Property Issues: Avoiding the Pitfalls

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Introduction

Although the Irish obsession with property investment may have waned over the past few years, the reality is that property-related tax issues are key in determining the optimal tax position for many clients.

Since 2007, a number of changes have been introduced to the manner in which allowances and reliefs (predominantly property-based allowances) can be claimed by individuals classified by Revenue as "high earners". These changes, together with the provisions introduced in Finance Act 2012 relating to the legacy property reliefs, result in a complex maze of rules that must be navigated by taxpayers and practitioners to ensure that tax returns are correctly filed. In addition, increased Revenue focus on the availability of allowances means that the importance of tracking remaining allowances cannot be underestimated.

In determining the correct utilisation of allowances and the final tax liability of individual taxpayers, there are a number of separate but intertwined factors that need to be borne in mind, as follows:

- the guillotine provisions introduced in FA 2012, which apply to property-based reliefs generally but not to "s23"-type reliefs or to allowances in respect of business buildings that are used as part of an active trade;
- the impact of the 5% property relief surcharge for the 2012 tax year onward, and its impact on the calculation of the 2011 preliminary tax obligation;
- the correct classification of the various categories of losses and reliefs being carried forward in respect of individual properties;
- the identification of allowances being carried forward as a result of the "high earner" restriction (s485F TCA 1997);
- the impact of the "high earner" restriction for spouses, given that they are treated as separate individuals, notwithstanding the fact that they may be jointly assessed;

- the identification of the correct PRSI charge, which is calculated as if the "high earner" restriction did not apply; and
- the use of the remaining allowances and reliefs having regard to the rules on the order of offset.

The impact of these separate but overlapping provisions is probably best illustrated by a number of examples, which are set out below.

Guillotine Provisions for Legacy Property Reliefs: FA 2012

FA 2012 finally provided certainty in relation to the rules governing the use of legacy property reliefs. In broad terms, property reliefs may not be carried forward beyond 1 January 2015 if the "tax life" of the property has expired before then or the end of the tax year in which the "tax life" ends.

There are, however, a number of points to bear in mind in relation to the provisions, as follows:

- They do not apply to "s23"-type allowances. Therefore, these allowances may be carried forward indefinitely.
- Allowances are terminated by reference to the end of the "tax life" of the property and not by reference to the period over which allowances are available. In many instances, the "tax life" will extend far beyond the period over which allowances are available, as follows:

Type of allowance	Period over which allowances available	Tax life
Rural Renewal	13 years	25 years
Nursing Homes and Private Hospitals pre-2007	7 years	10 years
Nursing Homes and Private Hospitals post-2007	7 years	15 years

- The guillotine provisions apply to investor allowances only and not to allowances in respect of buildings used as part of an active trade.
- Any allowances that are carried forward solely as a result of the "high earner" restriction can continue to be utilised past the guillotine date.

Property Relief Surcharge

FA 2012 introduced a 5% property relief surcharge. Where an individual has aggregate income of €100K or more in the 2012 tax year (and subsequent years) and the individual has claimed specified property reliefs in that year, a surcharge of 5% will apply to the part of the income that was sheltered by those reliefs.

There are a number of points to consider in the context of the surcharge, as follows:

- The surcharge is levied as an additional amount of USC payable. Therefore, in determining an individual's aggregate income, we must look to the definition in s531AL TCA 1997. It is worth noting that certain categories of income are not taken into account in determining aggregate income. These include deposit interest, tax-free termination payments, social welfare payments, and payments from certain life assurance policies and offshore funds.
- The 5% surcharge applies only by reference to property-based reliefs as defined. Therefore, other reliefs (e.g. film investment, BRICs relief etc.) that are impacted by the "high earner" restriction would not give rise to the 5% surcharge.
- Unlike the guillotine provisions relating to legacy property reliefs, there is no exception to the 5% surcharge where the property reliefs relate to allowances claimed as part of a trading situation.
- The surcharge applies by reference to the amount of reliefs **used** in a particular year. Therefore, it applies to the amount of allowances that are utilised having regard to the impact of the "high earner" restriction.
- Where preliminary tax liability for 2012 is being calculated by reference to 100% of the 2011 liability, the calculations must be done as if the additional 5% USC charge applied in the 2011 tax year.

Impact of the "High Earner" Restriction

The "high earner" restriction was introduced with effect from the 2007 tax year and was amended from 2010 onward.

The provisions restrict the use of various property reliefs and extend to other, non-property-related reliefs such as certain interest relief, charitable donations, film relief etc. The impact of the relief, therefore, is very wide-ranging.

It is perhaps worthwhile to recap on the allowances/reliefs that are **not** impacted by the “high earner” restriction, as follows:

- wear-and-tear (plant and machinery) allowances,
- normal rental deductions, e.g. property management fees,
- current-year trading losses,
- pension contributions,
- industrial buildings allowances (IBAs) associated with a factory, mill or dock undertaking,
- IBAs on buildings used for the production of fruit and vegetables for market gardening,
- IBAs on buildings used for intensive production of cattle, sheep, pigs, poultry or eggs (other than as part of the farming trade) and
- farm buildings allowances.

Revenue recently published its report on the impact of the “high earner” restriction for the 2010 tax year. Interestingly, the restriction affected just over 1,500 individuals and yielded *c*. €80m in additional taxes, or an average of €53K per taxpayer. This is a significant return for the Exchequer from a relatively small number of people when compared to the household charge, which has yielded €97m up to mid-July 2012.

Some Practical Examples

Example 1: Mr White

Rental income: *€160K*

Available property reliefs: *€500K*

“Tax life” of property ends: *2014*

Tax year	No high earner restriction	With high earner restriction
2012	€160K	€80K
2013	€160K	€80K
2014	€160K	€80K
Total allowances	€480K	€240K

Carry-forward under Part 9 TCA 1997: *€20K (€500K – €480K)*
Carry-forward under s485F TCA 1997: *€240K (€480K – €240K)*

Section 409F TCA 1997 sets out that the guillotine provisions apply to allowances carried forward “in accordance with Part 9”. As the allowances being carried forward as a result of the operation of the “high earner” restriction are carried forward in accordance with s485F TCA 1997 (and not in accordance with Part 9), any s485F allowances may be utilised beyond 2015. Therefore, in the case of Mr White, allowances of €20K are lost as a result of the provisions. The €240K being carried forward as a result of the “high earner” provisions can continue to be used past the expiry of the “tax life” of the property.

Example 2: Mr and Mrs Black

	Mr Black	Mrs Black
Professional income (doctor)	€200,000	
Rental income	€98,000	€98,000
Urban Renewal allowances (medical practice)	€80,000	
Other Case V capital allowances	€100,000	€100,000
Deposit interest		€10,000
Relevant payment from Luxembourg “offshore fund”		€10,000

For the 2012 tax year, the position is as follows:

- *As Mrs Black’s “aggregate income” is less than €100K in the year, she is not liable to the additional 5% property relief surcharge. The deposit interest and payment from the offshore fund are not taken into account in determining Mrs Black’s “aggregate income”.*
- *As Mrs Black’s adjusted income is less than the “income threshold amount” of €125K, she is not subject to the “high earner” restriction (in accordance with s485D TCA 1997). Therefore, she is in a position to shelter the full amount of her net rental income of €98K.*
- *Mr Black has adjusted income of €298K. The maximum amount of allowances that he may utilise in accordance with the “high earner” restriction is €80K.*
- *Mr Black’s PRSI liability is calculated as if the “high earner” restriction did not exist. Therefore, he is liable to PRSI on €120K of his income.*

Example 3: Mr Green

Mr Green owns and operates a grocery store. Allowances are available in respect of the shop building under the Urban Renewal Scheme. Mr Green has a significant rent roll and had acquired a number of tax-based property investments with a view to sheltering these rents into the future.

Case I trading income, shop	*€50,000*
Urban Renewal allowances ("tax life" expires 2014)	*€100,000*
Rental income	*€200,000*
"s23" relief forward	*€220,000*
Other investor capital allowances ("tax life" expires 2014)	*€220,000*

Tax position		
Case I	*€50,000*	
Less Urban Renewal allowances	*(€50,000)*	
Case V rental income	*€200,000*	
Less other investor capital allowances	*(€200,000)*	
Taxable income		*Nil*
Adjusted income	*€250,000*	
Less allowances claimed (Urban Renewal: €50K; other capital allowances €30K)	*(€80,000)*	
Recalculated taxable income		*€170,000*

- *Mr Green is restricted to utilising €80K of his allowances due to the "high earner" restriction.*
- *He is liable to a property relief surcharge of €4K (i.e. €80K @ 5%).*
- *The unutilised Urban Renewal shop allowances of €50K can be carried forward beyond the end of the "tax life" in 2014 as they relate to a trade (s409G(5) TCA 1997).*
- *Unutilised "other investor capital allowances" are €190K (i.e. €220K – €30K utilised in year). This carry-forward amount is split as follows:*

Carry-forward under s485F TCA 1997:	*€170K*
Carry-forward under Part 9 TCA 1997:	*€20K*
	€190K

The s485F carry-forward of €170K is "ring-fenced" from the guillotine provisions and may be carried forward beyond the end of the "tax life" in 2014. If the €20K is not utilised by the end of the "tax life", it will be lost.

The guillotine provisions do not apply to the "s23" relief. Therefore, any unutilised "s23" relief may be carried forward beyond 2015, and is available to shelter future rental income.

Importance of Tracking Information

In light of the additional complexity that has been introduced in recent Finance Acts relating to the utilisation of property-based allowances and losses, it is vital that clear and adequate information is retained relating to each category of allowance relief and, indeed, in relation to each property. In broad terms, the key information requirements are as follows:

- split of specified/unspecified reliefs being carried forward before the introduction of the "high earner" restriction in 2007,
- use of Case V losses and capital allowances,
- use of Case I losses and capital allowances,
- record of specified reliefs carried forward under s485F as a result of the "high earner" restriction,
- back-up for qualifying expenditure in relation to buildings in respect of which capital allowances are being claimed,
- bible of legal agreements put in place in relation to the acquisition/construction of tax-based investments,
- all relevant documentation (e.g. planning application acknowledgements, local authority certificates etc.) in a situation where a project qualified for allowances under the terms of any transitional rules.

We are aware of instances where Revenue has requested information to support the qualifying expenditure in relation to various

tax-based projects. It is particularly important to retain adequate back-up documentation to support the qualifying expenditure where, perhaps, a project has not been fully completed by the end of the qualifying period and, therefore, only a portion of the cost qualifies for capital allowance purposes.

Although VAT on property transactions is outside the scope of this article, care should be exercised in relation to maintaining all VAT records in respect of a property attracting enhanced capital allowances that is the subject of an investor group sale and leaseback arrangement. In many cases, these transactions will have been entered into before the introduction of the new VAT on property regime in July 2008. It is important, in the context of the unwind of any such transactions, that due care is exercised in relation to VAT and, in particular, regarding whether any sale, assignment or surrender arising on an unwind is chargeable to VAT in accordance with the transitional rules or with the new rules.

Non-Resident Landlords

In the current economic climate, many people are relocating from Ireland to work abroad. In many instances, these individuals continue to hold either their principal private residence in Ireland and/or Irish investment property. It is important, therefore, that individuals are aware of their Irish tax obligations arising from property ownership, even though they may no longer be tax-resident in Ireland.

The key points to remember are as follows.

PRTB registration

There is a requirement for all landlords of residential property to register their tenancies with the Private Residential Tenancies Board (PRTB). The landlord is required to register each new tenant in the property. Where the same tenant stays in the property for a number of years, the requirement to re-register arises only every four years. PRTB registration is important, as a deduction for interest relief is available only where a valid PRTB registration is in place (in accordance with s97 TCA 1997).

Household charge

Liability to the household charge arises in respect of residential properties, even where the landlord is not resident in Ireland.

Non-principal private residence charge

It is important to remind clients of their obligation under the NPPR charge, particularly in the context of properties that may have been their principal private residence before leaving Ireland. The carve-out for principal private residence would no longer apply and, therefore, this charge would arise.

CGT – principal private residence exemption

Periods of time spent abroad may impact on the availability of full principal private residence (PPR) relief for capital gains tax purposes. Section 604 TCA 1997 provides for PPR relief to be preserved during periods spent working outside of Ireland, but there are certain conditions attaching. For example, if you are required to work abroad as part of your employment, you must live in the property both before and after the period of absence to preserve the availability of the relief for the period during which you are absent from Ireland. The maximum period of absence in this case is four years.

The legislation is quite strict, however, in terms of the applicability of the carve-outs. For example, you cannot have any other house eligible for the relief throughout your period of absence. You must have worked in an “employment or office” throughout the period during which you were abroad. Arguably, therefore, if you have periods where, for example, you are not working and perhaps travelling, does the relief continue to apply?

The legislation refers to the exemption applying for periods of “employment”. Therefore, it would appear that the provisions do not apply to self-employed individuals. Alternatively, if an individual is an employee of a company that they own, they would be entitled to the relief.

Overall, therefore, this is something that requires consideration. Notwithstanding the substantial reductions in property prices, there may still be significant gains inherent in properties that have been held by owners for longer time periods. Therefore, it is worthwhile to consider structuring their affairs to ensure that, where possible, the entitlement to PPR CGT relief is preserved.

Obligation to file an Irish tax return

In the case of rents being paid to a non-resident landlord, tenants are obliged to deduct a 20% withholding tax and pay this over to Revenue. Alternatively, if an Irish agent is appointed to collect rents, there is no obligation to deduct this withholding tax.

Any net taxable rents after deductions for allowable interest, expenses etc. could give rise to a liability to Irish tax and an obligation to file a tax return.

Caretaker arrangements

From a practical perspective, in some instances individuals may allow friends and/or family members to occupy their properties while they are abroad, free of charge, under a caretaker-type of arrangement. This potentially gives rise to gift tax issues arising from the free use of the property. The value of the benefit is calculated by reference to the market rent achievable for the property. Clearly, any costs of maintenance borne by the individual occupying the property reduce the value of any benefit received. In addition, the annual small-gift exemption/tax-free threshold amount should help to reduce/eliminate any gift tax liability arising. Nonetheless, this is something that needs to be monitored in the context of properties that are being occupied rent-free.

Owner-occupier reliefs

Many of the reliefs that were available on the basis that the property was the PPR of the individual may no longer apply once the individual leaves Ireland. Examples include the entitlement to tax relief at source in respect of mortgage interest, stamp duty reliefs for owner-occupiers and capital allowances for owner-occupiers. Therefore, the relevant notifications need to be given to Revenue/the financial institution to ensure that, where appropriate, these reliefs are no longer claimed.

In the context of a property that is the subject of a gift/inheritance, and in respect of which dwelling-house capital acquisitions tax relief was claimed, the recipient is required to occupy the property as his or her PPR for a period of six years from the date of the gift/inheritance. There is a carve-out to this requirement in respect of any period of absence during which the individual works in an “employment or office”, all of the duties of which are carried on outside of Ireland. Although there is no time restriction on the length of the absence (as with capital gains tax PPR relief), the carve-out is somewhat restrictive in that it refers to “employment” arrangements only.

Overall, therefore, there is a checklist of items that need to be considered in the context of individuals moving from Ireland to work abroad. In many instances, the key focus of individuals is setting up abroad, which means that their obligations in respect of their Irish properties can sometimes be overlooked. We are aware that this is an area of Revenue scrutiny and, therefore, any oversights could prove to be costly in terms of unpaid taxes, interest and penalties.

Conclusion

Although the property “boom” has long since turned to “bust”, the tax rules continue to apply, and the impact of the “high earner” restriction rules, coupled with the FA 2012 guillotine rules, has made the situation all the more complex. Tracking allowance claims and allowances forward and determining the availability, or otherwise, of those allowances for use in the future are of fundamental importance to any property owner. In an environment where taxpayers are, for the most part, hard-pressed to meet tax bills and Revenue is under increased pressure to maximise yield, there is no scope for error.

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