for CGT purposes has arisen. Specifically a number of submissions have sought the introduction of CGT loss relief on failed or loss-making EII scheme investments, part funded by allowing a deduction for the acquisition cost of the EII scheme share from the ultimate disposal proceeds, therefore eliminating any "doubling up" of income tax and capital gains tax relief on gains.

This issue was also raised by Indecon in its 2018 review, with it referencing the Consultative Committee of Accountancy Bodies Ireland view that the availability of tax relief on losses in the UK schemes was a very useful dimension which had made the UK EIS/SEIS investments more attractive for investors given the high risk nature of investments in start-ups.

2.6.3 COST

Unable to cost this proposal as EII related losses are not captured separately in tax returns.

2.6.4 DISCUSSION POINTS

The treatment of gains secured on the subsequent sale of shares under the EII scheme are worth discussing in light of the desired neutrality of any tax system.

The impact of loss-offset provisions on risk taking and its consequences for the riskiness of capital portfolios is complex but that there is good reason to believe that incomplete loss offset will discourage risk taking. Nevertheless any such review of this area is likely to spill over to other areas where treatment of losses is restricted e.g. in relation to the treatment of funds.

2.7 Conclusion

CGT policy has changed significantly over the years, with fluctuating rates in response to the economic cycle and the introduction of reliefs to incentivise/deter certain behaviour. As with all taxes, a low rate can be funded through a wide base, similarly a narrower base designed to encourage/reward certain behaviour requires a higher rate. Currently the Irish system adopts the latter approach with significant reliefs such as retirement relief and the revised entrepreneur relief in place. Undoubtedly there is some overlap between these reliefs and an argument can be made that the entrepreneurial relief is not achieving its intended objective of incentivising entrepreneurial activity and therefore should be abolished (see last year's TSG paper for the pros and cons of this approach). However a decision to abolish could have detrimental effects particularly in these uncertain times so as per the Indecon Report it may be best to evaluate the relief before the end of 2024 with a view to determining whether it should be maintained.

While Ireland is often cited as uncompetitive in terms of its CGT rate, there does appear to be a wish to move towards higher rates of tax on capital gains as highlighted by developments in the UK and the US. In addition whilst that there may be an immediate Exchequer impact with a reduced rate of CGT, there are doubts as to the potential level of additional yield this could raise and its sustainability over time. Additionally the current economic environment may increase the uncertainty around any potential Exchequer impact. Moreover there is a significant risk of significant deadweight arising from a reduction in the CGT rate, as many assets would be sold regardless of the rate at a particular time.

In summary, there does not appear to be a compelling case for making a significant reduction in CGT rates at the current time, though it is acknowledged that there is a need to keep existing reliefs under continuing review.

3 DIRT and LAET

The issue of the taxation treatment of financial products subject to Deposit Interest Retention Tax (DIRT) and financial products subject to Life Assurance Exit Tax (LAET) has come to the fore since reductions in the rate of DIRT in 2017, specifically during the Finance Bill.

The Department of Finance published a report in 2018, which examined the tax treatment of financial products subject to DIRT and financial products subject to LAET. It concluded the products subject to DIRT and products subject to LAET are different in a number of respects, namely, the level and application of fees to clients, the level of risk and return and potential losses, and hence the way in which they are taxed. The insurance sector did not support the conclusions of this report.

Further work was conducted last year through the TSG paper following a commitment by the Minister to examine the issue in further detail in the context of a changing macroeconomic environment, specifically in relation to forecast interest rate changes.

3.1 DIRT and LAET rates and structures

3.1.1 DIRT

DIRT is deducted by deposit takers such as banks, credit unions and building societies from the deposit interest paid to accounts of Irish residents. The DIRT rates as a percentage of total interest have changed over recent years and are set out in Table 18.

Table 17 – *DIRT Tax Rates 2002-2020*

Period Rate Applied	Standard DIRT Rate
01 Jan 2002 – 31 Dec 2008	20%
01 Jan 2009 – 07 Apr 2009	23%
08 Apr 2009 – 31 Dec 2010	25%
01 Jan 2011 – 31 Dec 2011	27%
01 Jan 2012 – 31 Dec 2012	30%
01 Jan 2013 – 31 Dec 2013	33%
01 Jan 2014 – 31 Dec 2016	41%
01 Jan 2017 – 31 Dec 2017	39%
01 Jan 2018 – 31 Dec 2018	37%
01 Jan 2019 – 31 Dec 2019	35%

01 Jan 2020 – Present	33%

3.1.2 LAET

LAET is payable on any gain arising from a life assurance policy. If a policy has a return that is greater than the amount invested, that difference is a gain and LAET is deducted on this amount. The life assurance company is obliged to deduct any tax due directly from the gain and pay it to Revenue. Products subject to LAET include all life plans issued on or after 1 January 2001:

- all life savings plans,
- all life investment bonds (capital protected, trackers),
- all life protection plans.

Table 18 *LAET Rates 2001-2020*

Period Rate Applied	LAET Rate
Up to 31 Dec 2008	23%
1 Jan 2009 - 7 Apr 2009	26%
8 Apr 2009 - 31 Dec 2010	28%
1 Jan 2011 - 31 Dec 2011	30%
Jan 2012 - 31 Dec 2012	33%
1 Jan 2013 - 31 Dec 2013	36%
1 Jan 2014 - Present	41%

The issue of the treatment of specific financial products (e.g. sales of individual shares) has also been a source of contention. The argument is made that there should be no difference between the level of tax applied to sales of individual shares (33%) and the 41% applied to those who invest in 100% equity funds.

3.1.3 DIRT AND LAET YIELDS

Yields from both DIRT and LAET are shown in Table 19 below, with a clear collapse in DIRT receipts in recent years. The assumption is the deposits have increased but interest rates have decreased much more, leading to the collapse in receipts. In addition, it is worth noting the lagged impact of SSIA schemes on LAET which would have been invested following maturity of the scheme in 2007/08 and appear in the yield figures around 2015/16.

Table 20 *Annual Tax Yield from DIRT/LAET, €m*

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
DIRT	473	581	499	435	300	170	118	96	64	37
LAET	43	43.4	58.7	130	247	228	184	165	128	124

Source: Revenue Commissioners

*Figures provisional

3.1.4 COST

The cost/gain from a change in the rate of LAET is set out in Table 22.

Table 21 *Cost of Amending LAET Rate*

		€million Full Year
Reduction in the standard rate of LAET	From 41% to 40%	-3
	From 41% to 38%	-9
	From 41% to 35%	-18
	From 41% to 33%	-24
Increase in the Standard Rate of LAET	From 41% to 42%	3
	From 41% to 44%	9
	From 41% to 47%	18
	From 41% to 49%	24

Source: Revenue Commissioners

3.2 Conclusion

While the debate over the last number of years has surrounded differentials between DIRT and LAET and subsequently CGT, the focus has since broadened into a debate surrounding the lack of neutrality in the current system particularly in relation to Exchange Traded Funds (ETFs).

This raises the question as to whether or not a more fundamental review of the neutrality of the tax system for individual savings and investors is needed. For example, are the current differential rates linked to savings and investment distorting behaviour and direct funds into less productive forms of assets or contribute to inflation in certain sectors e.g. housing. Clearly this is not a discussion that can happen in isolation and any review of savings taxes needs to be considered in the context of the wider tax system, giving due consideration to the effective tax rate of investments including not just investor level taxes but also investment level and fund level taxes.

4 Capital Taxes and Equality Issues

Taxation policy has an important role to play in reducing and rebalancing inequality. The paper sets out options for making changes mainly to CGT and CAT but is not prescriptive as to the direction of those possible changes. Capital taxes (CGT and CAT) can help raise revenue in order to finance public expenditure, which assists health, education and welfare expenditures, can assist lower income households, reduce inequality and contribute to a more equitable distribution of resources. In particular, CAT is a tax levied on assets gifted or inherited and as such from the perspective of the beneficiary is a tax on wealth and the tax can help mitigate income and wealth inequality. The rules underpinning the operation of inheritance and gift tax do allow for specific exemptions where no tax is applied and this allows for some distribution of assets tax-free before the 33% rate engages thus enduring some benefit to beneficiaries.

The distributional impact of tax changes can be hard to quantify and may impact groups differently depending on their stage in the life cycle and therefore their interaction with the tax system. It is important to note the potential for the reduction in inequality by employment rich economic activity and that amending CGT rates/reliefs does create the possibility of increasing such economic activity. It is not possible to ignore this in any analysis of changes to the CGT regime.

In summary however, given the extent of receipts from CAT, CGT, DIRT and LAET compared to the receipts from other tax heads the potential overall equality impact of any changes in the rate or application of these taxes is likely to be limited.

The TSG is asked to consider the issues in the paper.

An Roinn Airgeadais
Department of Finance

Tithe an Rialtas. Sráid Mhuirfean Uacht,
Baile Átha Cliath 2, D02 R583, Éire
Government Buildings, Upper Merrion Street,
Dublin 2, D02 R583, Ireland

T:+353 1 676 7571
@IRLDeptFinance
www.gov.ie/finance