

Restriction of Certain Reliefs for High Earners

Author: Jim Byrne, Examiner: Advanced Taxation, Professional 2.

Introduction

The Finance Act 2006 introduced a restriction on the amount of certain “specified reliefs” that an individual can claim, in calculating their income tax liability. This restriction applies from 1st January 2007. In general, where the restrictions apply, such individuals will have an effective tax rate of at least 20%. In general where an individual’s “adjusted income” exceeds €250,000, the amount of the “specified reliefs” that they can claim will be limited to €250,000 or 50% of the individual’s “adjusted income”, whichever is the greater. The amount of relief that is disallowed for the year is then added to the individual’s taxable income for the year to give an increased taxable income figure for the year.

Application of restriction

The restriction will apply if:

1. Adjusted income (A) is greater than or equal to the threshold amount (TA),
2. The total of specified reliefs (S) is greater than or equal to the threshold amount (TA), and
3. The total of specified reliefs (S) is greater than 50% of Adjusted income (A).

Adjusted Income	=	(TI + S – R)
TI	=	Taxable Income
S	=	Specified Reliefs
R	=	Ring-fenced income

Thus the individual is finally taxable on an amount calculated as follows:

1. The individual’s taxable income computed as if the limitation did not apply (TI)

Plus

2. The total of specified reliefs (S)

Less

3. The greater of:
 - a) The threshold amount (TA) (see below as to how this is calculated). or
 - b) 50% of the individuals adjusted income (A) X 50%

Adjusted Income

An individual’s “adjusted income” is his/her income calculated after adding back specified reliefs less ring-fenced income.

Ring-fenced income

In calculating the individual's "adjusted income" certain income is disregarded ("ring-fenced income") including:

- ❖ Deposit interest subject to DIRT
- ❖ Qualifying EU deposit account interest subject to tax at 20%
- ❖ Profits from the sale of residential property taxed at 20%
- ❖ Payments and income from certain offshore funds taxable at 23%
- ❖ Payments and income from certain foreign life policies taxable at 23%.

The reliefs affected (specified reliefs)

Broadly, the reliefs to be restricted are those reliefs that are primarily used by high-income individuals to significantly reduce their tax liability. These are:-

- ❖ Certain property based tax incentives, including section 23 and any properties qualifying for accelerated capital allowances
- ❖ Certain exemptions including artists' exemption, stallion fees, woodland income and patent royalties,
- ❖ Reliefs for donations to charities and to sports bodies.
- ❖ Certain investment reliefs such as the BES, film relief and interest relief on loans to invest in companies and partnerships.

The reliefs not affected

In general, the more commonly claimed credits and allowances such as medical expenses, service charges, personal tax credits and exemptions will not be restricted. In addition, normal business or rental expenses, deductions for capital allowances on plant and machinery, genuine business or rental trading losses will not be restricted. Items not included in the definition of specified reliefs include:

- Personal tax credits and exemptions
- Pension contributions
- Medical expenses
- Case V (or Case III in the case of foreign lettings) rental deductions for expenses of lettings.
- Case V (or Case III in the case of foreign lettings) interest on loan to acquire or improve rental property.
- Case I/II capital allowances
- Case I/II expenses
- Case I/II losses

Threshold Amount

Where:

1. The individual's adjusted income for the year is less than €500,000 **and**
2. The individual's income includes ring-fenced income,

The threshold amount is:

$\text{€}250,000 \times [\text{adjusted income}(A) / (\text{adjusted income} + \text{ring-fenced income}(A) + (R))]$.

Otherwise the threshold amount is €250,000.

Example

Arthur Penney had the following income, reliefs and allowances.

Case I	350,000	
Capital allowances	100,000	250,000
Case V	90,000	
Section 23	50,000	40,000
Case IV (interest)		100,000
Artist's Exempt income		
Interest on Loan to acquire shares		220,000

		Taxable Income (TI)	Specified Amount(S)	Ringfenced Income(R)
Case I	350,000			
Capital allowances	100,000	250,000		
Case V	90,000			
Section 23	50,000	40,000	50,000	
Case IV (interest)		100,000		100,000
Artist's Exempt income			150,000	
Interest on Loan to acquire shares		220,000	220,000	
Total Income		170,000	420,000	100,000
	34,000@20%	6,800		
	100,000@20%	20,000		
	36,000@41%	14,760		
		41,560		
Personal Credit	1,760			
DIRT	20,000	21,760		
		19,800		
Adjusted Income (A) =(TI + S – R)		490,000	(170,000+420,000-100,000)	
Threshold Amount (TA) (Note 1)		207,627	[250,000 X (490,000/590,000)]	
Does the restriction apply?				
(A) is greater than or equal to the (TA)			490,000 > 207,627	
(S) is greater than or equal to (TA)			420,000 > 207,627	
(S) is greater than 50% of (A)			420,000 > 245,000	
Penney is taxable on:	(Note 2)	345,000	(170,000 + 420,000 – 245,000)	
	34,000@20%	6,800		
	100,000@20%	20,000		
	211,000@41%	86,510		
		113,310		
Personal Credit	1,760			
DIRT	20,000	21,760		
Tax Due		91,550		

Note 1 (A) is < 500,000 and (TI) includes Ringfenced income (R) therefore
 $TA = 250,000 \times A/(A+R)$

Note 2 $[(TI + S) - (\text{the greater of } TA \text{ or } (A) \times 50\%)]$

Carrying forward of excess relief

Any unused specified reliefs can be carried forward and claimed in future tax years. They may be carried forward indefinitely until they are all used. Any amounts so carried forward are claimed after all other reliefs have been claimed.