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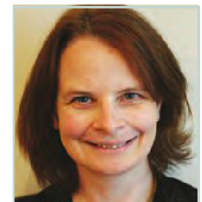
The Tax Man Cometh



Us Irish are drawn towards owning property and nobody likes paying tax. In Revenue's eyes, this is a potentially dangerous mix and the taxman has been targeting landlords since the origins of the Irish property love affair. Finola O'Hanlon and Brian Broderick say that this time, Revenue might just have it nailed

An article in the previous edition of this publication highlighted the fact that there were 5,534 audits and other compliance interventions in relation to rental properties in 2014. Approximately 539 of these were full scale audits which resulted in a yield of €22.4m (average yield of circa €42,000) and 4,995 were non-audit compliance interventions resulting in a yield of €21.7m (average yield of circa €4,000). The conclusions that can be drawn from this are that Revenue should continue to focus on the rental sector, and it is in taxpayers' interests to try and avoid a rental income audit.

Revenue Sources

Revenue is drawing information from a variety of different sources to facilitate the review of landlords. At the Public Accounts Committee hearing the Revenue chairman Mr Niall Cody said on July 2nd 2015 that:

> *"We select cases for intervention based on the presence of various risk indicators and other information available to us. Third-party information is a really important element... Matching this data against returns filed by taxpayers... has been a feature of our compliance strategy for many years. This approach is particularly relevant in the rental income sector where significant amounts of third-party information is made available to Revenue and matched to landlord records. Currently this data includes Private Residential Tenancies Board data, rent subsidy payments from the Department of Social Protection, rental accommodation scheme payments from the Department of the Environment, Community and Local Government, student accommodation lists, letting agent returns, non principal private residence data and of course our own local property tax data."*

Revenue also has information from stamp duty returns and Home Renovation Incentive (HRI) records. The extension of the HRI scheme to landlords in the Finance Act 2014 allowing landlords to carry out improvements or repairs on a rental property and avail of relief on the cost, may have been as much about encouraging tax compliance as providing landlords with a tax break.

Revenue officials have also been known to focus on housing estates where there's a high level of rental properties, carrying out door-to-door checks within these estates.

The Local Property Tax (LPT) register may be the jewel in the crown for Revenue when it comes to tracking rental properties. The LPT register gives Revenue a clear picture of the number of houses and other dwellings in Ireland. And together with other Revenue information (e.g. taxpayer correspondence addresses), Revenue can identify the properties that are not occupied by owners and therefore may be available to rent.

In addition, the linking of the LPT data with PPS numbers means that Revenue can identify the taxpayers that hold more than one property and who are potentially active as landlords.

In most cases, Revenue will give a taxpayer who has undeclared rental income an opportunity to make an unprompted voluntary disclosure by raising a compliance query, rather than launching an audit

Water Charges

Water charges have been a hot topic of late and Irish Water has asked landlords to provide it with tenants' details so that Irish Water can bill the tenants.

There was a potential data protection issue for landlords but a new S. 23A Water Services (No 2) Act 2013 (inserted by S.47 Environment (Miscellaneous Provisions) Act 2005) requires landlords to notify Irish Water of tenants' details and makes the landlord liable for water charges if he fails to provide these details. An article by Gary Fitzgerald in the August/September issue of the *Law Society Gazette* deals with this issue in more detail.

Dealing with Undeclared Rental Income

In most cases, Revenue will give a taxpayer who has undeclared rental income an opportunity to make an unprompted voluntary disclosure by raising a compliance query, rather than launching an audit. The benefits of making such an unprompted voluntary disclosure are that reduced penalties apply and publication as a defaulting taxpayer is avoided.

If a landlord has undeclared rental income and Revenue have not raised a query, it may be possible to minimise interest and penalties by declaring the rental income on a voluntary basis. Given the Revenue focus on rental properties, consideration should be given to regularising historic income tax returns in cases where tax has been underpaid on rent.

Reliefs

There are few tax reliefs for residential rental income. The main reliefs are rent-a-room relief and the well-known Section 23 relief. The Section 23 type reliefs operated to generate a large rental loss when an investment property was purchased, constructed or refurbished. Most landlords who were eligible would have claimed and used this relief a number of years ago, so Section 23 relief is now most relevant in the context of property sales. The sale of a Section 23 property within 10 years of first letting can result in a clawback of tax relief claimed.

The rent-a-room relief allows a taxpayer to rent a room (or rooms) in a residence free of income tax if the income does not exceed €12,000 per annum and the residence is the taxpayer's main residence. This relief has seen some media coverage recently as Revenue has indicated that income arising from online accommodation booking sites such as Airbnb is trading income – and not rental income, so rent-a-room relief would not be available.

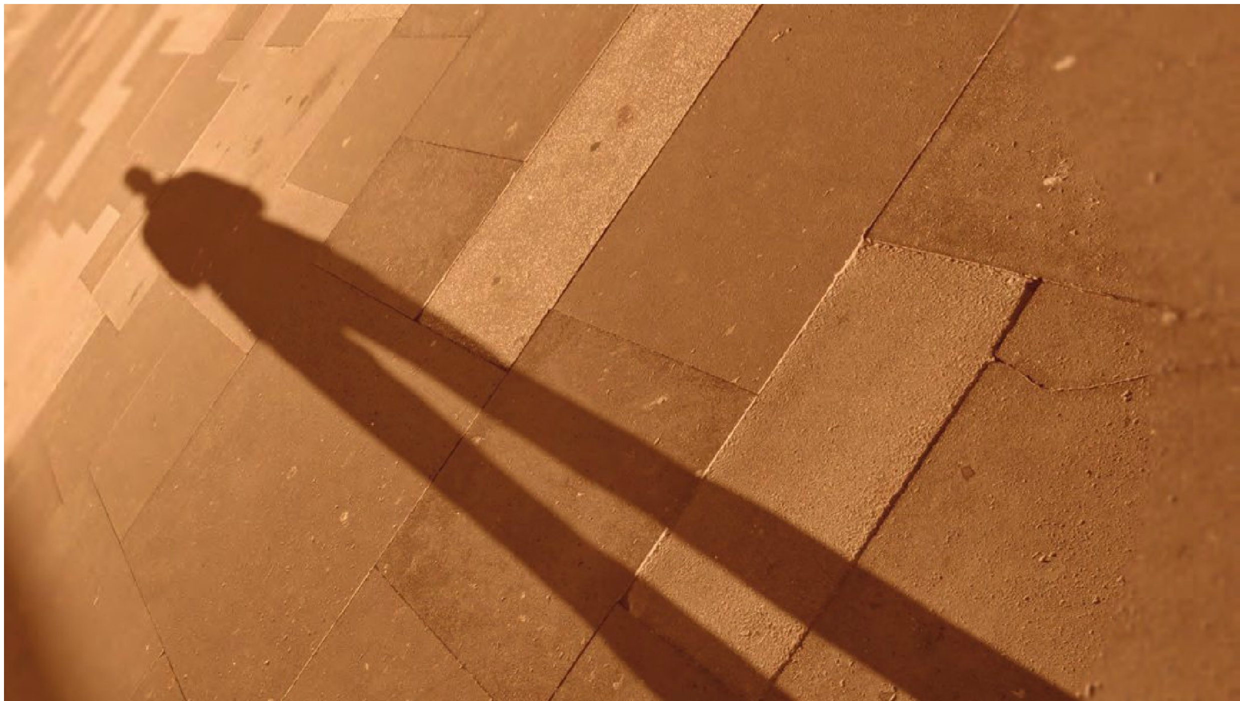
Deductions

Some deductions are available for expenditure incurred by a landlord renting property.

The expense must be incurred by the taxpayer and cannot be capital in nature; i.e. the expense must relate to maintenance or repair of the property rather than improvement of the property. When calculating the taxable profit on more than one rental property, a separate calculation should be done for each property and the following expenses may be deducted:

- Ground rent
- Rates payable to a local authority
- The cost of any service or goods provided to the tenant which are included in rent – (e.g. gas, electricity, water and refuse collection)
- Maintenance costs for the property – e.g. cleaning, painting and decorating
- Insurance of the premises against fire and public liability, etc.
- Costs of management – e.g. the actual cost of collection of rents and advertising for tenants, legal fees to cover the drawing up of leases, or the issue of solicitors' letters to tenants who default on payment of rent
- Accountancy fees paid for the preparation of a rental account
- The costs of repairs such as damp and rot treatments, mending broken windows and doors, and replacing roof slates.

Interest arising on a loan used to purchase, improve or repair a rental property can be claimed as a deduction from rent and certain mortgage protection policy premiums taken out to secure the loan, will also be allowed. It should be noted that if a mortgage is on a 'capital and income' basis the capital element of the mortgage repayments cannot be deducted for income tax purposes. The lending institution will issue a letter or interest certificate after the end of each calendar year advising of the interest charged on the loan in the course of that year. From April 7th 2009, only 75% of the interest paid on a loan for a residential property can be deducted.



Since 2006, a landlord needs to have registered with the Private Residential Tenancies Board (PRTB) to claim an interest deduction. A PRTB registration lasts for four years, so if a tenancy continues beyond four years the tenancy needs to be re-registered.

Expenses Not Allowed

The following expenses are not allowed as a deduction in calculating the net rental income subject to income tax:

- Pre-letting expenses, (an exception is made for auctioneer's letting fees, advertising fees and legal expenses incurred on first lettings, which are allowed)
- Post-letting expenses – i.e. expenses incurred after the final letting
- Capital expenditure (generally allocated to CGT, not income tax)
- Local authority charges (e.g. the €100 household charge and the €200 NPPR charge)
- Local property tax

The Revenue will not allow an expense claim unless a payment has been made, so a taxpayer who works on his own rental property is not allowed to claim a deduction for the value of his own labour.

Capital Allowances

Wear and tear allowances are available for the capital cost of fixtures and fittings (furniture, kitchen appliances etc.) provided to furnish rented residential accommodation. The expenditure must be incurred wholly and exclusively on a property which is used solely as a dwelling and let, furnished on *bona fide* commercial terms on the open market. The rate of wear and tear allowed depends on when the capital expenditure was incurred. For expenditure incurred on or after December 4th 2002, the allowance is 12.5% per annum and the allowances are granted over a period of eight years.

It should be noted that if a mortgage is on a 'capital and income' basis, the capital element of the mortgage repayments cannot be deducted for income tax purposes

Full tax relief is available on expenditure qualifying for capital allowances and the primary difference between capital allowances and the deductions outlined above is, that capital allowances expenditure is relieved over an eight-year period instead of a single 100% deduction in the year that the expenditure is incurred.

Conclusion

If rental income is being returned to Revenue, a landlord will want to ensure that the above deductions and allowances are claimed (insofar as they are applicable) to minimise tax liabilities. This should be a taxpayer's focus when returning historical, undeclared rental income or filing annual income tax returns.

Given the yield from compliance interventions on rental properties, it's likely that Revenue will continue to focus on landlords and to encourage income tax compliance.