Irish Tax Institute

Response to public consultation on the Tax and Fiscal Treatment of Landlords

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About the Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax.

The Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. With over 5,000 members in Ireland, along with the Chartered Institute of Taxation UK and The Tax Institute of Australia, we are part of the 28,000-strong international CTA network and a member of the Confédération Fiscale Européenne, (CFE) the European umbrella body for tax professionals.

Our members provide tax education and expertise to thousands of businesses, multinationals, and individuals in Ireland and internationally. In addition, many hold senior roles within professional service firms, global companies, Government, Revenue, state bodies and the European Commission.

After 50 years, the Institute remains deeply committed to the role it can play in education, tax administration and tax policy in Ireland and in building an efficient and innovative tax system that contributes to a successful economy and society. We are also committed to the future of the tax profession, our members and our role in serving Ireland's taxpayers and best interests in a new international world order.

Introduction

The Irish Tax Institute ("the Institute") welcomes the publication of the consultation on the *Tax and Fiscal Treatment of Landlords.*

The scope of the consultation is very broad and the questions consider many different aspects of the residential property market. Detailed economic and behavioural analysis will be required to address a number of these questions and we expect that stakeholders who are closely connected with the property sector will be able to provide this level of detail.

The Institute has made representations on several areas of tax policy relevant to the residential property market over a number of years and some positive changes have been introduced in recent Budgets. In responding to the consultation, we have addressed what we consider to be the key tax measures that would help increase supply in the residential property market. We have not considered the economic or Exchequer impact of these measures.

Summary of recommendations

1. Owing to the rules for calculating taxable rental income, residential landlords are faced with very high effective tax rates. To bring the tax treatment of these individuals more in line with those engaged in other trades/business and to reduce the underlying tax burden, we believe that consideration could be given to the deductibility of certain expenses;

    - **Interest:** We welcome the Government's recent commitment to restore full interest deductibility for residential landlords by 2021. Consideration should be given to accelerating the re-introduction of full relief so as to reduce effective tax rates and thus encourage additional investment in the residential property sector.

    - **Certain capital expenditure:** Consideration might be given to allowing for targeted deductions for certain capital expenditure which, say, improves the quality of rental stock or is needed to satisfy regulatory requirements.

    - **Local Property Tax:** Legislation permitting the deductibility of Local Property Tax ("LPT") should be introduced in Finance Bill 2017.

    - **Non Principal Private Residence Charge:** The High Court has recently ruled that the Non Principal Private Residence ("NPPR") charge is a deductible expense for landlords against rental profits. This decision has been appealed by Revenue to the Court of Appeal. If the position of landlords is upheld by the Court of Appeal, it is important that refund claims arising to landlords are processed as a matter of priority.

2. **Capital Gains Tax:** Ireland’s capital gains tax (“CGT”) rate has increased by over 60% since 2008 and currently stands at 33%. This rate is very high by international standards. We have made a number of recommendations to encourage both;
    - new investors to enter the residential property market (e.g. lower CGT rate for long term residential property and Indexation Relief)
    - existing landlords to remain in the market (e.g. Rollover Relief).

Question 1

What is the single most significant issue which is causing existing landlords to consider exiting the rental market, or deterring potential investors from entering the residential property market? Is there any tax or fiscal measure that could address this issue, having regard to existing Budget constraints?

A significant number of individual investors entered the buy-to-let sector during the so-called "Celtic Tiger" era, with many of these investors using bank borrowings to fund their investments. The economic downturn triggered a significant fall in the value of property in Ireland, leaving many investors in a negative equity position. In our view, the combined high income tax and CGT burden for landlords is a significant deterrent to entering and remaining in the market;

- The marginal rate of tax has been increased and currently stands at 52% (or even 55% for high levels of non-PAYE income).
- Finance Act 2009 introduced a restriction of 75%[1] on the amount of interest that would otherwise be deductible where a loan is used to purchase residential property.
- LPT was introduced in 2013.
- Certain property-based capital allowances were guillotined with effect from 2015

The combined impact of these economic and tax developments, together with the recent rent control provisions, increasing insurance costs and PRTB compliance obligations, is that landlords are struggling to pay both the bank borrowings and the underlying tax liability. These measures are also discouraging new investors from entering the market, creating supply issues and driving rental inflation.

> *"The annual rate of rental inflation – at 13.5% in the final quarter of 2016 – was the highest in the history of the Daft.ie Report, which extends back to 2002….unsurprisingly, the issue is a severe imbalance between supply and demand. Fewer than 4,000 homes were available to rent across the country on February 1st."*
>
> *"The private rented sector doubled in just five years – and may have increased further since. And yet, instead of availability doubling, it has fallen, even compared to the worst days of the Celtic Tiger"*
>
> **The Daft.ie Rental Price Report – 2016 in Review**

Economists have also suggested that tax measures could cause upward pressure on rents.

> *"The restriction on deductions and increased tax [including USC and local property taxes] charges could justify increases in gross rents of approximately 20% to 24%, depending on the personal circumstances of a landlord"*
>
> **DKM Economic Consultants, Report on Rent Stability in the Private Rented Sector**

Section 97 Taxes Consolidation Act ("TCA") 1997 sets out the rules for the computation of taxable rental profits. A number of expenses incurred by landlords are not deductible in computing

[1] This was increased to 80% in Finance Act 2016

taxable rental income, meaning that there can be significant differences between a landlord's actual rental profit and the amount on which tax is assessable. This can lead to high effective tax rates as set out in the *Sample Computations* below;

Sample Computation (A): Year 5 of Mortgage

Tax Computation assuming an 80% restriction on interest payments	
	€
Rental Income	18,000
Less:	
Interest payments	(8,000)
Capital repayments	(2,000)
Management fees	(1,000)
Local Property Tax	(500)
Rental profit	6,500
Disallowed expenses in 2017:	
Interest payments disallowed (80% restriction)	1,600
Capital repayments	2,000
Local Property Tax	500
Case V taxable profits	10,600
Tax at 52%	5,512
Net income (after tax)	988
Effective Tax Rate	84.8%

Sample Computation (B): Year 15 of Mortgage

Tax Computation assuming an 80% restriction on interest payments	
	€
Rental Income	18,000
Less:	
Interest payments	(2,000)
Capital repayments	(8,000)
Management fees	(1,000)
Local Property Tax	(500)
Rental profit	6,500
Disallowed expenses in 2017:	
Interest payments disallowed (80% restriction)	400
Capital repayments	8,000
Local Property Tax	500
Case V taxable profits	15,400
Tax at 52%	8,008
Net income (after tax) - **LOSS**	**(1,508)**
Effective Tax Rate	123.2%

Question 2

Property is, in many cases, a highly leveraged investment involving significant mortgage borrowings in addition to the capital invested by the landlord. Mortgage interest paid is allowable as a deduction in calculating taxable income from rental property. Similar treatment is not afforded to interest on borrowings used for other forms of income-generating investment – for example interest on monies borrowed to invest in shares is not allowable as a deduction against dividend income. Is it appropriate for the State to incentivise concentrated investment risk through the granting of interest relief for rental property investment?

From 2009 to 2016, residential landlords were only entitled to a tax deduction for 75% of the interest expense on borrowings used to acquire rental property. This was in contrast to landlords of commercial property who could avail of full interest deductibility.

The 75% restriction was introduced in 2009 at the time of the economic downturn when Exchequer resources were limited. The economy has experienced significant growth since then, with continued growth forecasted for the coming years.

In Budget 2017, the Government committed to restoring full interest deductibility for residential landlords. This will be introduced on a gradual basis;

- The restriction has been increased to 80% from 1 January 2017
- The restriction will be increased incrementally by a further 5% per year, with full deductibility by 2021.

We welcome the Government's commitment to restore full relief for interest payments. Given that interest typically represents the most significant expense for landlords, consideration should be given to accelerating the restoration of full relief. This would address the disparity with commercial landlords and could help to encourage additional investment in the residential property sector, thereby addressing market supply issues.

Full interest deductibility in say 2018, would have the following impact on the *Sample Computations.*

Sample Computation (A): Year 5 of Mortgage

Tax Computation assuming a full deduction for interest payments	
	€
Rental Income	18,000
Less:	
Interest payments	(8,000)
Capital repayments	(2,000)
Management fees	(1,000)
Local Property Tax	(500)
Rental profit	6,500
Disallowed expenses	
Capital repayments	2,000
Local Property Tax	500
Case V taxable profits	9,000
Tax at 52%	4,680
Net income (after tax)	1,820
Effective Tax Rate	72%

Sample Computation (B): Year 15 of Mortgage

Tax Computation assuming a full deduction for interest payments	
	€
Rental Income	18,000
Less:	
Interest payments	(2,000)
Capital repayments	(8,000)
Management fees	(1,000)
Local Property Tax	(500)
Rental profit	6,500
Disallowed expenses	
Capital repayments	8,000
Local Property Tax	500
Case V taxable profits	15,000
Tax at 52%	7,800
Net income (after tax) - **LOSS**	**(1,300)**
Effective Tax Rate	120%

Question 5(a)

Would improved deductibility for rental expenses make a material difference to landlords when deciding to enter or remain in the rental market, and if so what expenses?

We believe that improved deductibility for rental expenses would encourage landlords to both enter and remain in the rental market. Whilst immediate full deductibility for interest payments would provide some relief for landlords against the impact of very high effective tax rates, consideration needs to be given to the deductibility of other expenses.

(i) Certain capital expenditure

At present, capital expenditure on a rental property is not deductible against rental income although some capital allowances are available in respect of fixtures and fittings. Therefore the cost of undertaking improvements e.g. to meet regulatory standards or even to improve the quality of the rental stock available to tenants cannot be deducted and are contributing to high effective tax rates. Consideration therefore might be given to allowing for targeted deductions for certain capital expenditure.

(ii) Local Property Tax

LPT came into effect in 2013. LPT applies to all residential properties in the State (subject to certain exempt properties) and is calculated on a self-assessment basis based on the market value of the property. The initial valuation date was initially due to run for three years until 2016, although the Government recently extended this valuation period until 2019[2].

The obligation to pay the LPT falls on the landlord. We believe that the LPT should be deductible in calculating the landlord's rental profits. This is on the basis that it is a genuine expense of the transaction under which the rents are received. In this regard, it is comparable with commercial rates, which are directly related to providing local services for the rental properties. This view is shared by the Inter Departmental Group who considered the design of LPT in 2012.

> *"There would appear to be an equity argument for allowing, at least a portion of, LPT (including the NPPR addition) paid in respect of a rented property to be deductible for tax purposes in the same way as commercial rates are deductible for tax purposes".*
>
> **Report of the Inter Departmental Group, Design of a local property tax**

[2] Announced in Budget 2016

Revenue has also acknowledged that a deduction for LPT will be phased in when Exchequer resources allow;

> *"The Government has accepted in principle the recommendation in the Thornhill Report that LPT be a deductible expense in calculating a landlord's taxable rental income and that the deduction be phased in over a number of years with the start date being determined by the economic and budgetary situation"*
>
> **Revenue Commissioners, February 2014**

We believe that legislation permitting the deductibility of LPT should be introduced without further delay in Finance Bill 2017.

(iii) Non Principal Private Residence charge (NPPR)

The NPPR charge was introduced in the Local Government (Charges) Act 2009. Under the NPPR regime, landlords were required to pay a €200 annual charge on non principal private residences to the local authority in the area in which their property was located. The NPPR was abolished with effect from 2014.

Revenue's interpretation of the law is that the NPPR charge is not an allowable expense in computing taxable rental income under Section 97 TCA 1997.

The Institute has long contended that, on technical interpretation of the legislation, the NPPR charge <u>**is**</u> tax deductible. Section 97(2) specifically sets out the deductions that may be taken in arriving at the taxable rental income. Under this section, sums borne in respect of "<u>any</u> rate levied by a local authority" are deductible as a rental expense.

We consider that the NPPR charge should be deductible as a rental expense on the basis that it is akin to a rate levied by a local authority. The charge was announced by the Taoiseach as a revenue-generating mechanism for local authorities. It is levied and administered by the local authorities, to whom payments must be made and the nature of the payment would indicate that it is a rate payable to a local authority.

As you will be aware, the High Court has recently ruled that the NPPR charge is a deductible expense for landlords against rental profits. This decision has been appealed by Revenue to the Court of Appeal.

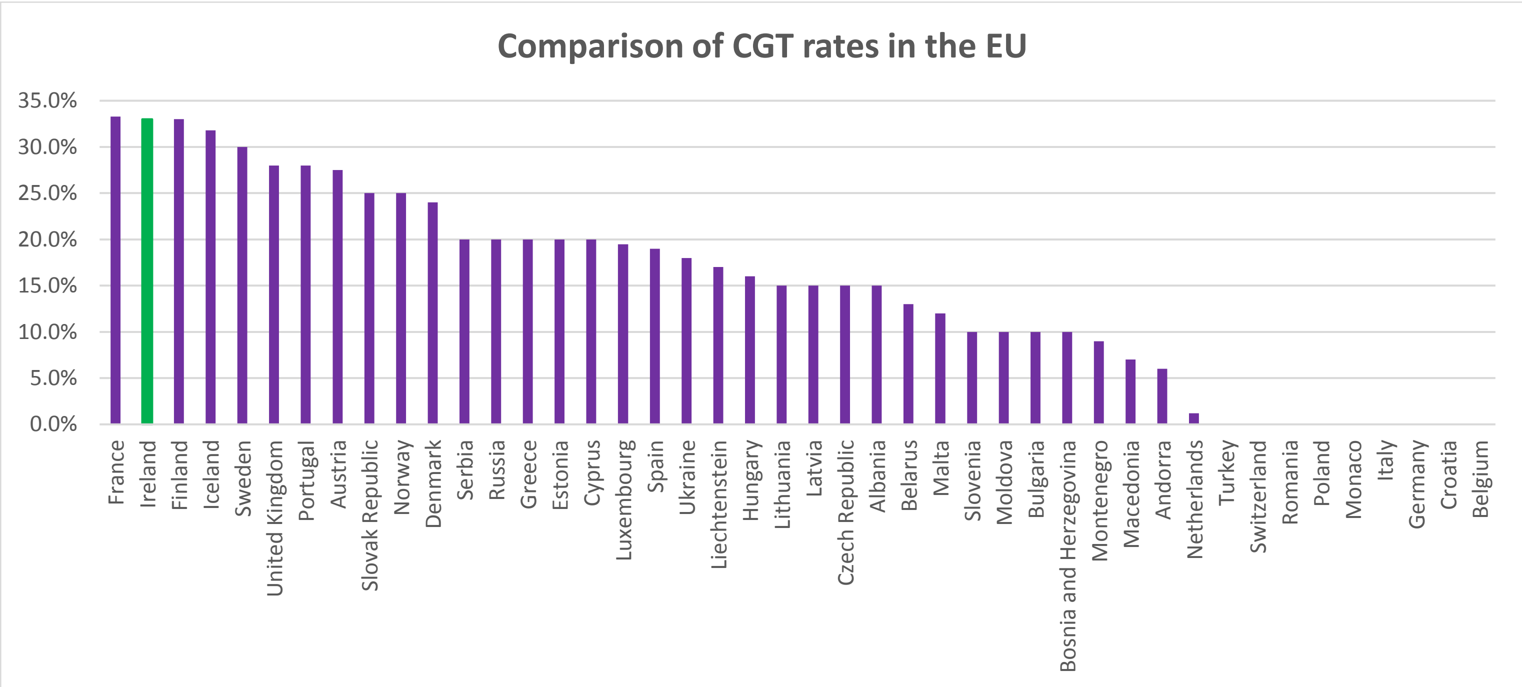
We recognise that Revenue will not be in a position to amend assessments until such time as the appeal has been heard. Revenue has recently released a *Non Principal Private Residence (NPPR) Notification Form* which enables taxpayers to notify Revenue of their intention to claim a deduction for the NPPR for 2013 (the only tax year for which returns can still be amended). We welcome the release of this notification mechanism.

If the position of landlords is upheld by the Court of Appeal, it is important that refund claims arising are processed as a matter of priority. As things stand, taxpayers have already foregone four years of possible refund claims due to the four-year statute of limitation.

Question 6

Would a relief from capital gains tax on disposal of a long-term rental property in the future encourage landlords to remain in, or to enter, the residential letting market at present? Alternatively is it possible that it would lead to a greater exodus of landlords from the rental market?

Ireland's CGT rate is currently 33%, having increased from 20% in 2008. The rate increases have coincided with a sharp decline in CGT receipts, which have fallen from a peak of €3.1 billion in 2006 to €0.8m billion in 2016. This rate is very high by international standards.



(Source: Global Property Guide http://www.globalpropertyguide.com/Europe/capital-gains-tax)

Certain types of CGT reliefs would encourage existing landlords to remain in the property market, while others would provide a greater incentive to new landlords. We consider in *Question 7* a measure which could be aimed at existing landlords.

For investors considering acquiring rental property, the high rate of CGT, coupled with the marginal income tax rate of 52% (or up to 55%) on rental income, are deterrents. Consideration could therefore be given to the introduction of some targeted measures which seek to increase the supply of additional properties into the rental market;

- **A reduced CGT rate for long term residential rental property**: It is not uncommon in other countries internationally for a lower CGT rate to apply to gains that are not speculative in nature but arise from the long term holding of property. There is merit to considering a similar regime in Ireland. This might be particularly useful if linked with targeted rollover relief suggested in *Question 7* below.

- **Indexation relief:** For properties acquired before 2003, indexation relief effectively adjusted the cost in line with an inflation factor. This relief was abolished following a reduction in the CGT rate and during a period of low inflation. The economy is in an inflationary period once more, meaning that a portion of capital gains on property are being driven by inflation alone. The Commission on Taxation suggested that such gains should not be subject to CGT.

> *"Our view is that a capital gains tax charge should only be applied to real gains; that is, that gains attributable to inflation should be excluded".*
>
> **Commission on Taxation Report 2009**

The reintroduction of indexation relief would provide greater certainty for prospective investors in the property sector and, depending on the base year, is unlikely to have a significant impact on the Exchequer.

Question 7

Would a relief from capital gains tax on disposal of a rental property, conditional on the property being sold with a tenant in situ and/or a requirement for the property to continue in use as a rental property, be operable in practice? What protections could be used to ensure the continued tenancy rights of the sitting tenant, and in what manner could a clawback of relief be achieved if the new owner ceases to let out the property?

While the measures identified in *Question 6* would encourage new investors to enter the rental market, other reliefs could be used to incentivise existing landlords to remain in the market.

In previous periods where Ireland had a high CGT rate, rollover relief for certain investment property was available. Rollover relief enabled a chargeable gain to be rolled over where the disposal proceeds of the property were reinvested in another residential property. Rollover relief essentially provides for a deferral of CGT with the tax becoming payable on the ultimate disposal of the new property.

Consideration could be given to the reintroduction of rollover relief which might only apply in situations where the property being sold would continue to be used as a rental property and the proceeds are reinvested in another rental property. This might be subject to a minimum holding period with a tapered clawback of the relief for properties sold before the holding period elapses.

Question 8

It is possible that 'accidental' landlords may choose to exit the rental market as property prices rise, reducing or eliminating negative equity on the rental property. Is there a specific tax measure or treatment which could incentivise such individuals to remain in the rental market as landlords?

Many families who acquired their homes at the peak of the property market now find themselves in negative equity and unable to sell. Some of these families have opted to rent out their homes and rent larger properties more suitable for their needs. These families are burdened with significant costs relating to both properties: mortgage payments; tax on rental income; LPT; and the increasing cost of renting the 'new' property.

We have outlined above various tax measures which could ease the tax burden on landlords. We believe that a combination of these measures would also help to incentivise accidental landlords to remain in the rental market.

We also note that other stakeholders have suggested allowing accidental landlords, who acquired homes at the peak of the property market, to offset the cost of renting their new property against rental income. There would be merit in considering this proposal further.