

Budget 2011 Changes.

Property Reliefs.

[Note:

The restrictions to the various property reliefs, which were announced in the Budget 2011, are set out below and were contained in Financial Resolutions No. 20, 21 and 22, as passed by Dail Eireann on 7 December 2010.

Certain changes relating to the commencement of these provisions are now contained in sections 22, 23 and 24 of the Finance Act 2011 (signed by the President on 6 February 2011). In summary, the changes now mean that the restrictions will not come into effect at the beginning of 2011, as was the original intention.

The Finance Act 2011 now provides that the commencement of these restrictions will take place by order of the Minister for Finance with effect from a date not less than 60 days after the completion and publication of the results of the economic impact assessment into this area, which was announced in the Budget 2011.]

A number of significant changes have been introduced in the Budget 2011 to the entire range of property and area based tax incentives. Subject to a number of transitional arrangements already in place, virtually all of the schemes themselves have already been brought to an end in recent Finance Acts.

There are 2 categories of changes to the taxation of these schemes which the Minister for Finance announced in the Budget. The first relates to what is commonly described as “section 23 type relief” and the second relates to the various schemes of accelerated capital allowances which apply.

Guillotine and Impact Assessment.

The Minister for Finance announced in the Budget that a guillotine will be introduced to terminate all unclaimed and unused capital allowances,

arising after, or carried forward from 2014 as well as unused section 23 relief carried forward from 2014. An impact assessment will be undertaken into the effects of the phased abolition of the property-based measures and the guillotine provision.

This guillotine provision, which is intended to take effect at end 2014, will be provided for in future legislation. It is not contained in any of the Financial Resolutions passed by Dail Eireann on Budget Day (7 December 2010).

Section 23 Type Relief.

Background.

In almost all cases, section 23 relief is given as a loss in the first chargeable period in which the property is let under a qualifying lease. In the case of the refurbishment of certain “special qualifying premises”, the section 23 relief is given at the rate of 15% in each of 6 years with the balance in year 7. These losses, as with all other expenses associated with earning rental income, may be aggregated and set against the aggregate of all rental income of the person. Irish rental income is chargeable to tax under Case V of Schedule D and is treated as coming from a single source. Where there is an excess of losses and expenses in a single year over rental income the excess may be carried forward to the next year and set against that year’s rental income. This process may continue indefinitely (provided a rental business continues) until all the losses are used up. In order to continue to be entitled to the relief, the property must be let continuously for a total of 10 years under a qualifying lease/leases, beginning with the date of the first of these leases. Short periods of vacancy between tenants, are allowed.

If a person either stops letting the property or sells it to another person within this 10 year period, there is a clawback of all the relief which the first person originally got. In the case of a sale of the property, the new owner need only let the property under another qualifying lease for the balance of the 10 year period in order to maintain entitlement to the full amount of the relief. The sale price to the second owner largely determines the amount of the section 23 relief to which he/she becomes entitled, but it cannot be greater than the amount of relief which the first owner got.

Budget Changes.

The changes, which have been announced in the Budget, apply to both individuals and companies and for the purposes of these explanatory notes the term “chargeable period” is used to denote a year of assessment for individuals and an accounting period for companies. It should also be noted that the relief, commonly known as owner/occupier relief is not affected by these new measures.

- Firstly, for chargeable periods ending on or after 1 January 2011, section 23 type relief will be restricted to set-off against rental income only from the section 23 property itself. Up until now this set-off could be against all rental income in that year.
- Secondly, unused section 23 type relief which is carried forward beyond the 10 year period referred to above will be lost. In the case of properties where the period has ended in a chargeable period ending before 1 January 2011, unused relief cannot be carried forward from that chargeable period into the chargeable period ending in 2011 or any subsequent one. In the case where the 10 year period ends in a chargeable period ending on or after 1 January 2011, unused relief cannot be carried forward into the next chargeable period or any subsequent one.
- Thirdly, where a person sells a section 23 property within the 10 year period at any time on or after 1 January 2011, the new owner will get no section 23 relief. Up until now, subject to certain requirements, the relief passed onto the new owner who only had to hold the property for the balance of the 10 year period. The clawback of relief, which had already been given to the first owner, however, will continue to apply.
- Fourthly, due to the economic downturn, some unused section 23 properties are, as yet unsold. The relevant 10 year period for these properties would normally begin once the property is sold and let under a qualifying lease. Where any of these properties are unsold as of 30 June 2011, the 10 year period will commence on that day. This means that the longer these properties remain unsold the shorter will be the time within which to claim the relief. In certain circumstances, section 23 type relief is given at the rate of 15% per annum for 6 years with 10% in the 7th year, rather than given in its entirety in year 1. These are called “special qualifying premises”. It is possible that as a result of these changes, such a property may remain unsold for such a long period that there is insufficient time left within which to claim the full amount of the section 23 type

relief. In these circumstances, any relief not given because of this foreshortening will be lost.

Because of this restriction on the use of the relief to the property which gave rise to it, it will be necessary in the future to be aware of the order in which expenses, losses and reliefs can be set-off against income. This is to ensure that the correct amount of section 23 type relief may be carried forward from one chargeable period into the next. The Budget changes applies the order of set-off provided for in the high earners restriction, which was introduced in the Finance Act 2007. In effect, section 23 losses are the last to be set against income, all other expenses coming first.

Accelerated Capital Allowances.

Under the heading of Capital Allowances, there are 2 separate, but interlinked classes of changes which are being introduced as on and from Budget Day. The first change will narrow the range of income to which the allowances can apply, while the second change will curtail the ability of the person to carry forward unused allowances beyond certain deadlines.

These measures will only apply to capital allowances arising under the various area and property based tax incentive schemes and only to persons who are passive investors in the relevant businesses. This means those who are not actively engaged in the conduct of their respective businesses.

Narrowing the Range of Income.

- With effect from the year of assessment 2011, where an individual becomes entitled to any capital allowances, including any balancing allowances, in respect of a building or structure for use in a trade, those allowances may only be set against the income of that trade. The allowances can no longer be used against income of another trade of that individual or against any other form of income of that individual. This restriction will apply, not just to capital allowances arising in a particular year of assessment, but also to those allowances carried forward from a previous year of assessment. In some specific cases, this restriction was already provided for in the Taxes Consolidation

Act 1997, in other cases the sideways set-off was restricted to €1,750 per annum while in yet other situations, there was no restriction. From 1 January 2011, these allowances will be fully restricted in all cases.

- For any chargeable period commencing on or after Budget Day (7 December 2010), where a person (a company or an individual) has let a building or structure and is receiving rental income from it, any capital allowances, to which that person becomes entitled, may only be set against the rental income from the building or structure itself. This restriction is analogous to the one restricting the use of section 23 type relief.

Curtailing the Carry Forward.

Currently, the rate at which normal capital allowances on industrial buildings is given is 4% per annum over 25 years. Under the various property and area-based tax incentive schemes, this period can be shortened to 7 or 10 years and in some cases to periods greater than 10 years but less than 25 years. In order that the full amount of the capital allowance can be given, the annual rates of the allowances are higher when the periods over which they can be claimed are shorter and these are commonly known as accelerated capital allowances.

The Budget changes, which will apply to individuals and companies with effect from 7 December 2010, are as follows:

- For the 7 and 10 year schemes, any unused capital allowances carried forward to the respective 7th or 10th chargeable periods after the chargeable period in which they were first claimed, will be lost. This will apply both to circumstances where those 7th and 10th chargeable periods have yet to be reached and those where they have already passed. In the former case any unused amount carried forward into the 8th or 11th chargeable periods, as the case may be, will be lost. In the latter case, any unused amount carried forward into the next chargeable period commencing on or after 7 December 2010 will also be lost.
- Where the capital allowance is given over a period greater than 10 years, this period will now be revised downwards to 7 chargeable

periods, including the chargeable period in which the allowance was first claimed. The consequences of this are as follows:

- in circumstances where this 7th chargeable period has already ended, any capital allowances, which have yet to be given will be lost,
- where the 7th chargeable period has not yet elapsed as of Budget Day, the amount of capital allowances yet to be given will be reduced by 20% and given over the balance of the 7 chargeable periods, and
- in all cases, any capital allowances, carried forward beyond the end of the 7th chargeable period and into any subsequent chargeable period commencing on or after Budget Day, will be lost.

The reason for reducing the amount of future capital allowances by 20% in these particular circumstances is to take account of the fact that some of these allowances will be made available faster than would otherwise have been the case. In fact, most of these types of schemes tended to front-load the allowances, typically with 50% of the total allowance being made available in the first chargeable period. In such circumstances the balance of these capital allowances are at the rate of 4% per annum until the full amount of the allowance has been given.