



An Roinn Airgeadais  
Department of Finance

# Capital & Savings Taxes

## Tax Strategy Group – 20/10

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## 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 2021.

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# 1 Capital Acquisitions Tax

The Capital Acquisitions Tax (CAT) code includes gift tax, inheritance tax and discretionary trust tax. It was first introduced in the Capital Acquisitions Tax Act 1976, replacing the system of death duties, which had been in place for over a century. CAT is charged on the amount gifted to, or inherited by, the beneficiary over a particular threshold. Capital Acquisitions Tax applies to gifts taken on or after 28 February 1974 and to inheritances taken on or after 1 April 1975. The tax became a self-assessment tax in 1989.

The Capital Acquisitions Tax Consolidation Act 2003 (CATCA) was introduced into law to consolidate the various CAT related measures, and it has been amended by subsequent Finance Acts since then.

## 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 donor 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 donor. Parents also fall within this threshold where they take an absolute inheritance from a child.

**Group B** threshold (€32,500) - Applies where the beneficiary is a brother, sister, niece, nephew, or lineal ancestor or lineal descendant of the donor.

**Group C** threshold (€16,250) - Applies in all other cases.

All gifts/inheritances received since 1991 from all donors 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

	<b>Dec 2012- Oct 2015</b>	<b>Budget 2016</b>	<b>Budget 2017</b>	<b>Budget 2019</b>	<b>Budget 2020</b>	<b>Total € change since 2016</b>	<b>Total % change since 2016</b>
<b>Group A</b>	€225,000	€280,000	€310,000	€320,000	€335,000	+ €110,000	+49%
<b>Group B</b>	€30,150		€32,500			+ €2,350	+ 8%
<b>Group C</b>	€15,075		€16,250			+ €1,175	+ 8%

## 1.3 CAT Yield 2007-2020

The CAT yield to the Exchequer for each year from 2007 to 2019 is shown in Table 2 below, together with the projected yield (P) for 2020. The CAT yield is taken from Revenue net receipts 2007-2019.

**Table 2** CAT Yield 2007-2020

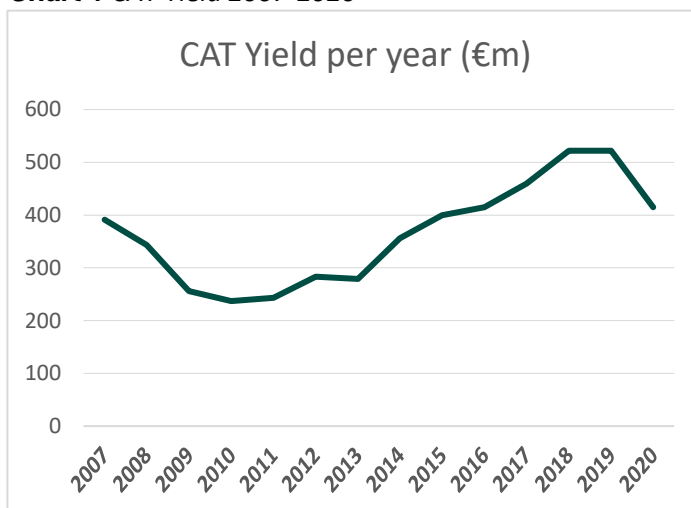
<b>Year</b>	<b>Yield</b>	<b>% change</b>
<b>2007</b>	€391m	+11%
<b>2008</b>	€343m	-15%
<b>2009</b>	€256m	-23%
<b>2010</b>	€237m	-6%
<b>2011</b>	€243m	+3%
<b>2012</b>	€283m	+16%
<b>2013</b>	€279m	-1%
<b>2014</b>	€356m	+28%
<b>2015</b>	€400m	+12%

<b>2016</b>	€415m	+4%
<b>2017</b>	€460m	+11%
<b>2018</b>	€522m	+13%
<b>2019</b>	€533m	+2%
<b>2020</b>	€415*	-20%

Source: Revenue Commissioners

\*Projected yield for 2020 is taken from Department of Finance Stability Programme Update (incorporating Department of Finance spring forecasts).

**Chart 1** CAT Yield 2007-2020



Source: Revenue Commissioners

## 1.4 Main CAT Exemptions and Reliefs

- 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.
- **CGT/CAT “same event” relief:** If CGT and CAT are payable on the same event (for example, a gift of land by a parent to a child) any CGT paid by the parent can be used by the child as a credit against her/his CAT liability to avoid double taxation.
- **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 certain 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 addition, in the case of an inheritance, the exemption now applies only to the principal private residence of a disponer. In Finance Act 2019, the conditions of the relief were 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 Recent Finance Bill Amendments to CATCA 2003

Finance Act 2019 introduced the following principal amendments:

- Dwelling House Exemption

An amendment was made to the Dwelling House Exemption following the outcome of a High Court judgment in 2018 which provided that a beneficiary could inherit a CAT exempt house at the same time as inheriting other houses from the same estate. This fell outside the original policy intention of the Dwelling House Exemption. In order to reinstate the original policy objective, the conditions of the relief were amended to ensure that all properties inherited from the same disponer are considered when assessing eligibility for the Dwelling House Exemption.

- **Probate**

Probate is the legal process involving the administration of a deceased persons' estate in accordance with the terms of their will. Amendments were made to Section 48 and a new Section 48A was added to the Capital Acquisition Tax Consolidation Act 2003 to allow the making of regulations to enable the development of an electronic system (eProbate system). The Regulations will provide for the filing of the Inland Revenue Affidavit online with Revenue for transmission to the Probate Office and the renaming of the document. The document will no longer be required to be sworn. This will make the collection and the transfer of data between Revenue and Probate Office more efficient.

- **Group A Threshold:**

The CAT Group A threshold was increased from €320,000 to €335,000 in Budget 2020.

## **1.6 Options for Changing and Amending CAT**

As set out in Table 1 above, in recent years, the Group A threshold has been increased significantly compared with the B and C thresholds.

However, the response to Covid-19 has led to economic and financial disruption and a change in broader economic and financial circumstances of all sectors of society and the economy.

There may be some capacity within CAT for some revenue raising measures, such as an increase to the current CAT rate of 33% and/or a reduction to the Group A, B, or C thresholds.

If there were a change in the rate of CAT, account would be need to be taken of implications for CAT/CGT same event relief. This would apply equally apply if there were a change in the CGT rate.

As part of the Covid-19 pandemic response, there may be stimulus measures introduced. CAT is not structured in such a way that a reduction in the rate or thresholds has an immediate impact on domestic expenditure. Indeed, it is not obvious that there is capacity for changes in the CAT code to allow for such an outcome as CAT is structured to tax longer term more rare events. CAT is paid on inheritances and gifts and these are irregular events, often happening once or twice (at least in any significant way) in a lifetime. Given the way in which gifts or inheritances occur a reduction in the rate of CAT or the thresholds is not likely to encourage any expenditure in the domestic economy. Any larger gifts or inheritances are likely to be used to pay debt, saved or invested.

### **1.6.1 REDUCE/INCREASE RATE**

Revenue estimate that every 1% increase/decrease in the rate of CAT would yield/cost €14 million in a full year.



**Table 3: Cost of CAT Threshold Changes**

		€ million/Full Year
<b>Reduction in the CAT rate</b>	From 33% to 32%	-14
	From 33% to 30%	-41
	From 33% to 28%	-68
	From 33% to 23%	-136
<b>Increase in the CAT rate</b>	From 33% to 34%	14
	From 33% to 36%	41
	From 33% to 38%	68
	From 33% to 43%	136

Source: Revenue Commissioners

### 1.6.2 REDUCE/INCREASE 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 given the perceived importance of inheritance by children from their parents.

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 €230 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 10 below.

Analysis by Revenue indicates that the majority of CAT receipts, and the majority of the increase in receipts since 2010, is from inheritances. Receipts from inheritances were €455 million in 2019 from total CAT receipts of €522 million. Gifts at €59 million were the next largest, receipts from discretionary trusts were €7 million and receipts from probate tax (which was abolished in 2001) were less than €1 million in 2019.

If it were intended to raise revenue and rebalance the differential between the A and B and C thresholds, a greater reduction in the A threshold would reduce the proportionate amount of the yield from the B and C thresholds.

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

### 1.6.3 COST OF INCREASING GROUP THRESHOLDS

**Table 4** Group A Threshold

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

Source: Revenue Commissioners

**Table 5** Group B Threshold

Current Threshold	Proposed new threshold		
€32,500	€33,500	€35,000	€335,000
Estimated full year cost	-3m	-6m	-176m

Source: Revenue Commissioners

**Table 6** Group C Threshold

Current Threshold	Proposed new threshold		
€16,250	€17,000	€17,500	€335,000
Estimated full year cost	-1m	-1m	-53m

Source: Revenue Commissioners

### 1.6.4 YIELD FROM DECREASING THRESHOLDS

**Table 7** Group A Threshold

Current Threshold	Proposed new threshold			
€335,000	€225,000	€320,000	€310,000	€300,000
Estimated full year yield	76m	11m	19m	26m

Source: Revenue Commissioners

**Table 8** Group B Threshold

Current Threshold	Proposed new threshold		
€32,500	€25,000	€31,500	€30,000
Estimated full year yield	20m	3m	7m

Source: Revenue Commissioners

**Table 9** Group C Threshold

Current Threshold	Proposed new threshold		
€16,250	€10,000	€15,500	€15,000
Estimated full year yield	7m	1m	1m

Source: Revenue Commissioners

### 1.6.5 CAT CASES & REVENUE BY THRESHOLD 2014-2019

**Table 10** CAT Cases & Revenue by Threshold 2014-2019

	2014	2015	2016	2017	2018	2019
<b>Group A Threshold</b>	Cases: 5,078  Revenue: €146.2m	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
<b>Group B Threshold</b>	Cases: 10,561  Revenue: €163.4m	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
<b>Group C Threshold</b>	Cases: 3,802  Revenue: €44.8m	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

<b>Total</b>	Cases: 19,441	Cases: 22,451	Cases: 19,898	Cases: 23,924	Cases: 24,923	Cases: 24,128
	Revenue: €354.4m	Revenue: €398.1m	Revenue: €411.4m	Revenue: €457.9m	Revenue: €518.9m	Revenue: €514.5m

Source: Revenue Commissioners

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

### 1.6.6 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 €8 million for the full year. The estimated impact of reducing Business Relief from 90% to 80% is an additional yield of €18 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.

**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	53m	36m	20m	8m
Business	90	82m	60m	38m	18m

Source: Revenue Commissioners

### 1.6.7 AMENDMENT OF SMALL GIFT EXEMPTION

Consideration could be given to increasing or reducing this exemption.

There could be consideration to restricting its use. Currently there is no restriction on who can receive or gift the allowance. For example, it may be appropriate to only allow its use within immediate family members.

**Table 12** *Cost of Amendments to Small Gift Exemption*

<b>Proposed Exemption Amount</b>	<b>Effect of Change - Yield/Cost</b>	<b>Estimated €m</b>
€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

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.

The Tax Strategy Group may wish to consider these issues.

## 2 Capital Gains Tax

In general, 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 – a gift of an asset counts as a disposal and will be liable to CGT if a gain is made. 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

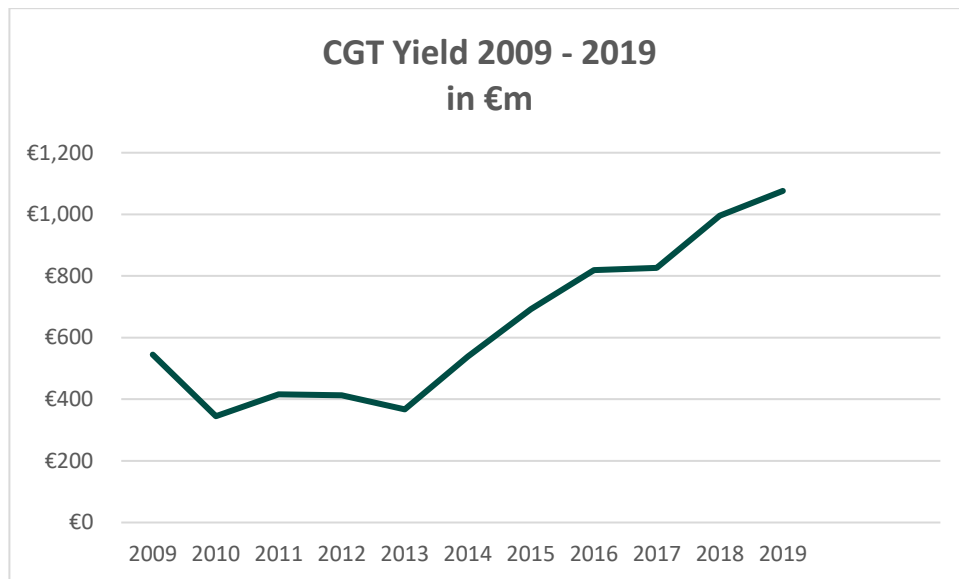
The CGT yield to the Exchequer for each year of the last 10 years is shown in Table 13 together with the provisional yield (p) for 2019. The CGT yield is taken from Revenue net receipts 2009-2018. With the provisional yield for 2019 also provided by Revenue. It is important to note however that these are receipts of capital gains tax 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 13** CGT Yield from 2009 to 2019

Year	Yield	Percentage Annual Change
2009	€545m	-61.7%
2010	€345m	-36.7%
2011	€416m	+20.6%
2012	€413m	-0.7%
2013	€367m	-11.1%
2014	€539m	46.9%
2015	€692m	+28.4%
2016	€819m	+18.4%
2017	€826m	+0.9%
2018	€996m	+20.6%
2019	€1,076m (p)	+7.9%

Source: Revenue Commissioners

**Chart 2** CGT Yield 2009 – 2019\*



Source: Revenue Commissioners

\* The 2019 figure is provisional

## 2.2 Rate of CGT

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 disposer.

### **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 1<sup>st</sup> 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% up to a lifetime limit of €1 million in chargeable gains. To qualify, among other conditions, an individual must own at least 5% 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. This relief is examined in more detail in Section 2.5.

#### **2.3.8 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.

Following an ex-post review of this relief, the relief, which was due to expire on 31 December 2019, was extended to 31 December 2022 as part of Finance Act 2019.

#### **2.3.9 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 capital gains tax, carried interest is charged at 15% where received by an individual or partnership and 12.5% where received by a company.

## 2.4 Options 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. CGT policy and legislation is subject to consideration in the TSG, as part of the annual Budget and Finance Bill process, and considered as part of a wider policy mix (e.g. reliefs for entrepreneurs in 2019) and in tax expenditure evaluation work.

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 2021

Against the backdrop of Budget 2021, the economic climate, both domestically and internationally, has fundamentally changed as the necessary health protocols put in place to suppress the transmission of Covid-19 have resulted in a sharp decline in economic activity.

The Department of Finance April Stability Programme Update indicates that it is highly unlikely that there will be a rapid recovery to pre-pandemic levels of economic activity. It expects that there will be an economic contraction in the first and second quarter of 2020 (with a sharp contraction in the second quarter) and a modest recovery beginning gradually in the third quarter of this year and continuing over the course of 2021. Under this baseline scenario, economic activity does not reach its pre-pandemic level until 2022. The main assumption underlying this baseline scenario is that the containment measures, both domestic and international, do not remain in place longer than anticipated.

Non-food retail, entertainment and hospitality are among the sectors most affected. External demand for Irish-produced goods and services, personal consumer spending and construction activity are all set, and indeed have already begun, to significantly decline.

The Covid-19 pandemic has also caused a significant shock to the world economy, mirrored across the economies of almost all countries. Containment measures around the world have already begun to depress household consumption, investment in firms and exports to foreign markets creating a substantial demand-side shock.

There is also uncertainty about the outcome of negotiations between the UK and the EU on its future relationship and the potential immediate and longer-term economic impact.

### 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 this regard, as part of the work on the analysis of the revised CGT Entrepreneur Relief in 2019, Indecon noted that Ireland has one of the highest rates of CGT when compared with the headline rate in a number of comparator countries. The table produced by Indecon has been reproduced below for ease of reference.

**Table 14** *Capital Gains Tax rates for Selected Countries*

State	Rate	State	Rate
Finland	34	Czech Republic	15
France	30	Albania	15
Ireland	33	Greece	15
Iceland	22	Belarus	18
Sweden	30	Malta	12
Portugal	28	Switzerland	12-24
United Kingdom	28/20	Bosnia and Herzegovina	10
Austria	27.5	Slovenia	25
Slovak Republic	25	Moldova	12
Norway	22	Bulgaria	10
Denmark	27	Macedonia	10
Russia	20	Montenegro	9
Serbia	15	Andorra	10
Cyprus	20	Netherlands	1.62
Estonia	20	Romania	10
Luxembourg	17	Turkey	22
Spain	19-23	Croatia	18
Ukraine	18	Italy	24
Lichtenstein	12.5	Germany	25
Hungary	15	Monaco	0
Lithuania	15/20	Belgium	0
Latvia	20	Poland	19

Source: Indecon (2019) Indecon Evaluation of the Revised Entrepreneur Relief

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 rate of CGT against selected euro area countries plus the UK, Denmark and Norway.

**Table 15:** *Headline Rates of Capital Gains Tax for Individuals and Business, Selected Euro area plus UK, Denmark and Norway*

State	Individual, CGT Rate %	Corporate, CGT Rate %
Austria	27.5	subject to the normal CIT rate
Belgium	NA	subject to the normal CIT rate (except capital gains on shares under certain conditions)
Denmark	Subject to normal PIT rate	subject to the normal CIT rate
Finland	30 (34 on income exceeding €30,000 annually)	subject to the normal CIT rate.
France	30, plus exceptional income tax for high earners at 4%	subject to the normal CIT rate
Germany	25, plus solidarity surcharge	subject to the normal corporation tax rate
Ireland	33	33
Italy	subject to the normal PIT rate	Capital gains are subject to the normal CIT rate. For financial investments PEX regime at 95% may be applied provided that the conditions set by the law are met
Latvia	20	subject to the normal CIT rate
Lithuania	20	subject to the normal CIT rate
Luxembourg	subject to the normal PIT rate	subject to the normal CIT rate
Netherlands	NA	subject to the normal CIT rate (25%). Capital gains on qualifying participations are tax exempt under the participation exemption
Norway	subject to the normal PIT rate	subject to the ordinary CIT rate
Slovak Rep	19	subject to the normal CIT rate
Slovenia	25	subject to the normal CIT rate
Spain	Residents – 23 Non-residents - 19	subject to the normal CIT rate
Sweden	30	non-tax-exempt capital gains taxed at the corporate tax rate of 21.4%
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).	subject to the normal corporation tax rate

Source: PwC Worldwide Tax Summaries, June 2020

Ireland is distinctive in that it applies a common rate to all such gains whereas other countries examined operate a diverse system. It is necessary to take care in comparing any set of CGT rates with another in different countries and drawing definitive conclusions about rates from

such comparisons. In addition, 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.

Internationally, there is also uncertainty regarding the outcome of the negotiations between the EU and the UK on the future relationship that will take affect at the end of the current transition period on 31 December 2020. The level of change and therefore the impact on the economy is likely to be dependent on the outcome of the negotiations as the UK is a significant economic competitor. In the case of cross-border activity and investment between Ireland and Northern Ireland, CGT may be payable either in Ireland or the UK with the relevant taxation regime and rates applying, therefore, it is important to consider the rates that apply under the UK CGT regime.

Different rules apply for individuals on the UK basic rate of income tax, where if the final chargeable gain is within the basic income tax band (following necessary calculations), an individual will pay 18% on residential property and 10% on other chargeable assets. An individual who pays the higher rate of income tax pays 28% on gains from residential property and 20% on gains from other chargeable assets. Corporation tax applies to businesses in respect of gains made on the disposal of assets.

#### 2.4.3 AMENDING THE CGT RATE

There has been consideration of the arguments in favour of and against amending the current 33% rate of CGT in previous TSG papers. It is therefore not necessary to restate them again in full. In brief the arguments are:

- **Exchequer Impact:** There is likely to be an immediate Exchequer impact with a reduced rate. However, while there may be an increase in Exchequer revenue from an increase in assets sold to take advantage of a lower CGT rate, there are doubts as to the potential level of additional yield this could raise and the sustainability over time. Additionally, the current economic environment may increase the uncertainty around any potential Exchequer impact.
- **Investment impact:** The extent to which a lower rate of CGT drives investment decisions, improves returns for entrepreneurs and encourages serial and additional investment needs to be considered. Conversely, the extent to which higher rates of CGT can “lock-in” investments and affect the timing of the sale or acquisition of assets is also a factor for consideration. CGT is paid when an asset is disposed of and investors can chose when to make this disposal and pay the tax. Owners of capital may retain their current investments because of high rates of CGT in anticipation of future lower rates, even if more profitable and productive opportunities are available leading to those projects going underfunded in favour of less productive activities.
- **Deadweight effect:** The level of potential deadweight arising from a reduction in the CGT rate relating to the sale of assets, which would be sold irrespective of the rate of CGT.

- **Tax arbitration:** If there are different rates of capital and income taxes, it may be possible to manage receipt of income so that it is taxed as capital rather than income tax. While it is possible to counter such outcomes via anti-avoidance legislation, this can be difficult to introduce and administer and can add to the complexity of the tax system.
- **Targeting:** A lower rate of CGT could potentially encourage innovation and risk taking, encourage the sale and purchase of assets, which drives investment activity, and would improve the returns for entrepreneurs. Conversely, over-reliance on a small segment of activity can create issues in terms of sustainability of the public finances.
- **Competitiveness:** Tax competitiveness remains an important issue and is an important feature of the economic and fiscal policy of all economies. The tax rates of countries with which Ireland trades are important comparators. The UK has lower CGT rates as outlined above. Other EU member states also have lower rates of CGT and this needs to be taken into account if any rate change was made. One of the arguments in favour of reducing the rate of CGT is to maintain Ireland's international tax competitiveness as against the UK and EU Member States.

#### 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%	(32)
	From 33% to 31%	(65)
	From 33% to 28%	(162)
Increase in the CGT rate	From 33% to 38%	162
	From 33% to 35%	65
	From 33% to 34%	32

Source: Revenue Commissioners

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 €32 million, assuming no behavioural change. A 5% reduction in the CGT rate in a single Budget would have an Exchequer impact of €162 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. This issue is addressed in more detail in sections 2.4.5 and 2.4.6.

#### **2.4.5 OPTIONS FOR 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 following factors: investment climate, economic impact and deadweight, Exchequer impact, and international competitiveness. Any decision to amend the rate is made more complicated by the uncertain economic impact of the Covid-19 pandemic.

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 main argument in favour of an increase in the headline rate of CGT is the potential for additional Exchequer revenue. Any one-off rate change (either an increase or reduction) would need to address the issues raised in section 2.4.3.

The issue of whether some form of temporary CGT rate change may be useful in terms of part of a set of tax-focused measures to deal with the Covid-19 economic and fiscal disruption also merits consideration. In the past and during the financial and economic crisis, there was relief from CGT for land or buildings acquired during a three-year window (between 2011 and 2014) on the subsequent sale in order to encourage activity in the property market.

This Covid-19 related economic and financial crisis differs in that businesses have had to close because of the adoption of specific public health measures and not because of a direct financial or economic crisis. The Stability Programme Update notes this global economic crisis is fundamentally different to previous crises, as it was not triggered by the need to correct macroeconomic imbalances or policy mistakes, and the same is the case for the Irish economy. To the extent that any change in the CGT rate may be relevant, it is likely to be part of a package of tax and other measures.

Thus, the extent to which a temporary rate reduction may be appropriate depends on a number of factors. These factors are considered to be (but not exclusively): the extent to which it is affordable; the rationale for such a change; and, the design (e.g. a temporary reduction to return to the current rate or to return to a new lower CGT 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 (as considered in section 2.4.6). The economic and other factors supporting a rate reduction (either temporary or permanent) are outlined in section 2.4.3.



In terms of a reduction of the rate of CGT, a time limited lower rate of CGT for a period of one year, for some or all sales of assets subject to CGT may provide for a temporary stimulus. This could encourage economic activity, allow for the disposal of potentially unproductive assets, which may arise because of the current crisis. The time limited, nature (e.g. one year) of such an approach could encourage sales and speed up the decision-making process.

Given the specific current economic circumstances, which are notably different to the economic position in 2008 and prior to this public health crisis, it appears that the introduction of a similar scheme to that adopted in 2011 would not be necessary. Instead, if it is considered appropriate a temporary reduced rate, which applied to the sale of some or all assets, may have a stimulus effect in terms of the disposal of assets.

The other factor to consider is the most appropriate CGT rate to introduce if a temporary rate were to be adopted once this temporary rate had expired. The introduction of a change in the headline CGT rate opens up the possibility of a reform of the CGT rate structure with a number of options:

- return to the existing 33% rate;
- a lower CGT rate (which might be an average of EU and UK rates); or,
- a lower general rate with a higher rate for a set of clearly defined assets.

Introducing a temporary lower rate and then restoring the current 33% rate has the merits of simplicity and potential Exchequer benefits in terms of cashflow. However, it misses any potential to reform the rate and structure of CGT as well as certain reliefs and also does not take into account tax competitiveness issues. It is difficult to see acceptance for reform of reliefs in the absence of changes to the CGT rate.

A temporary reduced rate followed by a newer reduced rate will have an Exchequer impact but the extent of that impact is less as a result of the new reduced rate. A reduced rate could make the capital tax system more competitive (both with the UK and other jurisdictions) and allow for reform of specific CGT reliefs. Indeed, a condition for any change in the rate should be reform of specific CGT reliefs, as discussed further.

The retention of the 33% rate (or a higher rate) for the sale of specific and closely defined assets and a lower general rate of CGT would allow for some offset of the costs of a permanently lower general rate but would increase the administrative burden. It could encourage specific economic activity through the lower rate while generating a higher yield from other economic activity.

#### **2.4.6 POTENTIAL COMPENSATORY CHANGES**

It could be possible to offset the Exchequer cost of any change in the headline CGT rate through trade-offs in terms of restriction or abolition of existing CGT business reliefs. These trade-offs are not necessarily easy and always as in the case of any trade-off there are winners and losers. Depending on the scope of such changes, a reduction in the rate could be revenue neutral or at a minimum, there could be acceptance of some Exchequer cost, depending on the ambition and scope in terms of a new rate of CGT.



There are a number of CGT reliefs and exemptions, which have already been set out in further detail in section 2.3 of this paper:

- Annual exemption of €1,270;
- Transfers between spouses and civil partners under court order;
- Principal Private Residence Relief;
- Transfer of a site from a parent to a child;
- Retirement Relief;
- Farm Restructuring Relief;
- Revised CGT Entrepreneur Relief; and
- CGT treatment of carried interest.

To the extent that there is scope for making changes, the following considerations might apply. The abolition or amendment of any relief should be as straightforward as possible with few changes as possible to the relief. It should also have the potential to yield sufficient Exchequer revenue and be linked to the business activities that benefit most from the existence of the relief. These criteria together would exclude the consideration of all of the above reliefs with the exception of the revised CGT Entrepreneur Relief and CGT Treatment of Carried Interest.

#### ***CGT treatment of carried interest***

There is an overview of the CGT treatment of carried interest in 2.3.9 above.

In terms of the CGT treatment of carried interest, a possible policy option that merits further consideration is that carried interest should attract the 33% rate of capital gains tax instead of the rate of 15% or 12.5% that is currently applied.

The 15% rate for individuals and joint-partnerships and 12.5% for corporations was amended in Finance Act 2013 as part of a wider set of measures to stimulate economic activity. The potential option in respect of the CGT treatment of carried interest is to increase the rate of carried interest from 12.5% or 15% to 33% in the context of a reform of the rate of CGT.

Applying the headline rate of CGT of 33% to carried interest could yield approximately €20 million per year. Clearly, this would be lower if there was an overall lower rate of CGT.

Treating carried interest as a chargeable gain subject to the full rate of capital gains tax means venture capital managers are able to avail of a lower rate of tax than if carried interest were to be classified as income.

A change in the CGT treatment of carried interest would widen the CGT base and this could potentially both partially fund and also support a lower headline rate of capital gains tax.

#### ***CGT Entrepreneur Relief***

Options in relation to the revised CGT Entrepreneur Relief which has recently been reviewed on behalf of the Department by Indecon International Economic Consultants are discussed in Section 2.5.

## **2.5 Policy Options regarding Revised CGT Entrepreneur Relief**

### **2.5.1 BACKGROUND TO CONSIDERATION OF A POSSIBLE CHANGE TO THE REVISED ENTREPRENEUR RELIEF**

As part of Budget 2020, there were no changes made to the structure or lifetime limit for the Revised CGT Entrepreneur Relief. However, there was a commitment made to consider the outcome of an external review of the Relief carried out by Indecon International Economic Consultants (Indecon), as well as the public consultation carried out in 2019, in order to determine possible changes that could be made to the relief to better support entrepreneurs and businesses.

The external review 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 CGT Entrepreneur Relief, both through the public consultation exercise as well as the Indecon evaluation. These are as follows:

- Reduction in the headline rate of CGT of 33%
- 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% 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 3 of the 5 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

Based on the Indecon review and public consultation process this part of the TSG paper explores a number of potential policy options in respect of the Revised CGT Entrepreneur Relief. These are set out below in further detail in sections 2.5.3 and 2.5.4.

### **2.5.2 COMPARISON WITH THE EQUIVALENT UK ENTREPRENEUR RELIEF**

The UK in particular is cited as a competitor for mobile Irish investment and is seen as having a more attractive CGT regime for entrepreneurs. The existence and operation of the similar UK relief with a lifetime limit of £10 million has been one of the most significant arguments made in favour of a higher lifetime threshold in Ireland. An increase in the lifetime threshold,

in line with the UK, was the overarching suggestion that arose out of the responses to the public consultation in 2019.

There has been considerable engagement in recent years seeking an increase in the lifetime limit of the Revised CGT Entrepreneur Relief to €10 million or indeed €15 million and effectively aligning the level of the relief with the equivalent UK regime.

The UK CGT relief for entrepreneurs was the subject of two external reviews, the more recent one by the Institute for Fiscal Studies (IFS). The IFS noted a cost of on average £2.4 billion per annum. It suggested that the 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 Entrepreneur Relief. No evidence was found that tax-motivated retention of profits translates into more investment in business capital.

The recent decision by the UK Chancellor of the Exchequer in his 2020 Budget to reduce the lifetime limit from £10 million to £1 million has undermined the argument that the UK is more competitive than Ireland in terms of this CGT relief. It also undermines the argument in favour of an increase in the domestic lifetime limit of the scheme in Ireland to €10 million or €15 million. It is also worth noting that the €1m limit is the main relief available to those who want to dispose of their businesses and/or retire. This contrasts with Ireland where we have the Revised CGT Entrepreneur Relief and a retirement relief.

### **2.5.3 RETAIN THE CGT ENTREPRENEUR RELIEF AND REVIEW BEFORE END 2024**

This option proposes no immediate change to the relief. It considers that the relief would not be retained indefinitely and that there would be a public commitment to the evaluation of the relief before the end of 2024.

The Indecon report supported a further review. Carrying out a new review would also be in line with Department of Finance tax expenditure guidelines and would help to determine whether there was merit in retaining or ending the relief on 31 December 2024.

The Indecon evaluation also recommended improving the quality of data to be captured to improve the basis on which to carry out any further review. Such a new review could allow determination of a number of factual issues such as:

- whether the relief assisted the development of new businesses;
- whether the relief supported additional entrepreneurial activity as part of a survey of beneficiaries of the relief;
- whether the relief encouraged reinvestment of the proceeds of the sale of a business asset; and
- the number of businesses sold and how close to the €1 million lifetime threshold the gain from such a sale in each case is and the number of businesses sold for a gain that exceeds or remains below the lifetime threshold.

Retaining the relief as is up until the end of 2024 would continue to have costs in terms of revenue foregone. There was €20.4 million in 2016 (412 claims) and €81.5 million in 2017 (875 claims) of CGT revenue foregone. The provisional figures from the Revenue Commissioners for the cost of Revised CGT Entrepreneur Relief in 2018 are €92.4 million (875 claims). It is not obvious that the cost will increase in a similar manner if the relief remains in place until the end of 2024 given the current economic difficulties arising from the pandemic, however there would continue to be costs associated with this scheme.

Retaining the relief means that it would continue to support business activity and indeed the Indecon study supported its retention in its conclusions.

As part of the process of evaluating the various potential options in respect of the Revised CGT Entrepreneur Relief, the possibility of amending it to take into account the recommendation arising from the Indecon study of introducing a reinvestment relief was considered. The possibility of amending and reintroducing a revised version of the previous Section 597A Entrepreneur Relief to make it more attractive to repeat investors by improving the return they would receive was also considered.

There were a number of issues identified from an administrative perspective regarding how a reinvestment relief would operate. For example, coordinating the difference between the timing of when CGT falls due to be paid on an annual basis, and a potentially longer timeframe allowed for in which entrepreneurs must reinvest gains to qualify. Additionally, how legitimate reinvestment could be verified by the Revenue Commissioners to ensure that the beneficiaries of the relief were only able to avail of it in genuine circumstances of reinvestment in new business activities. Any proposed reinvestment relief could give rise to potential misuse and would require appropriate anti-avoidance measures in order to address this.

There is also the possibility of adding a layer of complexity for small businesses with the introduction of a reinvestment relief. Indeed, the original section 597A relief suffered from poor take up and it is not obvious there is a demand for a similar, albeit amended, relief for reinvestment by entrepreneurs. Certainly, it has not featured in the policy aims of any individual organisations.

#### **2.5.4 ABOLISH THE CGT ENTREPRENEUR RELIEF**

There are ongoing doubts about the merits of broad based reliefs such as this one in terms of cost-benefits to the taxpayer. 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

An option therefore is the abolition of the revised entrepreneur relief by the end of 2020. This could potentially raise in the order of €92 million, based on the forecast revenue foregone for 2018, assuming no change in behaviour. However, given the current economic climate and uncertainty for businesses, the level of any expected savings may be lower.

Arguments in favour of abolition include:

- The ability to recycle the revenue into a reduction in the headline rate of CGT;
- Savings for the Exchequer that would free up resources and allow them to be deployed elsewhere, for example, to fund other tax related business supports;
- There is no requirement to have a lower CGT rate for the sale of the types of businesses benefiting from this relief and no expectation that the relief would exist when they were set up; for a number of such businesses the existence of the relief was not a determining factor when they were established;
- The sellers have the potential to benefit from other specific CAT and CGT business reliefs in terms of the existence of retirement relief; and,
- There are a wide range of important tax and other expenditure related supports in place for SMEs.

Arguments against abolition include:

- The external review of the scheme supported its retention given the international competition for investment;
- The expectation of the continuation of the relief, for example, there may have been some businesses that came into being and established themselves in Ireland expecting to ultimately benefit from the relief;
- The possibility that the relief will benefit and encourage serial or repeat investors notwithstanding that the current limit of €1 million is a lifetime limit and reinvestment is not a condition of the relief;
- The impact on the development of small business with external challenges (such as the UK departure from the EU and the current Covid-19 pandemic);
- The impact on the decision and timing of the disposal of the asset based on the review of the scheme;

Clearly, any decision to abolish the relief would have to take into account the pros and cons of such a decision and the wider context regarding a potential trade off with the rate of CGT already considered in this paper.

## 2.6 Examination of the Possible Extension of CGT Principal Private Residence Relief to Carers

A Committee Stage amendment was proposed to the CGT Principal Private Residence (PPR) Relief provided for in Section 604 of the Taxes Consolidation Act, 1997 (TCA, 1997) during the Finance Bill 2018 and 2019 debates. The CGT PPR Relief provides for relief from CGT on the sale of the PPR of an individual (with some limited exceptions).

The proposed amendment was to extend the application of CGT PPR Relief to the following situation. A person who owns a property, which is their PPR, moves into a relative's home to care for them on a full time basis and, following the death of their relative, inherits their relative's property, retains the inherited residence as their PPR and sells their current principal residence.

There was consideration of this issue in the 2019 capital taxes paper. As the Minister for Finance agreed to examine this issue in further detail at the Committee Stage of the Finance Bill 2019, this is the outcome of this work.

### 2.6.1 IMPLICATIONS FOR CAPITAL ACQUISITION TAX

Any potential change to the CGT PPR treatment would also need to take into account the possible implications for Capital Acquisitions Tax (CAT) and possible pressure for changes to the CAT regime that might arise if there were changes made to the CGT PPR Relief. Any and all such changes would have an Exchequer cost.

Currently, a person with a PPR who inherits another dwelling house cannot benefit from the CAT dwelling house exemption. Therefore, if an individual moves into their relative's house, while retaining ownership of their own house, they would not benefit from the dwelling house exemption in respect of their relative's house upon inheritance, as they already own another property at the time of inheritance.

Consequently, even if it was possible to agree the proposed CGT relief change, a CAT liability could still arise. The extent of that liability would depend on the relationship between the beneficiary and the disponer and which CAT category and lifetime threshold would apply as a result, as previously outlined.

A change in the CGT PPR Relief rules is likely to drive an expectation that there would be changes in the CAT rules given the potential liability involved. While the Category A lifetime threshold may cover an inheritance in many cases, this would not be the case for Category B and C inheritances where the thresholds are lower at €32,500 and €16,250.

Any change to the to the existing CAT rules to provide relief on the inheritance of a property where there have been changes to the applicable CGT treatment would undermine the existing CAT policy. The recent changes in the law in recent Finance Acts reinforced the policy intention of the dwelling house exemption and ultimately the yield from the tax.

## **2.6.2 ISSUES TO BE CONSIDERED IN ANY EXTENSION OF THE RELIEF**

The policy considerations addressed below are relevant to any consideration to amend the CGT PPR Relief to accommodate the issues raised during the Committee Stage.

The main beneficiaries of such a policy change would be homeowners. It would not benefit others (e.g. renters, those living in social housing or other similar situations where a person does not own the property).

### ***Objective***

As it currently stands, the CGT PPR Relief is a valuable and important relief and allows people to sell their family home and move to one that suits their needs and circumstances without incurring a tax liability. There is also strong public support for the continuation of the relief.

### ***Ability to use the existing CGT relief for caring responsibilities***

The final 12 months of ownership of a property constitute a period of deemed occupation with full CGT relief available even if the property is not occupied during that 12 month period. A period of caring could coincide with that time and this would not affect any entitlement to the CGT PPR Relief.

If someone does not occupy a property as their PPR for the entirety of the period of ownership of their property, relief from CGT on any gain from the sale of that property is still available. This is restricted to the gain associated with the time where the property was occupied and the potential CGT liability could be relatively small as a result. However, this would still depend on individual circumstances.

It is therefore possible in many instances to engage in caring responsibilities under the terms of the CGT PPR as it operates now with no or potentially limited CGT charge.

### ***Potential to amend aspects of existing CGT relief to accommodate caring responsibilities***

There is a deemed period of occupancy provided certain conditions are met when an individual is prevented from residing in his or her PPR as a result of a condition imposed by their employer. There are significant differences between allowing a deemed period of occupancy in respect of employment conditions and providing for it in the case of caring responsibilities.

The exception in respect of employment is time limited and it may be difficult to readily apply similar time limits in the case of caring, the length of which varies and may not be easily defined. It would be helpful for the implementation of such a relief to determine when a period of caring commenced but this may not always be practical and may not align with the reality of many situations where the need for caring develops on a more gradual basis.

Caring could be short or long term depending on the illness or disability. The carer may live near to the dependent relative; however, the situation under consideration is that carer will not live in his or her own house but live in the dependent relative's house and eventually inherit this.

At present, the CGT PPR Relief has limited and well defined exceptions, and operates on a mainly self-assessed basis. Extending the Relief to carers could be operationally cumbersome for the recipient of the relief and for Revenue. Introducing a health and illness related



component is likely to require an assessment process in order to determine the validity of any claim, which could be intrusive.

The CGT PPR is efficient and effective from a tax administration point of view and for those who benefit from the relief. It would be difficult to administer any proposed change which loosened its terms and conditions without further significant engagement from Revenue and from homeowners.

***Cost implications and definitional and other issues regarding caring responsibilities***

There is no direct information on the number of carers who could avail of the CGT PPR Relief if it were extended in the circumstances proposed. Consequently, it is extremely difficult to estimate the cost to the Exchequer of such an extension of the relief. The possible cost is likely to be influenced by the scope of the definition of carers, caring situations and take up.

As with any potential demand led scheme, it is impossible to estimate adequately potential beneficiaries. Clearly if even a relatively small percentage of individuals in receipt of current carers allowance payments qualified for the extended relief, there could be a significant impact on CGT receipts.

The underlying assumption is that the carer would live with the person they are caring for. A requirement that the carer has to be full time would exclude those who provide caring responsibilities on a part time basis where a dependent relative does not need full time care. Extending a potential relief to any level of caring for a dependent relative would increase the potential CGT cost significantly.

In respect of specific illnesses and health conditions that are being cared for, the question becomes which of these should be covered by or excluded from the relief. Creating a category of specific illnesses or disabilities raises boundary issues and perceptions of unfair treatment. Introducing a health and illness related component is likely to require a formal assessment procedure in order to determine the validity of a claim for the relief.

### **2.6.3 CONCLUSION**

CGT PPR Relief is a longstanding and generous relief available to all individuals who own and occupy a property as their PPR. It is important that this relief is not undermined as it could affect the longer term existence of the relief.

As it is a self-assessed relief, it is important that it remains straightforward and transparent to preserve the relief and the self-assessed nature of its operation.

There is potential under the terms of the relief to deal with caring responsibilities (e.g. 12 month deemed period) and indeed where potentially only a small percentage of the gain would be subject to CGT (depending of course on the time involved in caring).

Any extension of the relief to caring is likely to complicate its operation for recipients and Revenue. Introducing a health/illness component is likely to require some formal assessment procedure in order to determine the validity of a claim for the relief. Such changes could also be intrusive for an individual where their health condition is assessed.



Given the potential to use the existing relief to cope with many caring responsibilities, the limited amount of CGT that might be incurred in any longer term caring situation and the complexity and potential intrusive nature of any assessment process, it is not obvious that that there is a basis for an extension of the relief as proposed.

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## 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. In addition, Insurance Ireland has also been to the fore in raising this issue.

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.

The Minister made a commitment at Committee Stage of the Finance Bill 2019 process to examine the issue in further detail in the context of a changing macroeconomic environment, specifically in relation to forecast interest rate changes. In particular, the Minister agreed to consider whether the different rates of taxation applied to financial products subject to DIRT and those subject to LAET would in the longer-term skew investment towards deposit accounts and away from longer-term life insurance products. There was agreement to an analysis in the TSG and this represents the outcome of this work.

### 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 17.

**Table 17 – DIRT Tax Rates 2002-2020**

<b>Period Rate Applied</b>	<b>Standard DIRT Rate</b>
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 19 Annual Tax Yield from DIRT/LAET, €m**

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019*
<b>DIRT</b>	446	473	581	499	435	300	170	118	96	64
<b>LAET</b>	31.2	43.0	43.4	58.7	130	247	228	184	165	128

Source: Revenue Commissioners

\*Figures provisional

### 3.1.4 COMPARISONS BETWEEN PRODUCTS SUBJECT TO DIRT AND LAET

The review conducted by the Department and Revenue in 2018 compared DIRT and LAET on the basis of:

- Fees/costs to the client

- Taxation treatment and exemptions;
- Risk and return.

It is worth providing an overview on the main outcomes of that report.

### ***Fees/costs to the client***

Deposit products tend to be relatively simple where the relevant amounts are deposited and do not normally attract fees or commissions. There can be account fees or service charges levied for transactions carried out on the account or penalties if money is withdrawn in term accounts. There may also be fixed fees or charges in respect of the operation of current accounts but current accounts would not normally be regarded as intermediate or long-term savings vehicles.

Life assurance products are generally subject to fees and brokers' commissions (where the latter provide advice or other services). These can take the form of annual fund charges, entry fees, exit fees and ongoing management fees (where they differ from annual fund charges). The level of fees can also be set as a percentage rate based on the level of investment. There may also be fees for provision of advice on an ongoing basis. These fees can be levied irrespective of the performance of the underlying investment. The rates charged also vary depending on the institution, and products can attract fees ranging from approximately 1% to 2% for product and account management to between 1% and 5% charges on early encashment.

It can therefore be said that the level and variety of fees charged (by either brokers and/or life assurance companies) are an indicator of the greater complexity of the life assurance investment product over deposit accounts. If this argument is developed further, investors are likely to consider not just the interest rate to be paid or the expected rate of return on an investment. They are also likely to consider the rate of return after costs and fees have been taken into account.

### ***Taxation Treatment and Exemptions***

DIRT is deducted at source, on any interest paid or credited, by the financial institution holding the funds. DIRT is a "final liability tax" – that is, it satisfies the individual's full liability to Income Tax in respect of deposit interest. However, the individual may still be liable to PRSI on the interest. Deposit interest subject to DIRT is not subject to the Universal Social Charge.

From 2002 to 31 December 2013 a higher rate of DIRT applied to "tracker type", or "hybrid" deposit products where the return on the investment was linked to the growth in a particular group of stocks or shares.

The reason for this higher rate being introduced was that while DIRT was deducted annually on standard deposit accounts, tax on these "hybrid" products would not be deducted until a chargeable event occurred. When the DIRT legislation was being amended to take account of tracker and other long-term investment products the DIRT rate for these "hybrid" products was set at the exit tax rate (i.e. the DIRT rate plus 3%) as they were viewed as similar to the products that suffered exit tax. These "hybrid" products have not been identified as available in the market in recent years.

Exemptions to DIRT may apply to individuals aged 65 and over whose total income, including deposit interest, is below the relevant income tax exemption threshold (€18,000 for single individuals and €36,000 for married couples/civil partners). These individuals can have interest paid without deduction of DIRT or can apply for a refund of the DIRT deducted (subject to a four year maximum lookback period). An exemption also applies for permanently incapacitated persons whose tax credits exceed any tax payable (including DIRT).

LAET is deducted on life assurance policy gains which were written on or after 1 January 2001 (referred to as "new basis business"), the current rate of which is 41% for individuals.

New basis business is taxable under the "gross roll-up" tax regime whereby the investments are allowed to grow tax-free until such time as a chargeable event occurs. A chargeable event includes:

- the maturity of the policy, including where payments are made on death or disability, which result in the termination of the policy;
- the surrender in whole or in part of the rights conferred by the life policy;
- the assignment in whole or in part of the life policy;
- to prevent long term deferral of any tax due the ending of an 8-year period beginning with the inception of the life policy and each subsequent 8-year period beginning when the previous one ends.

There are currently no exemptions from LAET for Irish resident individuals. However, a policyholder to whom the provisions of sections 189, 189A or 192 of the Taxes Consolidation Act 1997 (as amended) apply (i.e. payments in respect of personal injuries, special trusts for permanently incapacitated individuals and payments in respect of thalidomide children) can make a claim for repayment of any LAET deducted.

A recent OECD study, 'Taxation of Household Savings', which examined how OECD countries tax household savings, noted that there is a difference in tax treatment between taxation of bank accounts and investment funds. In relation to bank accounts, it noted that most countries tax bank accounts following either a broadly comprehensive or flat rate capital income tax approach.

In relation to investment funds, it notes a range of approaches is taken. Some countries apply a broadly comprehensive approach, many apply a tax deferral approach, while a tax exempt approach is also applied in some countries. On the purchase of a share in an investment fund, it highlighted France is the only country to provide tax relief – and then only in relation to savings placed in specified funds and subject to a ceiling.

At the holding stage, 10 countries examined tax income as it accrues in the investment fund. They do this either by treating the fund as a pass-through entity (e.g. Australia, Canada, the United Kingdom and the United States); by deeming a distribution to have occurred each year if income has not been actually distributed (e.g. Germany); or by requiring distribution each year (e.g. Korea). Eight of these countries impose progressive personal income tax rates and the other three impose flat rates.

### ***Risk and Return***

Deposit accounts are considered risk free. However, the rate of return on deposit products has fallen significantly as discussed in Section 3.2.1 below. It should be noted that term deposits (excluding state savings) attract a higher rate of interest. The interest earned on deposit accounts is in part a factor of decisions by the ECB.

Life assurance policies aim to build on the capital invested by investing in assets with the expectation of generating an acceptable rate of return over time. These products therefore by necessity carry a higher level of risk due to the investment products potential to increase or decrease in value.

## **3.2 Savings Environment and Trends**

In order to assess whether in a low interest environment the different tax treatment of financial products subject to DIRT and LAET can direct savings and investment in a specific manner, it is important to consider the macroeconomic environment as well as the motivation for saving and saving trends across households and the life-cycle.

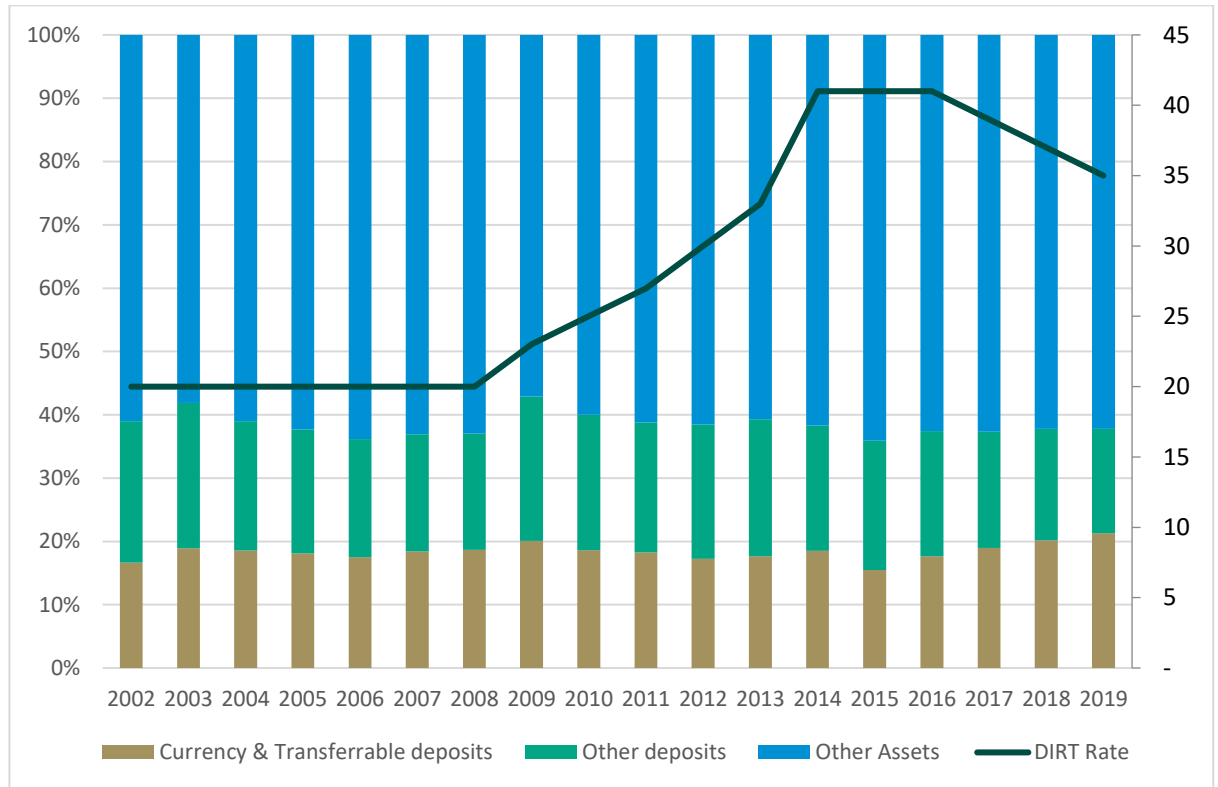
### **3.2.1 SAVING TRENDS IN IRELAND**

This section deals with savings trends in Ireland relating to deposit accounts and financial products subject to LAET, as well as the interest rate environment over the past decade and projected trajectory.

#### ***Household Asset Trends and Interest Rate Environment***

It is important to understand where household financial assets are held in Ireland. Chart 3 shows the pattern of deposits and other financial assets held by households (left axis) since January 2002 mapped against the changes in the rate of DIRT (right axis). As can be seen from Chart 3, deposits represented by the gold and green bars have remained broadly stable (with the exception of a slight increase in 2009 during the last financial crisis which we will discuss in more detail in motives for savings later) at around 40% of financial assets regardless of the rate of DIRT. All other household assets including life assurance products are represented by the blue bar. What is interesting to highlight here is that an increasing portion of household assets in this group are pension products.

**Chart 3** Households and Non-Profit Institutions Serving Households, Financial Balance Sheet, Q1 2002 – Q1 2019

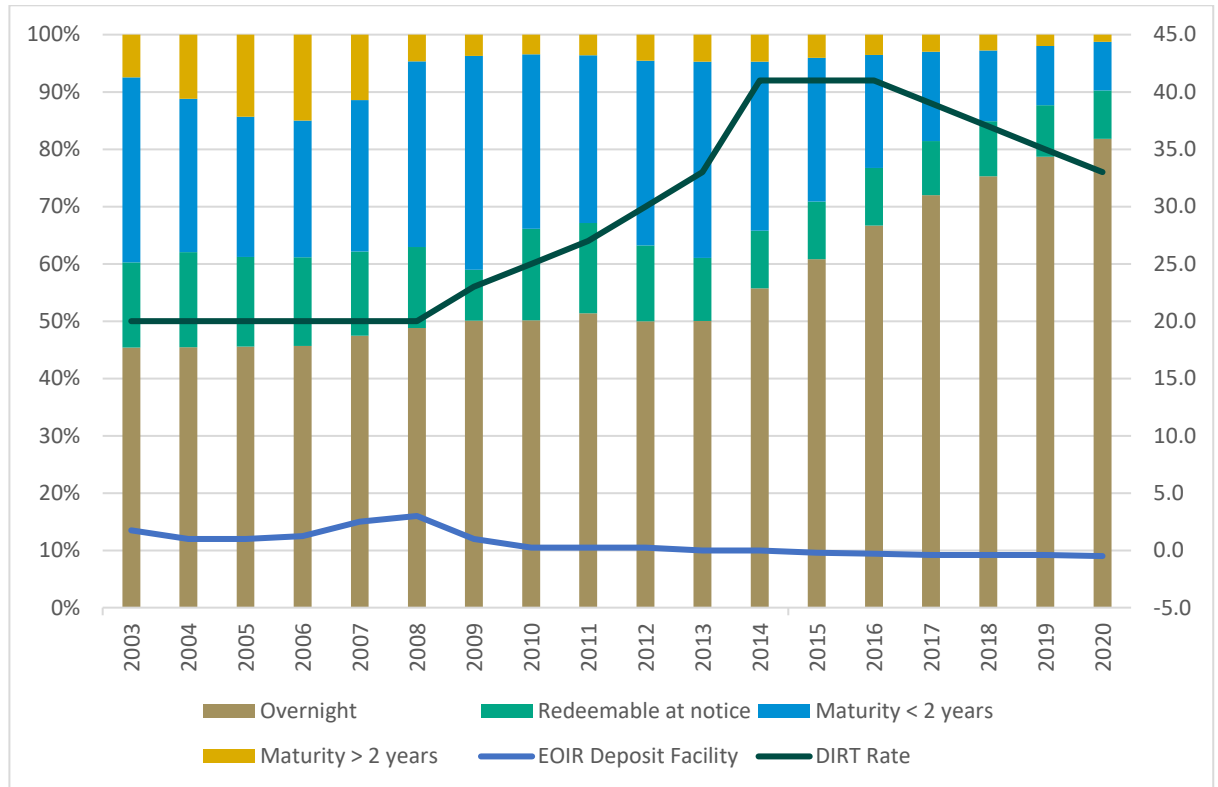


Source: Central Bank of Ireland

Taking a deeper look into the composition of household assets held on deposit in Chart 4, we can see an increasing proportion of deposits held where there is no notice or maturity requirements represented by overnight deposits in the gold bar. The changing DIRT rate (right axis - navy line) appears to have had little impact on this upward trajectory. This increased holding of deposits with unrestricted access has continued to increase from approximately 45% of deposits in 2003 to just over 80% in 2020.



**Chart 4** Outstanding Deposit Amounts (Left Axis), Eurosystem Official Interest Rate on Deposit Facility and DIRT rate (Right Axis), January 2003 – January 2020



Source: Central Bank of Ireland

It is worth noting that interest rate (blue line – right axis) has declined over this period from 3% in 2008 to a negative rate of 0.5% in January 2020. In this regard, it is worth noting that during the June meeting of the Governing Council of the ECB, the interest rate on the deposit facility remained unchanged at -0.50%. In addition, the Governing Council signalled its expectation that the key ECB interest rates would remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon. Therefore, it would seem that deposit rates would remain low for the near future.

Turning to life assurance products specifically, Table 20 shows the year-end value of investments from 2013-2017, which is the latest available data. What is clear is there is a continuous steady increase in the value of life investments over the period.

**Table 20** Year End Value of Life Investments 2013-2017

	2013 €bn	2014 €bn	2015 €bn	2016 €bn	2017 €bn	% change p.a.
Life	82,309	89,217	98,712	107,280	114,811	8.7

Source: Insurance Ireland Fact File 2017

When looking at a more granular level of data, statistics from Insurance Ireland show that life assurance individual assurances and annuities new business from Single Premiums, which are lump sum investments, stood at €2.3 billion in 2017. While there is limited data available post 2016 for the life assurance statistics when DIRT and LAET 'decoupled', available statistics show continued growth in the market and this is reinforced by commentary from Insurance Ireland.

### 3.2.2 MOTIVATION FOR SAVING

As can be seen from section 3.2.1 above, money on deposit as a percentage of household financial assets has remained stable over the period examined with a greater weight towards deposits with unrestricted access versus notice or maturity accounts. Therefore, it is important to examine motives for savings. Motives for savings differ within the population and across the life cycle. Specifically in relation to the life cycle, the following motivations can be found in academic literature:

- Precautionary saving
- Retirement saving
- Saving for bequest or education
- Saving for children or grandchildren
- Saving for specific purchases (home, car etc.)

Both household characteristics and macroeconomic variables are significant and economically important determinants of saving preferences. Saving for home purchase and precautionary saving tend to be decreasingly important with age. In addition, where a higher degree of uncertainty in income and other economic circumstances exist, higher household savings rates in the form precautionary are most likely to feature.

Work undertaken by the Central Bank in 2016 in the context of the previous financial crisis provides some insight as to why individuals save in Ireland and it appears to mirror that of the academic literature. The most significant reasons for saving were:

- Provision for unexpected events
- Old age provision
- Major purchases (house, vehicles, furniture etc.)
- Travel and holidays

- Education/support of grandchildren

A small number (less than 4%) invested in financial assets as their motivation for saving. It would seem that some, but not all the motivations are for short to medium term savings, which may favour more immediate access to the savings and short-term savings in the form of deposit accounts.

### **3.2.3 ABILITY TO SAVE**

An important component of determining savings behaviour is the extent to which individuals can save and the amounts they are able to save. The following indicators of households' economic and financial situation were examined in the Central Bank study mentioned above:

- The ability and propensity to save
- The proportion of households with negative savings,
- The proportion of households with debt, and those that are credit constrained

Some overarching observations which were found when the above characteristics were cross-referenced by income quintile are as follows:

- The ability to save increases with the highest income quintile.
- Older households are less likely to be able to save given move from salary to reliance on retirement income
- Household size plays a negative role in the ability to save i.e. the larger the household the less ability there is to save.
- 60% of households save at least occasionally mainly as a buffer against future unexpected events. The evidence also shows that households with low net wealth and credit-constrained households save to pay down debt. A significant number at that stage were likely to have negative savings and be vulnerable to shocks in the wider economy and their own personal circumstances.

Clearly, there are many who cannot save in any significant way and for longer periods. This is important since the ability to invest significantly and over longer periods is the difference between investing and saving. To the extent that taxation is an issue between deposit and insurance products is one for a smaller cohort of individuals and families.

## **3.3 Some explanations for savings behaviour**

The OECD study 'Taxation of Household Savings', suggested that those with high levels of both income and net wealth hold a larger share of their assets in the form of second residences, shares, bonds, self-employed businesses, and mutual and other managed funds.

It also suggested that those with low levels of both income and net wealth hold a larger share of their assets in the form of bank deposits, vehicles and valuables. It recognised that the share of pensions in total assets is rising with income. The trend in Ireland identified above of increased holding of pension products, does not seem unique to Ireland. High net wealth individuals have more choices where they invest and this choice falls with income.

The tax treatment of these investments can differ depending on the type of investment. However, there remains a cohort of savers in Ireland, which continue to use deposit accounts as their main way in which to save and increase their wealth.

This section seeks to address some issues around preferences in savings behaviour to provide some further explanation for choices made in savings and investment.

### **3.3.1 COMPLEXITY AND FINANCIAL LITERACY**

As already discussed, the extent of any potential issue is linked to the ability to save or invest. As noted above, this represents a smaller proportion of the population as a significant element do not have the resources to save or do not save for the long term. To the extent that there is an issue, it is only for those individuals or households who have the ability to invest and who want to invest in deposit accounts or life assurance products.

A number of explanations can be put forward for the different form of saving behaviour and help explain individual and household preferences for saving in deposit accounts.

#### ***Complexity***

The complexity of financial instruments has increased over time. Outside of such deposit accounts, financial products can be complex to use and understand. Deposit accounts have the benefit of simplicity and are easier to understand. The bank accepts the deposit, pays whatever relevant interest is payable, remits DIRT on that interest to the State. The deposit account is on the surface a simpler financial product and easy to understand in its day-to-day use and operation.

Many elements can make a product difficult to understand. A product is likely to be considered complex for example if the product:

- has underlying assets or indices that are not easily valued, or whose prices or values are not publicly available;
- has a fixed investment term with, for example, penalties in case of early withdrawal that are not clearly explained;
- uses multiple variables or complex mathematical formulas to determine your investment return;
- includes guarantees or capital protection that are conditional or partial, or that can disappear on the happening of certain events

With a deposit account, the level of risk is likely to be low. The deposit account remains intact from year to year – even if the real value of the deposit account may reduce over time due to inflation. The interest rate offered is unlikely to offset any falls in real value, particularly in the

current environment. However, the individual who invested €100 will still have €100, even if its value is diminished.

With products subject to LAET, there is the risk of a fall in value but also the possibility of an increase, which can offset inflationary effects and deliver a real rate of return. Some investors may have difficulty understanding this trade off and may be unwilling to potentially risk savings.

### ***Financial Literacy***

The associated risks, costs, and expected returns with products subject to LAET are in many cases not immediately apparent or easy to understand without financial advice. The investors may need a high level of knowledge to evaluate and assess risk.

In addition, investing in more complex financial products such as those subject to LAET requires the ability to plan the most appropriate investment strategy for them or their households. The decision process around this can be demanding. In order to invest, individuals by themselves have to inform themselves about potential investments, the expected level of return, levels of return for each form of investment and at a minimum are likely to require an understanding of concepts such as compound interest and the time value of money.

Individuals may have to spend considerable time and effort searching for all the information required to make saving decisions. In such cases they may resort to default and simpler savings options.

As with anything complex, it can prove time consuming, impractical and difficult and therefore not an option for many.

Reliance on professional advice, while appropriate in many cases, adds to costs. The ability of investors to understand and take risk into account was considered a key explanation of the reasons for investing in deposit accounts compared to more complex financial products in the 2018 paper by the Department of the Finance. Not all investors have:

- Perfect information;
- An understanding of the nature of all the financial products in which they could invest;
- An understanding and capacity to apply concepts such as compounding and real rates of return;
- An awareness of the level of risk; and
- Give the same consideration to the level of tax applicable in investing and makes the investment on that basis.

Notwithstanding the above arguments, it may seem logical that an individual faced with a rate differential of 33% (current DIRT rate) vs 41% (current LAET rate) would choose the lower rate in order to make an investment with the expectation being that the level of return would be higher in line with a lower rate of taxation.

It is worth testing that proposition with an example comparing investment in a deposit account and a life assurance product. Table 21 below sets out an examination between a deposit

account and a life assurance product investment of €10,000 with the same rate of return of 5% for both life assurance and DIRT products.

**Table 21** *DIRT and LAET simulation A*

	<b>41% Exit Tax</b>	<b>41% DIRT</b>	<b>35% DIRT</b>	<b>2020 DIRT Rate</b>
	Life Assurance	Deposit	Deposit	Deposit
	5% Return	5% Return	5% Return	5% Return
		DIRT Deducted at 41% Annually	DIRT Deducted at 35% Annually	DIRT Deducted at 33% Annually
<b>Year 1</b>	10,000.00	10,000.00	10,000.00	10,000.00
<b>Year 2</b>	10,500.00	10,295.00	10,325.00	10,335.00
<b>Year 3</b>	11,025.00	10,598.70	10,660.56	10,681.22
<b>Year 4</b>	11,576.25	10,911.36	11,007.03	11,039.04
<b>Year 5</b>	12,155.06	11,233.25	11,364.76	11,364.76
<b>Year 6</b>	12,762.82	11,564.63	11,734.11	11,408.85
<b>Year 7</b>	13,400.96	11,905.79	12,115.47	11,791.05
<b>Year 8</b>	14,071.00	12,257.01	12,509.23	12,594.28
<b>Net</b>	12,401.89	12,257.01	12,509.23	12,594.28

Source: Revenue Commissioners

In order to equalise the tax impact, the same return on investment is assumed for both products and there is a comparison with a rate of 35% DIRT and 33% DIRT. On a gross basis, the rate of return for the life investment product is higher at the 41% DIRT rate than there is a higher rate of return.

It is the gross roll up which accounts for the higher return on the life assurance product as compared to the deposit product but on a net basis the current level of return is higher for the deposit product compared to the investment product although the difference is relatively small.

There are of course some important caveats. No deposit account pays a 5% return. It is not certain that the rate of return on an investment product is consistently 5% over an 8 year period. The calculation also does not take into account stamp duty on the initial invested sum.

Taking these issues into account the scenario is run again in Table 22 with a deposit account return of 1% and an investment return of 2.5%.

**Table 22 DIRT and LAET simulation B**

	<b>41% Exit Tax</b>	<b>41% DIRT</b>	<b>35% DIRT</b>	<b>2020 DIRT Rate</b>
	Life Assurance 2.5% Return	Deposit 1% Return DIRT Deducted at 41% Annually	Deposit 1% Return DIRT Deducted at 35% Annually	Deposit 1% Return DIRT Deducted at 33% Annually
<b>Year 1</b>	10,000.00	10,000.00	10,000.00	10,000.00
<b>Year 2</b>	10,250.00	10,059.00	10,065.00	10,067.00
<b>Year 3</b>	10,506.25	10,118.35	10,130.40	10,134.45
<b>Year 4</b>	10,768.91	10,178.05	10,196.27	10,202.35
<b>Year 5</b>	11,038.13	10,238.10	10,262.55	10,270.71
<b>Year 6</b>	11,314.08	10,298.50	10,329.25	10,339.52
<b>Year 7</b>	11,596.93	10,359.26	10,396.39	10,408.79
<b>Year 8</b>	11,886.86	10,420.38	10,463.97	10,478.53
<b>Net</b>	11,113.25	10,420.38	10,463.97	10,478.53

Source: Revenue Commissioners

This table assumes a consistent 2.5% return for the LAET product (ignoring the cost of fees and stamp duty) and for the DIRT (assumes a 1% return on which DIRT is deducted each year). Clearly these are illustrative examples but they do show that the rate of return on the product subject to LAET is higher even using the current 33% rate of DIRT applied compared to the 35% rate of DIRT which applied in 2019.

It should be noted that life assurance products are generally subject to fees and brokers' commissions (where the latter provide advice or other services). These can take the form of annual fund charges, entry fees, exit fees and ongoing management fees (where they differ from annual fund charges). The level of fees can also be set as a percentage rate based on

the level of investment. There may also be fees for provision of advice on an ongoing basis. These fees can be levied irrespective of the performance of the underlying investment. The rates charged also vary depending on the institution,

A 1% return used in simulation B on which DIRT is deducted is still a generous return based on an overview of fixed terms deposit rates at present. State Savings Products offer better returns, however the highest of these was 1.5%<sup>1</sup>.

### 3.4 Options for Change

In addition to the issues raised in the 2018 paper, further points are raised here. Many do not or cannot save, individuals may not understand or want to engage with a more complicated investment environment and may not wish to see a decline in the cash value of their savings and take on risk.

As regards the differences between LAET applied to an equity portfolio and CGT applied to sales of shares, these are applied in the context of different tax heads and treatment of different forms of assets. CGT is applied to the disposal of specific individual assets. LAET is applied to combinations of different equities in a portfolio. The different treatment can be justified by the different way in which these assets are held.

Finally, in the examination in 3.3 above, the analysis suggests that even with different rates of tax there is potential benefit in investing in financial products subject to LAET and it is not just a case of comparing the 33% and 41% rates of tax.

Notwithstanding the above, there are of course always options.

The option to reduce rates of LAET to 33% would cost €22 million in a full year. This could have potential consequences for the tax treatment of other similar investment products. It is not clear as to the benefit of reducing LAET in an environment where there is a need for consumer expenditure to increase. Given the current fiscal pressures, the possibility of reducing the rate of LAET is significantly diminished, particularly given the lack of evidence to support any distortionary impact of the rate.

An alternative is to reduce LAET on a trajectory over time – this would have smaller annual or bi-annual Exchequer costs. It is not obvious that reducing the rate would increase the yield from LAET over time and even if so it would be over a long period.

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<sup>1</sup> <https://www.bonkers.ie/compare-savings-accounts/your-results/>



**Table 23 Cost of Amending LAET Rate**

		€million Full Year
Reduction in the standard rate of LAET	From 41% to 40%	-3
	From 41% to 38%	-8
	From 41% to 35%	-17
	From 33% to 33%	-22
Increase in the Standard Rate of LAET	From 41% to 42%	3
	From 41% to 44%	8
	From 41% to 47%	17
	From 41% to 49%	22

Source: Revenue Commissioners

Consideration could be given to raising DIRT rate above 33% to 41% or indeed some rate in between or reintroducing the higher rate DIRT on tracker/hybrid type deposits to remove any distortionary impact on behaviour. The rationale for this would be to act as a disincentive to hold money on deposit and encouraging spending in a time when an economic stimulus is needed.

To the extent that it arises, it would reduce the perceived impact of the differential between DIRT and LAET.

However, given the current negative interest rate environment, it is likely that a change in the rate of DIRT would not have a significant stimulus impact in terms of encouraging spending in the economy. As noted by the ESRI, the increase in the savings rate at present is driven by the current restrictions, which prevent expenditure on certain goods and services, but also by precautionary savings caused by uncertainty over future incomes. However, changes to the rate of DIRT could be part of a broader package of taxation stimulus measures.

**Table 24 Cost of Amending DIRT Rate**

		€million Full Year
Reduction in the standard rate of DIRT	From 33% to 31%	-3
	From 33% to 29%	-7
	From 33% to 27%	-10
Increase in the Standard Rate of DIRT	From 33% to 35%	3
	From 33% to 37%	7
	From 33% to 39%	10

Source: Revenue Commissioners

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## 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 the potential role of CGT in increasing such economic activity. It is not possible to ignore this in any analysis of potential changes to the CGT regime.

In terms of any proposed changes these are aimed at changing the structure of CGT (offsetting to some degree the potential to reduce the rate but widen the base). As regards CAT the possibilities for reductions in the rate and thresholds are outlined in this paper, as is the extent of recent anti-avoidance activity in order to maintain the CAT base. It is not obvious that there is potential for stimulus from changes to CAT and it may better serve in its role as a tax on gifts and inheritances.

The paper also addresses possible changes to the perceived relationship between financial products subject to DIRT and LAET. It does not find any basis for a change in the rate of LAET. It does suggest the potential for rebalancing the DIRT rate as a potential stimulus measure.

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 address the issues in the paper.



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