# Property Investment
## a comparative analysis

**by Vincent Lynch**

Television series like *Location, Location, Location* are making more and more people think about property as an investment or even as a pension alternative. But there are some long term tax issues investors need to consider. Vincent Lynch took a look at them for the IPOA and in this article outlines the key points to bear in mind.

Over the past number of years a growing interest has developed in Ireland in property investment in the both the home and overseas markets. Investing in property for the long-term or as a pensionable option offers appeal to a wide-ranging spectrum of people who have invested in either one or more properties at home. But how viable is it to invest in Irish property at the moment and what sort of a return can be expected for your investment? A recent report commissioned by the Irish Property Owners Association (IPOA)[1] detailed the financial implications of being a property investor.

## INCOME TAX

### Rental Profit

Net Rental Profit from Investment Property is liable to Income Tax at the taxpayer's marginal rate. The allowable expenses which commonly arise in arriving at Rental Profits are:

- Rates
- Interest on Loans to buy or refurbish
- Maintenance
- Insurance
- Depreciation on Fixtures
- Accountancy Fees
- Mortgage Protection Premiums

### Special Reliefs

Investors may claim a deduction from Rental Income based on the construction cost of the following buildings:

- Those situated in certain designated areas
- Student accommodation (Section 50)
- Child Care Facilities
- Nursing / Convalescent Facilities, Housing Units for the Aged
- Hospitals or Sports Injury Clinics

Allowances available on the latter three categories are not restricted to Rental Income only. There is a limited transfer of allowances, up to €31,750, against Other Income.

### Retirement Annuity Relief

There is no relief against Rental Income for contributions to a Personal Pension Scheme. However, for a self-employed trader, contributions of up to 30% of trading profits qualify for relief at the taxpayer's marginal rate.

## VAT

This is now a particularly complex area but some general principles apply:

- VAT @ 13.5% may be added to the purchase price of a property depending on the Vendors circumstances and, in any case, will only arise where the property has been developed since 1972.
- Income from Short Term Lettings (under Lease or Tenancy of less than 10 Years) is exempt from VAT unless the Landlord waives his entitlement to the exemption. Therefore, the VAT content of Maintenance or other Management outlay will generally be an irrecoverable cost.
- A residential investor who waives the exemption on Short Lettings will have a positive Cash Flow in Year 1 when purchasing a new property.

*Example:*

| | € | VAT Content € |
|---|---|---|
| Cost of Residential Property | 500,000 | 59,471 |
| Annual Rental Value | 18,000 | 3,124 |
| Net VAT Claim Year 1 | | 56,347 |

- The creation of a Long Lease (period greater than 10 Years) usually gives rise to a VAT liability of 13.5% of the capitalized value of the Lease.

## CAPITAL GAINS TAX

Profit from the sale of an Investment Property is liable to Capital Gains Tax at 20%. Taxable Profit is calculated as Sale Proceeds less Purchase/ Enhancement Costs after indexing for inflation (no indexation after 2003).

Investment Property does not qualify for Retirement Relief. Under the Retirement Relief provisions a gain accruing to an individual over 55 from sale of his farm or business may be wholly or partially exempt from Capital Gains Tax.

The Rollover Relief that applied to certain residential properties was abolished for disposals after 4th December 2002.

## CAPITAL ACQUISITIONS TAX

Unlike certain other assets, Investment Property does not qualify for any reliefs under the Capital Acquisitions Tax legislation. Accordingly, Investment Property passing from parent to child which has a value in excess of the personal threshold of €466,725 will attract a CAT liability at 20% on the excess.

Certain other Assets qualify for a deduction of 90% from Market Value in arriving at Taxable Value for CAT purposes. These other Assets are:

- Agricultural Property (includes land, livestock and machinery)
- Business Assets (include property used for the purpose of a trade and Shares in a trading company)

## STAMP DUTY

Stamp Duty is payable at the following rates:

**RESIDENTIAL**

| Value | Rate |
|---|---|
| Up to €127,000 | Nil |
| €127,001 - €190,500 | 3% |
| €190,501 - €254,400 | 4% |
| €254,401 - €317,500 | 5% |
| €317,501 - €381,000 | 6% |
| €381,001 - €635,000 | 7.5% |
| Over €635,000 | 9% |

**OTHER PROPERTY**

| | |
|---|---|
| Up to €10,000 | Nil |
| € 10,001 - € 20,000 | 1% |
| € 20,001 - € 30,000 | 2% |
| € 30,001 - € 40,001 | 3% |
| € 40,001 - € 70,000 | 4% |
| € 70,001 - € 80,000 | 5% |
| € 80,001 - €100,000 | 6% |
| €100,001 - €120,000 | 7% |
| €120,001 - €150,000 | 8% |
| Over €150,000 | 9% |

The rates are reduced by 50% when property is transferred to a child or other defined relatives

No stamp duty is payable on the transfer of agricultural land to certain young farmers.

| SUMMARY OF TAX RELIEFS ON PROPERTY | | |
|---|---|---|
| | Farm / Business Assets | Investment Property |
| CGT Retirement Relief | Yes | No |
| CAT - Reduction to 10% of Market Value | Yes | No |
| Stamp Duty Relief | Yes (certain young farmers) | No |
| Pension Contributions allowed against Income | Yes | No |

## TRANSFER OF FARM/ BUSINESS TO CHILDREN

### Capital Gains Tax - Retirement Relief S.599 TCA 1997

No Capital Gains Tax will be payable on the transfer of agricultural or business assets to a child subject to the following conditions:

The transferor is over 55 years at date of transfer.

The assets being transferred have been owned for a period of 10 years ending with the transfer. The assets have been in use for the purposes of the trade for the 10 year period of ownership ending with the transfer.

If it is disposed of within 6 years the recipient becomes liable for the Capital Gains Tax which would have been payable on the transfer along with the Capital Gains Tax on the sale.

### Capital Acquisitions Tax - Agricultural Relief

The market value of agricultural property e.g. land, machinery, livestock, is reduced by 90% where the following conditions are met:

At least 80% of the recipients assets after the transfer must consist of agricultural assets. He must be resident in Ireland at the date of transfer and remain resident for three years following the year of transfer. There is no condition that he has ever farmed or will ever farm.

Additionally a gift of property (including cash) other than agricultural property will qualify for the relief providing it is stipulated that the gift be invested in agricultural property within 2 years.

The recipient must hold the property for 6 years to avoid a clawback of the relief.

### Capital Acquisitions Tax - Business Property

The market value of property being transferred is discounted by 90% subject to the following conditions:

| TRANSFER OF ASSETS TO CHILDREN - ILLUSTRATION OF TAX COSTS | | | | |
|---|---|---|---|---|
| | **Farm / Business** (See Table 1 below) | | **Investment Property Purchased 1995** (See Table 2 -opposite right) | |
| Market value 2005 | €1m | €3m | €1m | €3m |
| | € | € | € | € |
| Capital Gains Tax (Transferor) | Nil | Nil | 81,546 | 245,146 |
| Capital Acquisitions Tax (Transferee) | Nil | Nil | 25,109 | 261,509 |
| Stamp Duty (Transfreee) | 45,000 | 135,000 | 45,000 | 135,000 |
| Total Cost | 45,000 | 135,000 | 151,655 | 641,655 |

This illustration assumes the transfer of Farm/Business Assets qualifies for reliefs as outlined in this article.

Stamp Duty: Where land is transferred to a young trained farmer before 31st December 2005 no Stamp Duty arises.

| ***Table 1*** **TRANSFER OF INVESTMENT PROPERTY** | | |
|---|---|---|
| Market Value | €1m | €3m |
| Capital Gains Tax | € | € |
| Cost 1995 (Assume 8% growth p.a. | 463,000 | 1,389,000 |
| Index @ 1.277 | 591,000 | 1,773,000 |
| Chargeable Gain | 409,000 | 1,227,000 |
| CGT @ 20% | 81,546 | 245,146 |
| Capital Acquisitions Tax | | |
| * Class Threshold | 466,725 | 466,725 |
| Taxable | 533,275 | 2,533,275 |
| Tax @ 20% | 106,655 | 506,655 |
| ** Credit for CGT | 81,546 | 245,146 |
| Net CAT | 25,109 | 261,509 |

* Assuming no other gifvts or inheritances from parents since December 1991.

**Although the Capital Gains Tax is payable by the transferor it is allowed as a credit against the Capital Acquisitions Tax payable by the transferee (Sec. 104(1) CAT CA 2003)

The property must have been owned and used by the transferor for the purposes of his business for at least 5 years. Shares in companies dealing in land, shares, securities or currencies do not qualify as business property.

The assets must be retained by the recipient for 6 years to avoid a clawback of the relief.

| ***Table 2*** **TRANSFER OF FARM / BUSINESS** | | |
|---|---|---|
| Capital Gains Tax | No liability assuming Retirement Relief | |
| Capital Acquisitions Tax | | |
| | € | € |
| Market value of farm / business assets | 1,000,000 | 3,000,000 |
| Relief (90%) | 900,000 | 2,700,000 |
| Taxable Value | 100,000 | 300,000 |
| * Class Threshold | 466,725 | 466,725 |
| Taxable Amount | Nil | Nil |

*Assuming no other gifts or inheritances from parents since 5th December 1991.

The full IPOA report is available from the IPOA.See www.ipoa.ie

Notes

[1]The IPOA was founded in 1993 in response to the then government's introduction of extensive regulations governing the private rented service industry and seeks to protect and promote the interests of private residential property owners and encourage the supply of good quality accommodation and professional standards of management. It is the only association in Ireland representing the providers of private rented accommodation.

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