Brokers Ireland Budget 2019 Submission

JUNE 2018

Summary

Our Budget 2019 submission makes the following recommendations:

- **Link exit tax rate to the DIRT rate.**

  The exit tax and DIRT rates have traditionally been linked , but this link was broken in Budget 2017, with the reduction of the DIRT rate to 39%, with further phased reductions to 33% by 2020. Meanwhile the exit tax rate remains at 41%.

  The disparity in the DIRT rate with that from life assurance savings & investment policies and collective investment funds, along with the 1% premium levy, is illogical and distorts the personal investment market by encouraging investment in deposits and certain offshore collective investment funds.

  The longer the delay in relinking the DIRT and exit tax rates, the higher the cost becomes. If not relinked shortly, the disparity in rates may become a permanent distortion of the savings and investment market.

- **Allow exit tax to be exempted in the same circumstances as DIRT**

  Permanently incapacitated individuals and those over age 65 can in certain circumstances be exempted from DIRT through the completion of forms DE1 and DE2. There is no corresponding exemption from exit tax for such individuals.

  Exit tax exemption should be allowed in exactly the same circumstances as DIRT exemption.

- **Remove the 1% Life Assurance Premium Levy.**

  The levy was also intended to be 'temporary' and distorts the personal investment market given that it does not apply to investments in deposits and collective investment funds.

- **Retain marginal rate pension tax relief**

  Standard rating tax relief on personal pension contributions would penalise the unincorporated self employed who can only make personal contributions, reintroduce a tax on employer contributions to PRSAs, and widen the inequity in the tax treatment of personal and employer (explicit and implicit) contributions.

- **Index the pensions earnings tax relief limit**

  With earnings and profit growth returning to the economy it is appropriate for the Minister for Finance to recommence indexing the pensions earnings tax relief cap in s790A of €115,000.

We suggest that at a minimum, the pensions earnings limit for tax relief of €115,000 be increased in line with minimum public service salary increases as agreed under the Public Service Stability Agreement (2018-2020)

- **Index the Standard Fund Threshold limit**

  We urge the Minister for Finance to also recommence indexing the Standard Fund Threshold (SFT) limit from 2019 onwards, in line with the minimum public service salary increases provided in the Public Service Stability Agreement (2018-20).

  The SFT was always meant to move in line with earnings, and the non-indexation of the SFT is particularly unfair to those in defined contribution (DC) arrangements by favouring those in defined benefit (DB) arrangements, and is encouraging individuals to transfer their retirement funds overseas before their fund reaches the SFT level.

- **Allow private sector retirees the same option (s787TA TCA 1997) afforded to the public service to avoid a double taxation of retirement benefits in excess of the Threshold limit.**

  Retirement benefits taken over the Threshold limit are taxed at an effective marginal rate of close to 70%, when double taxation is allowed for. This is far in excess of the likely income tax relief granted to the contributions which funded the excess.

  Those in the private sector who have benefits projected to be over the Threshold limit should be allowed to use the S787TA Taxes Consolidation Act 1997 encashment option in the same manner as public sector employees can, i.e. to encash such benefits subject to one taxation charge prior to retirement.

Link exit tax rate to DIRT rate

Budget 2017 broke the then existing link between the exit tax rate on savings and investment policies/collective investment funds and DIRT on deposit interest. Previously both had been pegged at 41%.

Finance Act 2017 reduced the DIRT rate to 39% in 2017 with further phased reductions to 33% by 2020. However Finance Act 2017 made no reduction in the exit tax rate. **There is no logical reason why deposit interest should be taxed at a lower rate than returns from savings and investment policies/collective investment funds.**

Tax Strategy Group Paper 17/11 25th July 2017 indicated that the refusal to reduce the exit tax rate was based solely on cost grounds and not for any principled taxation or other policy objective reasons:

"The principal reason for not reducing the 41 per cent rate applicable to investment products in Budget 2017 when the rate of DIRT was being reduced was the cost of this change. At the time the cost of reducing the rates of exit taxes, by two percentage points, was estimated by the Revenue Commissioners to be €14 million per annum,"

The anomalous tax treatment of returns subject to exit tax is compounded in the case of savings/investment policies issued by domestic life assurance companies, by the 1% premium levy, referred to later.

Compare, for example, an investment in a five year tracker bond as between one issued by a domestic life assurance company and an identical deposit product:

	Life assurance tracker bond	Deposit tracker Bond
1% premium levy deducted at the outset	Yes	No
Tax on profits at maturity	41%	33%[1]

The difference in tax treatment between the two *identical* products above is equivalent to an extra return by the deposit product of circa 0.5% pa[2] (over and above the return from an identical life assurance tracker bond); this is inequitable and unfairly skews the personal investment market towards deposits and non EU domiciled exchange traded funds[3].

[1] *Assumed to mature in 2020 or later.*
[2] *Assuming a 25% gross gain in each case*
[3] *Gain is subject to CGT @ 33%, losses can be offset against gains, no deemed encashment every 8 years and use of annual CGT exemption.*

We believe the exit tax rate on savings and investment policies/collective investment fund returns should be linked to the DIRT rate from 2019 onwards, i.e. 35% in 2019 and 33% in 2020, in addition to the abolition of the 1% premium levy, in order to ensure consistency and equity of the taxation of investment returns as between life assurance policies, collective investment funds and deposits.

The longer the delay in relinking the DIRT and exit tax rates, the higher the cost becomes. If not relinked shortly, the disparity in rates may become a permanent distortion of the savings and investment market.

Allow exit tax to be exempted in the same circumstances as DIRT

There are currently anomalies in the ability of certain investors to be exempt from exit tax/DIRT on investment returns:

	Can be exempted from DIRT	Can be exempted from exit tax
Individuals over age 65 whose total income will be less than the income tax exemption limit	Yes; form DE1, if they would be entitled to a refund of the DIRT if it had applied.	No and can not reclaim the exit tax even if their total income is less than the income tax exemption limit.
Permanently Incapacitated Individual(s)	Yes; Form DE2, if they would be entitled to a refund of the DIRT if it had applied.	No; but a permanently incapacitated individual who is exempt from income tax under section 189 in respect of income arising from the investment of compensation payments in respect of personal injury claims can reclaim exit tax. Also a thalidomide victim who is exempt from income tax under section 192 in respect of income arising from the investment of compensation payments can reclaim the exit tax in certain circumstances.
Trustees of a special trust for Permanently Incapacitated Individual(s)	Yes, if the trust was set up exclusively for the benefit of one or more specified incapacitated individuals and the funds of such a trust were obtained by subscriptions from the general public	No; but can reclaim exit tax in similar circumstances

There is no logical reason for the anomalies above; **exit tax exemption should be allowed in exactly the same circumstances as DIRT exemptio**n, **through the use of Forms equivalent to DE1 and DE2.**

Such a chance would ensure that, for example, permanently incapacitated individuals could gain exemption from exit tax when investing in savings/investment policies and collective investment funds, and hence not be required to incur the expense of engaging a tax professional to reclaim exit tax already deducted from such an investment.

Remove the 1% levy on life assurance premiums

A stamp duty levy of 1% was introduced on life assurance premiums in the April 2009 Supplementary Budget.

The Tax Strategy Group Report of 31 July 2017 states, in this regard:

"The levy was introduced as one element of the Government's concerted effort to raise revenue necessary to help address the serious decline in the public finances evident in 2009. It was understood that in common with other taxation measures, the operation of the levy would be kept under review."

To the end of 2016, a total of €214m has been collected in this levy.

We suggest that the 1% levy on life assurance premiums be abolished from 2019 onwards for the following reasons.

- It increases the cost to individuals of protecting themselves and their families through life assurance and serious illness cover, as the levy increases their premiums by 1%.
- It amounts to a 1% confiscation of savings and investments made through life assurance policies issued by domestic life assurance companies. It is therefore discriminatory and probably illegal under EU law by not applying to policies effected with insurers established in other EU Member States and transacting business here on a cross border basis.
- It amounts to double taxation in that no credit or allowance is provided for the 1% premium levy paid in the calculation of a subsequent chargeable gain for exit tax purposes[4];
- It distorts the domestic savings and investment market by not applying to deposits, offshore policies, or domestic and offshore collective investment funds.
- It was introduced at a time of an emergency in public finances and the understanding was that it would be reviewed in 'better times'. Other emergency measures introduced at the time,

[4] *Example: A consumer invests €50,000 in a life assurance investment bond; 1% or €500 levy tax is taken off at the outset. If the individual encashes his or her bond six years later for, say, €67,000, exit tax @ 41% is applied to the gain of €17,000, i.e. €6,970, but with no credit or offset allowed for the 1% levy tax paid at the outset, i.e. the €500.*

e.g. the pension levy, the reduction in public service pensions, and USC rates/bands, have either been removed or significantly modified with the welcome improvement in Government finances. The Public Service Stability Agreement 2018-2020 unwinds many provisions of the FEMPI legislation by providing public service salary increases of up to 7.25% over the period 2018 to 2020.

Retain marginal rate pension tax relief

Currently marginal rate income tax relief (but not for PRSI or USC) is provided on personal contributions[5] to pension arrangements, within age related limits and an upper earnings limit of €115,000.

There have been a number of proposals to standardise such relief at a fixed rate regardless of the individual's marginal rate income tax rate, through providing a non refundable tax credit of, say, 30% of the contribution amount rather than a deduction against income. The impact on individuals paying a €1,000 gross contribution would be:

- Non taxpayers: None, as the tax credit is only available against an income tax liability;
- Standard rate taxpayers: It would reduce the net cost to €700 from €800.
- Higher rate taxpayers: it would increase the net cost from €600 to €700

While attempting to equalise the tax relief between higher and standard rate taxpayers, such a move would have the following consequences:

- It would impact most on the unincorporated self employed paying tax at higher rate, who can only fund their pensions through personal contributions.

  It would increase the net cost of a personal contribution by up to 17%, which could cause some to reduce their pension contributions accordingly.

- It would reintroduce a tax on employer contributions to an employee's PRSA.

  Currently such contributions are a BIK but the employee can claim income tax relief at marginal rate on them as personal contributions (within the limits which apply to tax relief on personal contributions). For a higher rate taxpayer this can mean that currently the personal tax relief equates to and wipes out the BIK related to the employer contribution.

[5] *Including public service employee superannuation contributions. The PRD also benefits from separate marginal rate tax relief.*

But if personal tax relief is limited to 30% say, but the BIK remains taxable at higher rate, (40%) the employee will have a tax liability at marginal rate based on a BIK of 10% of the employer contribution. This will discourage employer contributions to employee's PRSAs.

- If not also applied to employer contributions (explicit and implicit[6]) to occupational pension schemes, it would widen the tax inequity between personal contributions, where relief is limited to, say, 30%, and employer contributions where relief is in effect obtained at up to 52% through employer contributions being exempt from a BIK tax charge.
- If not applied to employer contributions, it is likely that large employers operating group DC schemes, and their employee representative bodies, would negotiate revised remuneration agreements to replace less tax efficient employee contributions with more tax efficient employer contributions. This would *increase* the cost to the Exchequer as relief would now be obtained at up to 52% (through BIK exemption for employer contribution) on contributions which previously obtained relief at just 40%. (with no relief for USC or PRSI)
- Public service unions would inevitably seek compensatory remuneration increases to offset the increased net cost for their higher rate taxpaying members of their normal superannuation and PRD[7]/ASC contributions.
- It would be inequitable to limit tax relief on personal contributions to, say, 30% (with no relief for USC), but to tax taxable benefits emerging in retirement from such contributions at marginal rate + USC.

We therefore urge the retention of marginal rate tax relief on personal pension contributions.

Recommence indexation of the pensions earnings tax relief limit

With earnings and profit growth returning to the economy (public service salaries will be increased by up to 7.25% over the period to 2020, under the Public Service Stability Agreement (2018-2020), it is appropriate for the Minister for Finance to recommence indexing the pensions earnings tax relief cap in s790A of €115,000.

[6] *In the case of the public service, an annual BIK could be imputed equal to the estimated value of the increase in the public service employee's pension and gratuity expectation over a year arising from an additional year's service and a salary increase, if any. A similar approach could be applied to funded DB schemes, in lieu of allocating actual employer contributions to each member.*
[7] *It is assumed that standardised tax relief would be also be applied to PRB relief*

If not increased in line with average earnings, the real value of retirement provision which can be made by sole traders and partnerships is being reduced, as retirement provision to be effective must be linked to earnings.

We suggest that at a minimum, the current pensions earnings limit for tax relief of €115,000 be increased in line with minimum public service salary increases as agreed under the Public Service Stability Agreement (2018-2020) (which will also be applied to public service pensioners who retired since February 2012).

Recommence indexation of Standard Fund Threshold (SFT)

Finance Act 2006 introduced[8], from 7 December 2005, a limit on the maximum value of retirement benefits which can be taken by an individual from all Irish pension arrangements, before a tax called 'chargeable excess tax' is applied at the higher rate of income tax to the value of benefits taken over that limit.

The limit is referred to as the Standard Fund Threshold and has been reduced a number of times from its initial (2005) €5m value to its current €2m value.

The original chargeable excess tax system allowed for automatic indexation of the SFT in line with an earnings index, and indexation was therefore applied in 2007 and 2008. However, since 2009 automatic indexation of the SFT has been replaced with optional indexation by the Minister for Finance in line with *"an earnings adjustment factor which may be designated in writing by the Minister for Finance in December of the year of assessment preceding the relevant year".*[9] The Minister has chosen not to index the €2m SFT limit since 2009.

With earnings and profit growth returning to the economy (public service salaries will be increased by up to 7.25% over the period to 2020, under the Public Service Stability Agreement 2018-2020), **we urge the Minister for Finance to also recommence indexing the Standard Fund Threshold limit from 2018 onwards, at least in line with the minimum public service salary increases,** i.e. :

- by 2% for 2018
- by 1.75% for 2019
- by 2% in 2020

We urge the Minister to recommence indexing the Standard Fund Threshold (SFT) because:

[8] *Part 30, Chapter 2C, TCA 1997*
[9] *From definition of Standard Fund Threshold in s787O(1) Taxes Consolidation Act, 1997*

- The SFT was always meant to move in line with earnings, as adequate pension provision should be linked to earnings. That was the clear intention of the original chargeable excess tax legislation introduced in 2009.
- The non-indexation of the SFT is particularly unfair to those in Defined Contribution (DC) arrangements because:
    - DB pensions are considerably undervalued relative to current market conditions. For example, compare the DB pension valuation factors for a retiree aged 65, for a pension increasing at 2% p.a. and with 50% survivor's death in retirement pension, with the current open market annuity rate equivalent:

Threshold factor: DB pension accrued prior to 1/1/14	20
Threshold factor: DB pension accrued prior 1/1/14	26
Current annuity rates	37.5[10]

      In effect, DB pensions, as compared with DC funds, are undervalued by up to 50% for the Threshold limits.
    - The Threshold system does not distinguish between DC contributions and investment growth so that an individual can end up using up their Threshold and possibly exceeding it, not through making additional tax deductible contributions but through investment returns.
- The non-indexation of the SFT may encourage some to transfer their retirement funds to overseas arrangements[11] before they reach the SFT level, with any further growth in their fund then outside the Irish Threshold limit system.

Remove the current chargeable excess double taxation

When an individual takes retirement benefits in excess of the Threshold limit, the excess value taken is taxed at the higher rate of income tax, representing a repayment of the notional tax relief granted on the contributions that funded the excess.

[10] *Open market annuity rate quoted by a major life assurance company, 26th March 2018*
[11] *Under S.I. No. 716/2003 - Occupational Pensions Schemes and Personal Retirement Savings Accounts (Overseas Transfer Payments) Regulations, 2003*

However the residual retirement fund, *after* deduction of the chargeable excess tax, is taxed again as taxable pension, annuity, or ARF withdrawals at

- marginal rate income tax,
- USC up to 8%, and
- Class S PRSI (for Class S retirees under age 66).

This amounts to *double taxation of the same retirement fund* and a recovery of tax way beyond the level of tax relief which initially may have been given on contributions which funded that excess fund.

Example: take a €100,000 DC fund in excess of the Threshold.

Excess	**€100,000**
Less	
chargeable excess tax	-€40,000
	€60,000
Less	
income tax @ 40%	-€24,000
USC @ 8%	-€4,800
Net Fund	**€31,200**

In effect the excess €100,000 fund over the Threshold has been taxed in this example at 68.8% which is far in excess of the higher rate tax relief that might initially have been obtained on the contribution (or BIK exemption in respect of employer contributions). **In effect the current chargeable excess tax system is a confiscatory or penal system and not a fair taxation system to simply recover the 'excess' income tax relief granted.**

This double taxation treatment is in stark contrast to the 'single taxation' treatment afforded to public service employees by S787TA Taxes Consolidation Act 1997, who can, prior to retirement, encash private pension benefits that are projected to be over the Threshold limit, subject to a higher rate income tax charge and USC at the low rate, currently 2.5%, with the encashment *not* being counted as a benefit crystallisation event for the purposes of the Threshold limit system.

Example: Take a public sector employee and a private sector employee who both have private pension benefits valued at €100,000, which are projected to be chargeable excess when they access these benefits. The public sector employee can use the s787TA TCA 1997 encashment option prior to accessing his or her benefits to encash the €100,000, **without it triggering a chargeable excess tax charge,** but the private sector employee cannot use the s787TA option and hence his or her €100,000 similar retirement fund will be double taxed as chargeable excess.

	Public Sector employee	**Private Sector employee**
Excess over Threshold limit	€100,000	€100,000
Less		
chargeable excess tax		-€40,000
		€60,000
Less		
income tax @ 40%	-€40,000	-€24,000
USC	-€2,500	-€4,800
Net Fund	**€57,500**	**€31,200**

Individuals in the private sector who have benefits projected to be over the Threshold limit should be allowed to use the S787TA Taxes Consolidation Act 1997 encashment option in a similar manner as public sector employees can, i.e. to encash such benefits before retirement subject to *one* taxation charge.

To deny this option to those who have worked exclusively in the private sector is to discriminate in favour of public sector employees who may have a similar projected chargeable excess from an identical private pension arrangement.