

# Simple Facts of Accounting

from infoCPA



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## Finance Act 2006



**This summarises some key measures in the 2006 Finance Act which affect business, but should not be taken as a comprehensive review of all of the provisions in the Act. Professional advice should be taken before proceeding.**

### Restriction on Tax Reliefs Available to Individuals

A cap on tax allowances and specified reliefs is introduced for the purpose of ensuring all individuals pay a minimum amount of income tax. More than 50 reliefs are included and the cap will take effect from 2007. The restriction applies so that the maximum amount of specified reliefs which an individual may claim in a tax year is 50% of the individual's "adjusted income". The individual's adjusted income is calculated by adding back the specified reliefs which he claims for that year to his taxable income. If the adjusted income is less than €250,000 the restriction does not apply. Where it applies, reliefs which cannot be used in that year are carried forward to subsequent years. The intention is to ensure that all high earners pay a minimum income tax rate of 20% on their total income.



### Remittance Basis of Assessment

Up to now, non-domiciled or non-ordinarily resident individuals (broadly foreign persons) were subject to Irish income tax on non-Irish and non-UK income only to the extent that such income was remitted to Ireland by them. With effect from 1 January 2006, non-Irish and non-UK income which relates to duties of an employment carried out in Ireland will no longer qualify for the remittance basis. Therefore foreign workers will not be able to organise salary payments so that they are paid outside Ireland with the Irish tax liability confined to remittances into Ireland. The remittance basis was regarded as an important incentive when attracting individuals to Ireland who had significant skills. The changes could reduce the attractiveness of Ireland for such individuals, resulting in a loss of key skills in important sectors of Irish business. The lack of consultation on the impact of the change for Ireland as an international location was disappointing and as was the fact that no transitional rules were introduced.



### Pensions

The maximum allowable pension fund for tax purposes is now €5 million or, if higher, the value of the fund on 7 December 2005, and these limits will be indexed annually. Where the fund exceeds the limit, the excess will be liable to a once off income tax charge on retirement. Thus if a private sector employee invests in his pension and the investments result in the value of the fund being €8 million at retirement, there could be a 42% income tax charge on €3 million at the date of retirement. There would also be income tax payable by the employee on any distributions from his pension fund at 42% on the remaining balance (58%) of this €3 million. This is a double charge to tax and a penalty for successful investments. The maximum pension lump sum which may be taken tax free, on or after 7 December 2005 is now limited to €1.25 million which will be indexed annually. Any payments in excess of this amount will be subject to income tax at the marginal rate. Currently, if funds are retained within an approved retirement fund (ARF) no tax liability arises for the holder. Under new rules an annual 3% imputed distribution will apply to the value of the assets held by the ARF at 31 December each year. This imputed distribution, which will apply only where the holder of the ARF is aged 60 or over will be taxable at the individual's marginal income tax rate. This will be phased in over three years from 2007. Where an actual distribution is made from the ARF during the year, this will be deducted from the imputed distribution.



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The tax relief limits for pension contributions by individuals near retirement age have been increased as follows:

<b>Age</b>	<b>Percentage Net Relevant Earnings</b>
55 but not less than 60	35% (increased from 30%)
60 and over	40% (increased from 30%)

(Percentages for under 55s remain unchanged)

The earnings limit to which the above percentages apply is €254,000, to be adjusted annually from 2007. Where an ARF acquires commercial property which is used by the ARF holder or a connected person, there is a deemed distribution by the ARF to the holder equal to the value of the asset. This distribution is taxable at the marginal rate of tax of the holder or of the ARF. There are also restrictions for investments in holiday homes or residences used by a member of the pension scheme. The Act provides that if these rules are breached the value of the asset is treated as a taxable payment from the scheme. The Act also includes a provision to encourage SSIA holders who pay tax at the standard rate only to reinvest in a pension.

## Passing on the Family Business

The clawback period for capital acquisitions tax business and agricultural relief is six years. The clawback period is extended to 10 years where the asset being disposed of is development land. The clawback also applies where the asset disposed of consists of shares in a company whose value has derived from development land.

## Property Incentives

The Finance Act confirms the phasing out of accelerated capital allowances and provides for changes to capital allowances for private hospitals, nursing homes and crèche facilities, as well as the introduction of relief for psychiatric hospitals. A range of property based incentive schemes will be discontinued, including urban renewal relief, rural renewal schemes, town renewal relief and car parks, student accommodation, sports injury clinics. The reliefs were due to expire at the end of July 2006, but the Act provides for an extension to 31 July 2008 subject to transitional provisions. These apply where at least 15% of the qualifying expenditure is incurred before end December 2006 and there is an appropriate certificate from a local authority. If the transitional provisions apply and all of the expenditure is incurred by 31 December 2006, 100% of the allowances are available. Where expenditure is incurred in 2007, 75% of the allowances are available and if the expenditure is incurred between 1 January to 31 July 2008, 50% is available.

Expenditure on hotels incurred after 31 July 2008 will continue to qualify for capital allowances, but at the 4% rate rather than the 15% rate which applies to hotels covered by the transitional rules. Changes were also introduced to the tax life of certain buildings qualifying for capital allowances. A balancing charge may now arise if the building is sold within 15 years. The buildings affected are qualifying hospitals, convalescent homes, nursing homes and childcare facilities. The changes affect buildings opened from 1 February 2007.

## Anti Avoidance

### *General Anti Avoidance*

Existing anti-avoidance provisions have been extended to provide that where, in the opinion of the Revenue Commissioners, a transaction is a tax avoidance transaction and where this opinion becomes final and conclusive, a 10% surcharge on the liability will apply and interest will be charged from the date the liability would have arisen but for the failed avoidance. In order to protect against the application of the surcharge and interest, a taxpayer may notify Revenue of the transaction concerned without prejudice as to whether or not there is tax avoidance involved.

### *Conversion of Income into Capital Gains*

The anti avoidance provision which deals with converting what would otherwise be an income receipt into a capital gain has been widened for transactions. The provision will now cover direct/indirect extractions. The requirement that the amount taxed be otherwise available for distribution, i.e. covered by retained earnings has been deleted.



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### **Disclaimer**

This information bulletin is intended to be used as a guide to the 2006 Finance Act. For further information the Act should be consulted or you should speak to your CPA professional advisor. Neither the Institute of Certified Public Accountants in Ireland, or the Small Firms Association can be held liable for any error, or for the consequences of any action, or lack of action arising from this bulletin.

### **For further assistance...**

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