

Budget 2010

This update provides commentary and summary of the main changes announced in the Budget on Wednesday 9th December 2010.

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The last of the very difficult budgets - we hope!

Commentary by Patrick O'Sullivan – Head of Investment Strategy

Budget 2010 may well go down as one of the most seminal budgets that any Irish government has had to introduce – and certainly it was one of the most severe. However, the actions of the Minister for Finance, Brian Lenihan, were broadly correct and should mark a key turning point in the level of confidence in the economy. History may well draw parallels with Budget 2010 and the MacSharry Budgets of the late 1980s which ultimately laid the foundations for recovery in the Irish economy during the 1990s.

This Budget exhibits the seriousness of intent by the government to tackle the current fiscal crisis and should result in increased investor confidence. Over the course of this year, the cost of borrowing by the Irish government has fallen and this Budget should continue to underpin this trend.

Main items of Budget 2010

Life & Pensions & Savings	General
Pensions – No immediate change but plans to review tax free lump sum and marginal rate of relief in the New Year	Expenditure Cuts -Public sector pay to be cut and generate savings of €1 billion in 2010 (and in a full year)
Life Assurance Levy – No mention of levy but may well pop up in the Finance Bill	Expenditure Cuts -Social welfare cuts of €760 million in 2010 (€809 million in a full year)
Solidarity Bond – A new national solidarity bond to be introduced in the New Year aimed at small retail savers.	Expenditure Cuts -Capital Expenditure cuts of €960 million in 2010
	Expenditure Cuts -Non-pay, non-social welfare day-to-day cuts of €980 million (in 2010)
	Tax changes -Introduction of a carbon tax on fossil fuels (such as petrol, diesel, home heating oil and gas etc.) will generate €250 million in 2010 and €330 million in a full year
	Tax changes – Reduction in VAT from 21.5% to 21%
	Tax changes – Reduction in excise duties on alcohol
	Tax changes – Reviewing the introduction of a property tax, plans to simplify the income tax system and to broaden it.

Implications

While the Minister did not alter the tax treatment of pensions in the Budget, he will look to review it early next year. The main implications from a Life and Pensions perspective is that it would make sense for those planning to retire to consider doing so before the next Budget at the latest (as there is the danger that only lump sum amounts of up to €200,000 will be tax free) and secondly, individuals should be making their maximum contributions now while the marginal rate of tax relief is still in place.

In general, while the economy is expected to decline by 1.3% in 2010, much of this will be front-ended and we should see modest growth in the second half of the year. Thereafter, the economy is expected to grow by 4% on average per annum between 2011 and 2014. In the short-term, the key will be consumer confidence because if confidence begins to improve, then individuals will start to spend and invest again. It should be remembered that Irish households have over €100 billion sitting in cash and deposits. Furthermore, broadening and simplifying the tax system should ensure that we will see no more income tax rises in Ireland in coming budgets. This should help reverse the situation whereby the top 4% of earners pay nearly half of the total tax yield.

Also, the credit review system on business lending, whereby SMEs will be given a right to appeal any refused credit application by any bank in the state guarantee system will be an interesting feature. The goal obviously is to get credit flowing again to the business and agricultural community in Ireland.



Irish Life

Budget 2010

Pension tax relief

The Minister for Finance decided not to alter the tax treatment of pensions in the Budget. He stated that he accepts "the Commission on Taxation's recommendation that pension lump sums below €200,000 should not be taxed. The treatment of sums above this level, and the tax treatment of pensions, including the consolidated 33 per cent rate of relief will be considered in the Government's National Pensions Framework shortly to be published by the Minister for Social and Family Affairs".

Irish Life strongly contends that changes to the tax treatment of pensions, and in particular the proposed reduction in the marginal rate relief, would be a very negative and a counterproductive step. The main beneficiaries from the present structure (those for whom the expenditure tax structure delivers most) are not the very rich, but those with middle incomes, ranging from €45,000 to €70,000. The reason is simple: middle income earners pay a larger proportion of any tax liability at a lower rate at the time of retirement than on the original income on which the pension is based.

For example, if a flat 33 per cent rate was introduced this means that anyone earning over €35,000 will face a reduced incentive to make pension contributions. The incentive declines more or less uniformly and disappears at about €130,000, and thereafter is actually negative: you are worse off if you subscribe to a pension than if you do not.

This is a strongly held position of Irish Life and one that we have continuously highlighted over the last 12 months. In fact, Gerry Hassett, CEO of Irish Life Retail, has stated on many occasions that the opponents of relief at the higher rate were seeking to caricature it as something that only the super-rich availed of but that was a myth. In fact the overwhelming majority of people availing of this relief are middle income earners who are trying to make some contribution to funding their retirement needs.

Best advice

In terms of the here and now, it would make sense for those planning to retire to consider doing so before the next Budget at the latest, and secondly, individuals should be making their maximum contributions now while the marginal rate of tax relief is still in place.

The proposed Life Assurance Levy

The Minister of Finance did not mention the proposed life assurance levy in the Budget but it is something that will probably be addressed in the Finance Bill in the New Year. Again, this is an area that we, along with other companies in the industry, have highlighted as being highly distortionary. We have proposed an alternative method that would generate an equivalent amount of revenue for the government and that would avoid skewing the playing pitch for pension providers.

Best advice

Nothing to worry about for the moment, but close scrutiny will have to be paid to the Finance Bill in the New Year

National Solidarity Bond

It is proposed to establish, early in the New Year, a new National Solidarity Bond to assist the financing of the capital investment programme underlying this Budget (i.e. the bond will not be used to fund additional spending).

The bond will be in addition to the current range of "State Savings" products (savings bonds, savings certificates, prize bonds, national instalment savings and the Post Office deposit account).

The main features of the new bond will be:-

- investors can choose to invest for a five, seven or ten year period;
- interest will be paid annually;
- investors will be entitled to a final redemption bonus on maturity as an incentive to leave their funds invested - the bonus will be different for each investment period;
- full details of the tax treatment of the bond will be provided in Finance Bill 2010;
- it will be possible to invest in the bond by lump sum or by occasional payments;
- the bond will be available through the following channels
 - internet,
 - telephone,
 - direct debit,
 - at your local Post Office.

The bond will be sold by An Post on behalf of the National Treasury Management Agency (NTMA). Further details will be announced by the NTMA early in the New Year.

Best Advice

Until exact details are known little can be said about the Solidarity Bond. However, it is unlikely to be a particularly high yielding bond as the government can currently fund at less than 4% at the moment.

Budget 2010

SUMMARY BY ADVISORY SERVICES

While there were none of the predicted changes to pensions taxation, the life assurance levy or Capital Acquisitions Tax reliefs there was plenty to comment on. The following is a summary & factsheet from Advisory Services on the various tax changes that have been announced.

Pensions

Despite the many rumours, no immediate changes were made to the taxation of pension arrangements. The minister did announce that he accepted the Commission on Taxation's recommendation that pension lump sums below €200,000 should not be taxed. Other aspects of the tax treatment of pensions are being looked at as part of the Government's National Pensions Framework. The minister said that items being considered as part of the Framework include

- the treatment of pension lump sums above €200,000, and
- a consolidated 33% rate of relief

We feel that in the short term this discussion on changes to the rate of relief may lead to individuals maximising pension contributions while relief is still available at their marginal rate. In the longer term new schemes for employees who pay tax at the higher rate may be structured to have greater levels of employer contributions and lower/no employee contributions, as the Commission on Taxation did not recommend any changes to relief for employer contributions to company pension schemes.

We view pension saving as an important long-term issue, and as such will continue to stress that any decisions taken regarding a consolidated 33% rate of relief must take into account the long term nature of pensions, including the fact that pension income is liable to income tax in retirement.

No date has been set for the publication of the National Pensions Framework. Initially scheduled for publication last year, the minister indicated that this will be available shortly.

Reminder of Commission on Taxation Report recommendation for pension lump sums at retirement

The maximum tax free lump sum available on retirement is currently 150% of final salary (occupational pensions) or 25% of the fund (PRSAs, Personal Pensions and proprietary directors in occupational pensions), subject to an overall cap of €1,354,521.

The report suggests that these lump sum restrictions remain. In addition lump sums should be subject to a tax free cap of €200,000. The balance of any lump sum above €200,000 would be subject to tax at the standard rate of income tax (currently 20%).

Example: A client with €1 million retirement fund who can take a lump sum of 25% of his fund would see his lump sum fall from €250,000 to €240,000.

	Current Position	Proposed Position
Total Fund	€1,000,000	€1,000,000
Tax Free Lump Sum	€250,000	€200,000
Balance of Lump Sum (after tax at 20%)	N/A	€40,000 (after €10,000 tax)
Balance to ARF/AMRF or annuity	€750,000	€750,000

Public Service Pensions

Together with significant changes announced in public sector salaries and professional fees, a new single scheme for all new entrants to the public service from 2010 onwards was announced. Some of the main provisions are as follows:

- Pensions to be based on "career average" earnings rather than final salary as currently applies. A specific "pension accrual rate" will be applied to pensionable pay so that each year public servants will earn a certain amount of pension payable on retirement. This calculation method lowers the pensions of people with high earnings increases, especially late in their career, with less impact on the pensions of lower paid public servants with relatively "flat" career earnings.
- Raising the minimum public service pension age to 66 years from 65 at present. Going forward the public service minimum pension age is to be linked with the State Pension age. The maximum retirement age will be set at 70.

The Government is also to consider using the CPI as the basis for post-retirement increases for both existing and future pensioners. Other details of the new scheme are to be finalised following consultation between the Department of Finance and public service employers and unions.

We feel the announcement that the minimum public sector retirement age will be linked to any future change in the State Pension age could suggest that the current State Pension of 66 may be reviewed in the National Pensions Framework.

Budget 2010

SUMMARY BY ADVISORY SERVICES

Mortgage Interest Relief

Mortgage Interest Relief will be abolished entirely by the end of 2017. Where a qualifying loan was taken out before 1 July 2011 it will continue to get relief for 7 years. Transitional measures will be provided for qualifying loans taken out between 1 July 2011 and end 2013.

It is useful to note that in cases where the entitlement to relief would have expired in 2010 or after, the relief will continue to apply up until end 2017.

Credit Review System on Business Lending

A right of appeal is being introduced for Small and Medium Enterprises (SMEs), farm enterprises and sole traders where an application for credit is refused by a participating bank, on completion of the bank's own internal process. Where it is recommended that credit should be granted, the participating institution which refused credit must comply or provide a satisfactory explanation.

A right to appeal will also be created where a decision on an application is not given by the participating institution within a reasonable period of 15 working days, or where the terms or conditions attached to a credit facility or its price are excessively onerous. A fee will be charged for each appeal, which will be refunded by the bank if successful.

In addition to reviewing individual business decisions, the credit review system will also take on the review of the credit policies and practices of the banks, in relation to all SME sectors, paying particular attention to sectors, such as the retail sector, including car dealerships, tourism, and agriculture, where particular stresses have been reported.

Corporation Tax

An extension has been announced to the existing scheme which provides a three year exemption from tax on the income and gains of new start-up companies to include companies who commence trading in 2010.

Income Levy Relief for certain Farm expenditure

Relief from the income levy will be allowed in respect of certain expenditure incurred by farmers to comply with specific EU requirements.

Vehicle Registration Tax (VRT)

A car scrappage scheme is being introduced with effect from 1 January 2010, to run until 31 December 2010. VRT relief of up to €1,500 will be provided where a car of 10 years or older is scrapped in accordance with certain criteria and a new car of emissions bands A or B is purchased.

Other proposed measures are the extension for two years until 31 December 2012 of the VRT exemption for Electric Vehicles and the VRT relief of up to €2,500 for plug-in hybrid electric vehicles, both of which were due to expire on 31 December 2010.

Carbon Tax

A carbon tax at a rate of €15 per tonne is being introduced on fossil fuels. The tax will apply to petrol and auto-diesel with effect from midnight, 9 December 2009; and from 1 May 2010 to certain other fuels i.e. Kerosene, Natural Gas. Electricity is not subject to the carbon tax while the application of the tax to coal and commercial peat is subject to a Commencement Order. Based on ESRI studies, the estimated direct impact on households will be €2 to €3 per week.

Income Tax, PRSI and other information

Standard Rate Bands	No Change
Single / Widowed No dependant children	€36,400
With dependant children	€40,400
Married – one income	€45,400
Married – two incomes <i>Max transferable between spouses</i>	€72,800 (€45,400)

Income Tax Credits	No Change
Personal	
<i>Single</i>	€1,830
<i>Married</i>	€3,660
PAYE / Employer Credit	€1,830
Incapacitated child	€3,660
Blind Person - single	€1,830
- married (Both Blind)	€3,660

Income Levy	No Change
Income up to €75,036	2%
Between €75,036 and €174,980	4%
Income in excess of €174,980	6%

The income levy exemption threshold remains at €15,028. This levy is paid on gross income, before deduction of capital allowances or pension contributions. It does not apply to social welfare payments, including contributory and non-contributory social welfare pensions.

Income Exemption Limits	No Change
Single / Widowed (aged 65+)	€20,000
Married (aged 65+)	€40,000

Savings & Investment Tax	No Change
DIRT	25%
Life Assurance Policies	28%
Wrapper Products	48%

PRSI Rates	No Change	
	A1	S1
Employee	4%	3%
Income up to €75,036 (earnings less than €352pw exempt)	First €127 pw exempt	on all income
Employer		
All income	10.75%	Nil

Health Levy	No Change
Health Levy	4%
Health Levy Higher Rate (income over €1,443 per week, €75,036 per year)	5%

The income exemption threshold for the 4% health levy is €500 per week. Where an individual's income is greater than this amount the levy is charged on all income.

Contact Details:

Life Advisory Services:

Caitriona Gaffney: 01 856 3160
(Manager) Caitriona.Gaffney@irishlife.ie

Edel Hughes: 01 856 3150
(Specialist) Edel.Hughes@irishlife.ie

Pensions Advisory Services:

Patrick O'Shea: 01 856 3166
(Manager) Patrick.O'Shea@irishlife.ie

Marie Ann Reidy: 01 856 3171
(Specialist) MarieAnn.Reidy@irishlife.ie

Social Welfare Benefits

The following table sets out the main changes in Social Welfare benefits

Social Welfare Benefits	Weekly Benefits	
	2010	2009
State Pension (Contributory + Transition)		
Personal Rate	€230.30	€230.30
Personal + Adult dependant (over 66)	€436.60	€436.60
Widow / Widowers Contributory Pension (under 66)	€201.50	€209.80
State Pension (Non-Contributory)		
Personal Rate	€219.00	€219.00
Personal + Adult dependant (under 66)	€363.70	€363.70
Widow / Widowers Non-Contributory Pension	€196.00	€204.30
Invalidity Pension		
Personal Rate (under 65)	€201.50	€209.80
Personal + Adult dependant (under 66)	€345.30	€359.50
Illness Benefit		
Personal Rate	€196.00	€204.30
Personal + Adult dependant	€326.10	€339.90
Jobseeker's Allowance		
18 and 19 years of age		
Personal Rate	€100.00	€100.00
Personal + Adult dependant	€200.00	€200.00
20 and 21 years of age		
Personal Rate	€100.00	€204.30
Personal + Adult dependant	€200.00	€339.30
22 to 24 years of age		
Personal Rate	€150.00	€204.30
Personal + Adult dependant	€280.10	€339.30
Over 25 years of age		
Personal Rate	€196.00	€204.30
Personal + Adult dependant	€326.10	€339.90
<i>Where a person aged 18 to 24 has a dependent child the basic personal rate (€196) applies</i>		
Increase for each Dependant Child	€29.80	€26.00

Child Benefit (Children's Allowance)	2010	2009
First and second child	€150.00	€166.00
Third and subsequent child	€187.00	€203.00
Benefit has ceased for children aged 18 with effect from 1 st January 2010		
Early child care supplement was abolished with effect from the end of 2009.		

Stamp Duty

Commercial Property – No Change

Consideration	Rate
Up to €10,000	Exempt
€10,001 - €20,000	1%
€20,001 - €30,000	2%
€30,001 - €40,000	3%
€40,001 - €70,000	4%
€70,001 - €80,000	5%
Over €80,000	6%

Residential Property – No Change

Consideration	Rate
Up to €125,000	Exempt
Next €875,000	7%
Balance	9%

No stamp duty on new residential property under 125m² for owner occupier