

# 16 Taxation of Rental Income

- 16.1** For tax purposes, rental income is the net income of property owners arising from the occupation or use of the property by others.<sup>1</sup> Sources from which rental income may be derived include
- the letting or rental of residential, commercial or agricultural property (in Ireland or elsewhere)
  - easements<sup>2</sup>
  - the granting of sporting rights and permits and
  - insurance payments received to compensate for non-payment of rent.
- 16.2** Income earned by individuals from the letting of domestic and foreign residential or commercial property is taxable under self-assessment income tax, while rental income earned by companies is assessable for corporation tax.
- 16.3** The focus of this report is on rental income earned by individuals. It provides an overview of the taxation of rental income accruing to individuals and, in particular, reviews
- the effectiveness of systems in place for identifying rental property owners and managing taxpayer compliance
  - progress by Revenue in implementing the recommendations of a 2006 report regarding data sharing and record matching with third party sources of information<sup>3</sup>
  - compliance work undertaken by Revenue in relation to rental activity in the shadow economy.

## Declared Rental Income

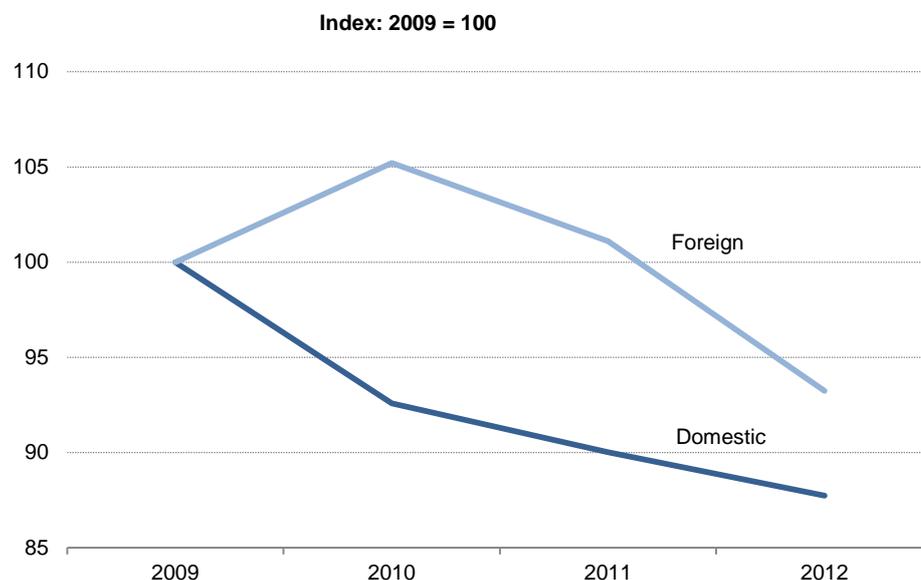
- 16.4** Individual taxpayers declared gross rental income of €4.4 billion to Revenue in respect of the 2012 tax year<sup>4</sup> of which
- €4.0 billion related to rents from property in Ireland (domestic rents), and
  - €0.4 billion related to rents from property elsewhere (foreign rents).
- 16.5** The amount of gross domestic rental income declared by taxpayers fell by 12% between 2009 (€4.6 billion) and 2012 (€4.0 billion). Declared gross rental income from foreign properties decreased by 7% during the same period (see Figure 16.1).

<sup>1</sup> Net rental income is gross rental income net of allowable expenses.

<sup>2</sup> An easement is a right of use of the property of others.

<sup>3</sup> Section 3.10, Report of the Comptroller and Auditor General 2006.

<sup>4</sup> The latest year for which data is available is 2012. Returns for 2013 are due at the end of October 2014.

**Figure 16.1 Index of declared rental income, 2009 – 2012**

Source: Office of the Revenue Commissioners. Analysis by the Office of the Comptroller and Auditor General.

- 16.6** Owners of rental properties are entitled to claim deductions and reliefs from gross rents for various expenses relating to their rental property.

### ***Deductible Expenses***

- 16.7** Revenue applies three main rules when assessing a person's right to claim expenses in order to reduce a rental income tax liability. The rules are that
- the expenses have been incurred by the landlord
  - the expenses are not of a capital nature
  - expenditure must generally be incurred during the period in which the landlord is entitled to receive rental income.
- 16.8** Some examples of expenses that may be claimed are repairs, insurance, advertising or property maintenance costs, accountancy fees in relation to the preparation of a rental account and management fees.
- 16.9** A deduction is also available for mortgage interest on loans used to purchase, improve or repair a rented residential property. The entitlement to a deduction for mortgage interest is conditional on compliance with the registration requirements of the Residential Tenancies Act 2004.

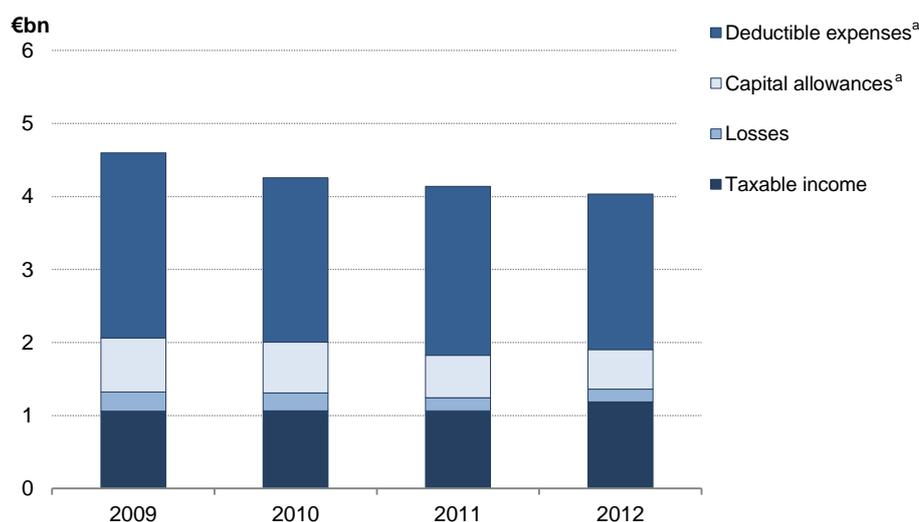
### Capital Allowances and Losses

- 16.10** Wear and tear allowances are available to landlords in respect of capital expenditure incurred by a landlord to furnish a rental property. The rate of the wear and tear allowance is 12.5% a year for eight years.
- 16.11** In circumstances where the taxpayer has incurred a loss following deduction of expenses and capital allowances from gross rental income, the unused capital allowances and other losses may be carried forward to offset against tax on rental income in future years.<sup>1</sup>

### Taxable Rental Income

- 16.12** Over the period 2009 to 2012, the effect of deductions for losses, expenses and capital allowances has been to reduce taxable rental income to between 23% (2009) and 29% (2012) of gross domestic rental income (see Figure 16.2).

**Figure 16.2 Taxable domestic rental income, 2009 – 2012**



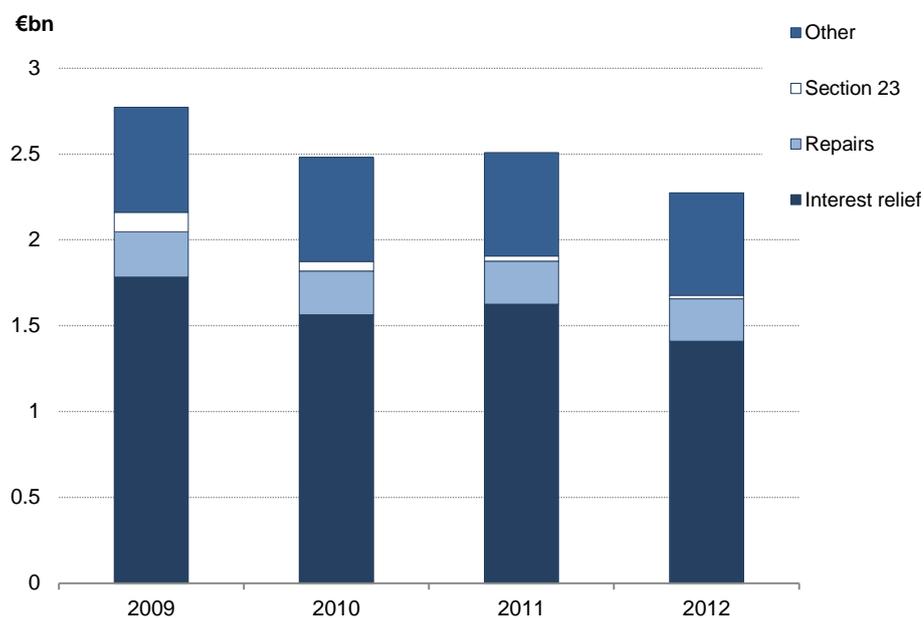
Source: Office of the Revenue Commissioners

Note: <sup>a</sup> Figures shown relate to deductible expenses and capital allowances used each year.

- 16.13** Notwithstanding the 12% (€564 million) decline in domestic gross rental income, the amount of rental income chargeable to tax increased by 12% from €1.06 billion to €1.19 billion between 2009 and 2012. This was attributable to a number of factors – deductible expenses fell by 16% (€411 million) while capital allowances and losses used against rental income declined by 26% (€194 million) and 33% (€87 million) respectively.
- 16.14** The biggest change in deductible expenses was in allowable interest which fell by 21% from almost €1.8 billion to just over €1.4 billion while section 23 type relief fell by 81% to €21 million.<sup>2</sup> Figure 16.3 shows the changes in deductible expenses claimed each year.

<sup>1</sup> Revenue Commissioners, IT 70, *A Guide to Rental Income*.

<sup>2</sup> Section 23 relief is a tax relief that applies to rented residential property in tax incentive areas.

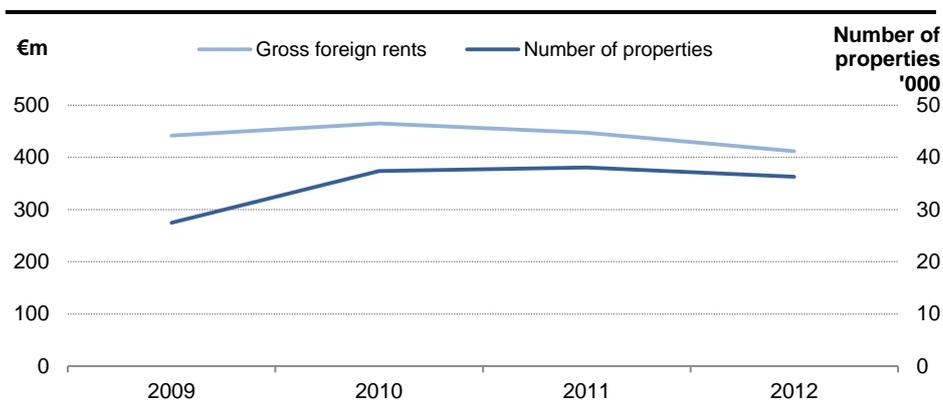
**Figure 16.3 Deductible expenses claimed 2009 – 2012**

Source: Office of the Revenue Commissioners

- 16.15** Significant unused capital allowances and losses were carried forward at the end of 2012
- unused capital allowances amounted to €1.96 billion – this represents almost four times the amount of capital allowances used in 2012
  - unused losses amounted to €1.89 billion, over ten times the amount of losses that were used in 2012.
- 16.16** Interest on loans to purchase, improve or repair a rental property is deductible for rental income tax purposes, subject to certain conditions, for example compliance with registration requirements of the Private Residential Tenancy Board (PRTB) for all tenancies that existed in the premises in the period for which the interest allowance is being claimed. In April 2009, as a result of a budget decision, a 75% restriction was placed on the allowable rental income deduction in respect of interest. The introduction of this restriction, combined with falling interest rates, resulted in the amount of allowable interest falling from €3 billion in 2008 to €1.8 billion in 2009, and then to €1.4 billion in 2012.

### Foreign Rental Income

- 16.17** The number of foreign rental properties declared to Revenue increased by 32% between 2009 and 2012, while the amount of gross rental income declared in respect of foreign properties fell by 7% to just over €0.4 billion during the same period (see Figure 16.4).

**Figure 16.4 Foreign rental income and number of foreign properties, 2009 – 2012**

Source: Office of the Revenue Commissioners

**16.18** Revenue stated that it is not possible to determine all the reasons for the sharp increase in the number of foreign rental properties reported to Revenue between 2009 and 2010, but considers that it is most probably due to a combination of increased purchase of foreign properties in prior years, an increase in letting of properties which were previously family holiday homes, and a degree of response to greater awareness of exchange of information between tax authorities and Revenue's compliance activities in relation to offshore assets.

**16.19** In response to a query as to why gross rental income did not increase commensurate with the rise in the number of foreign rental properties declared, Revenue stated that the two most likely reasons are that yields from rental properties dropped due to the overall economic situation and that some of the newer buy-to-let property purchases are in less attractive markets, with lower average rents.

### ***Taxation of Foreign Rental Income***

**16.20** Rental income earned by an Irish resident from a property situated outside the State is taxable in the State notwithstanding that such rental income may also be taxed in the country in which the property is situated. However, in circumstances where the individual is not Irish domiciled, tax is only due on the amount of foreign net rental income remitted to the State.

**16.21** Double taxation agreements ensure that a taxpayer does not pay income tax twice on the same income. Credit is given by Revenue for any tax paid overseas in respect of foreign rental income that is also taxed in the State. These credits have been around €20 million annually since 2010 (see Figure 16.5).

**Figure 16.5 Credits claimed under double taxation agreements, 2010 – 2012**

Tax year	Credits claimed € million
2010	21
2011	20
2012	18

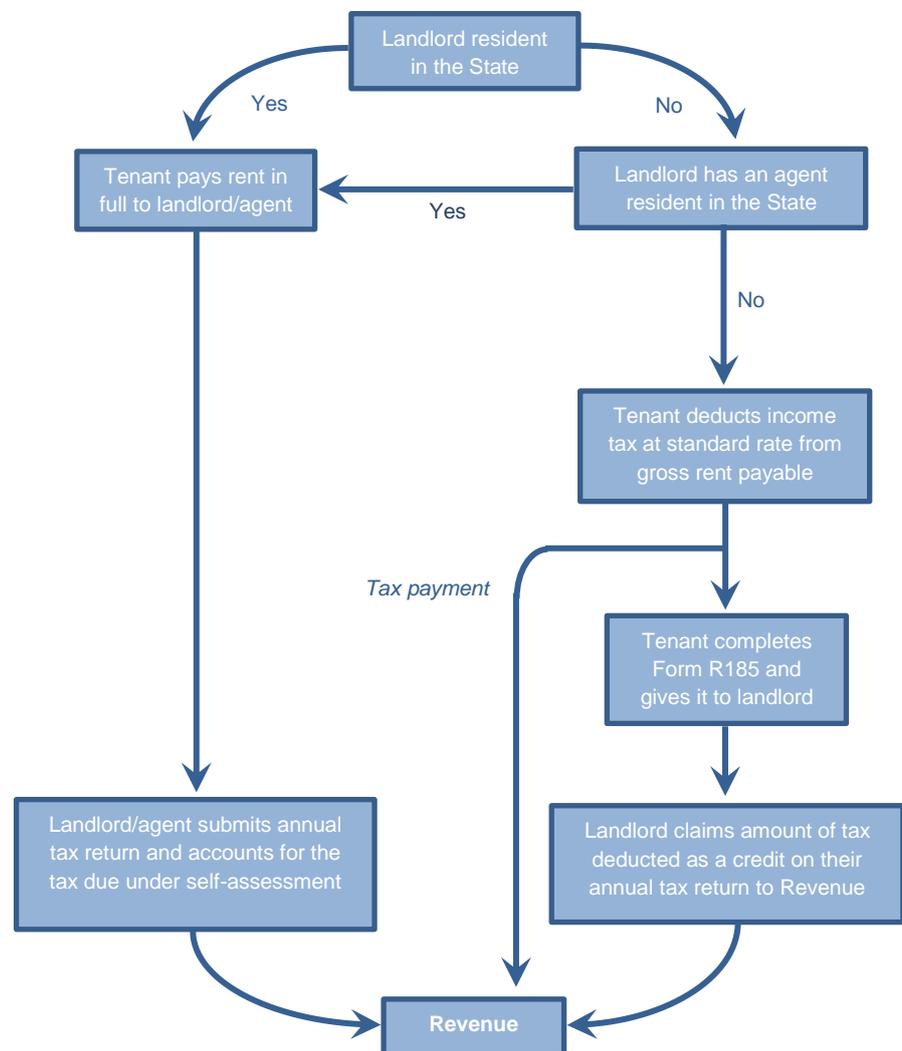
Source: Office of the Revenue Commissioners

**16.22** Other countries are not obliged to notify Revenue in respect of property purchased by Irish residents. Non-compliant foreign property owners are most commonly identified during the course of a general tax audit.

### Returns to Revenue by Agents and Tenants

**16.23** Landlords who derive income from a property situated in the State are obliged to submit an annual income tax return to Revenue, regardless of their residency status. Filing options differ depending on where a landlord lives (or is resident for tax purposes). Figure 16.6 sets out rental income filing options for resident and non-resident landlords.

**Figure 16.6 Filing options for landlords**



Source: Analysis by the Office of the Comptroller and Auditor General

### ***Letting Agents***

- 16.24** A letting agent is a person or company, who on a professional basis arranges the letting out of property on behalf of a landlord. Letting agents and managers of property are required to submit a return, detailing the address of the rented premises, the name, address and personal public service (PPS) number of the property owner and the gross annual rent for the property.
- 16.25** The agent's return must be completed whether the agent receives rent on behalf of a landlord or if rent is paid directly to the landlord by a tenant. There is no systematic matching of the returns with Revenue's taxpayer records as the information contained on them is not captured electronically. The returns are manual and information is retained at district level. Revenue stated that checks are carried out at district level to ensure that the landlord disclosed on a letting agent's return is declaring the relevant rental income.
- 16.26** Revenue stated that it is unable to provide details of the number and value of returns filed by letting agents because the information is not captured electronically.

### ***Non-Resident Landlords***

- 16.27** Rental income from an Irish property is subject to income tax in Ireland, regardless of where a liable person resides. If a tenant makes a rental payment directly to a landlord who resides outside of Ireland, or makes a payment electronically to a non-resident landlord's bank account (either in Ireland or abroad), the tenant is obliged to deduct 20% income tax from the gross rent payable and to pay this amount to Revenue. Failure to deduct income tax may result in a tenant being liable for any tax that should have been deducted.
- 16.28** A tenant is also obliged to complete a form (R185) at the time of making payment of rent which indicates the amount of tax deducted from payment to a non-resident landlord. This form should be sent/given to the landlord, who can claim a credit from Revenue for the amount of tax paid.
- 16.29** The number of non-resident landlords from whom tax is withheld is low, but has increased in recent years. Landlords submitting R185 returns increased by 127% between 2009 (225) and 2012 (510). In 2012, landlords claimed just under €1 million in credits in respect of tax withheld from rent payments by tenants, an increase of 83% when compared with 2009 (see Figure 16.7).
- 16.30** In response to an audit query, Revenue attributed the low number of cases to many tenants of non-resident landlords not being aware that their landlord is non-resident, or not being aware of the obligation to deduct tax at source on the payment of rent to such landlords.

**Figure 16.7 Credits claimed by non-resident landlords in respect of tax withheld by tenants, 2009 – 2012**

Tax year	Credits claimed €000
2009	502
2010	538
2011	717
2012	919

Source: Office of the Revenue Commissioners

### **Collection Agent**

- 16.31** There is no obligation for a tenant to deduct tax from rental payments if a non-resident landlord has appointed an agent who lives in Ireland. The tenant pays the gross rent to the collection agent, who is required to account for the tax due to Revenue.<sup>1</sup>
- 16.32** The rent collection agent on behalf of a non-resident landlord is set up under a new PPS number on the Revenue system. While the assessment for income tax is in the name of the Irish collection agent, the tax charged is the amount attributable to the non-resident landlord as if assessed in his or her own right.
- 16.33** Revenue stated that, for the 2012 year of assessment, collection agents filed returns on behalf of just over 2,400 non-resident landlords. The total net rent, before capital allowances, amounted to just over €22 million.

### **Use of Third Party Information**

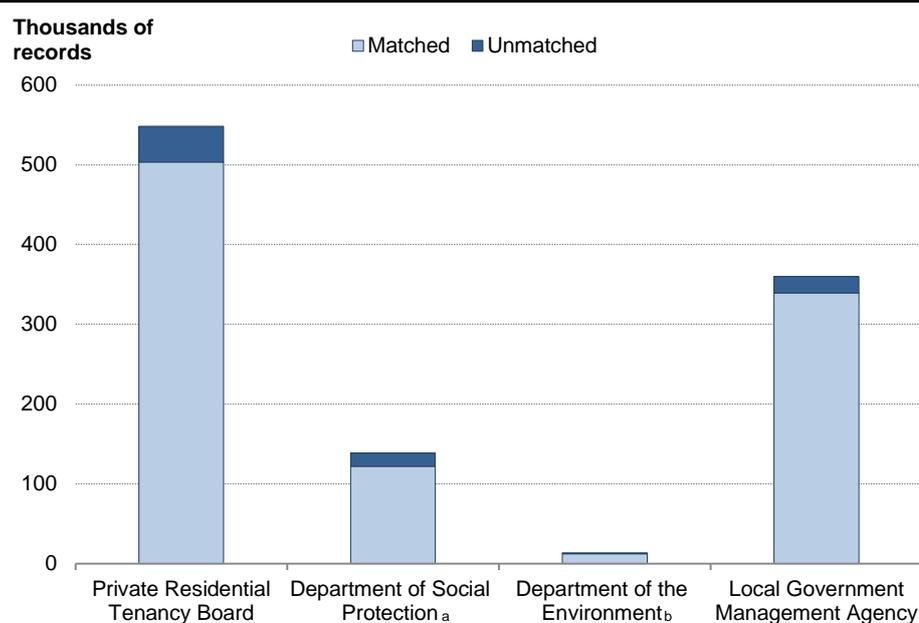
- 16.34** A previous report highlighted concerns in relation to matching records supplied by other departments and agencies. The report found that
- only 40% of rent supplement records for 2006 were successfully matched to the Revenue records of declared rental income
  - data in respect of 2006 rental accommodation payments was incomplete and in a format which did not allow any matching to taxpayers' records in Revenue's systems.
- 16.35** On foot of that report, the Committee of Public Accounts (PAC) examined the matter and in 2008, it reported a necessity for greater communication between State agencies, in order to ensure greater compliance by rental property owners.<sup>2</sup> Following on from this, Revenue sought, and subsequently received, approval from the Minister for Finance for access to the Private Residential Tenancy Board's list of registered tenancies.

<sup>1</sup> A collection agent is an Irish resident person or company, for example, a family member or professional letting agent, appointed by a non-resident landlord to collect rent on his or her behalf. Collection agents are obliged to file a return on behalf of a non-resident landlord to Revenue annually.

<sup>2</sup> Committee of Public Accounts, *Taxation of Rental Income Receipts*, Second Interim Report, September 2008.

- 16.36** For the purposes of identifying landlords who may not be declaring all rental income, Revenue uses information from four principal sources.
- Private Residential Tenancy Board (PRTB) – the PRTB operates a national tenancy registration system. Landlords are required to register details of all their tenancies within one month of their commencement with the PRTB.
  - Department of Social Protection – details in respect of rent supplement payments.
  - Department of the Environment, Community and Local Government – details of payments under the rental accommodation scheme (RAS).
  - Local Government Management Agency for information about the non-principal private residence charge. (2013 was the final year for which this charge applied.)
- 16.37** The examination found that data matching had improved significantly between 2006 and 2012. In 2012, between 88% and 94% of records received from the four principal sources of third party information were matched to Revenue records (see Figure 16.8).

**Figure 16.8 Third party sources of matched information, 2012**



Source: Office of the Revenue Commissioners

Notes: a In 2012, the value of unmatched rent supplement records amounted to €48.5 million.

b In 2012, the value of unmatched (1,401 of 13,582) rental accommodation scheme payments amounted to €10 million.

- 16.38** Revenue matches data provided with existing Revenue taxpayer information, based on unique fields, for example a tax reference or PPS number. Revenue does not have a formal system in place for dealing with unmatched records. However, Revenue pointed out that significant efforts are made to deal with unmatched records. These include
- Unmatched data from the bulk matching process are loaded onto Revenue's Integrated Business Intelligence (IBI) platform and are available to be manually searched on a name and address basis by Revenue compliance officers who have access to this system. Revenue stated that all Revenue officers are regularly reminded of the procedures in place to link unmatched data to the appropriate Revenue record when the appropriate connections have been established. This process applies to rent supplement payments and the rental accommodation scheme.
  - Revenue also has a programme of work in place to manually match unmatched rent supplement payments and rental accommodation scheme payments.
- 16.39** Revenue stated that failure to match some data from third parties to its taxpayer records does not necessarily mean that the case is non-compliant. There may be issues with reference numbers provided. Revenue also pointed out that the implementation of postcodes will be of considerable assistance in developing automated data matching.

### Targeted Audits

- 16.40** Revenue focuses on specific sectors of the economy as part of a targeted approach to identifying and pursuing non-compliant taxpayers.
- 16.41** The shadow economy (also known as the hidden economy) encompasses businesses and individuals that seek to avoid compliance with legal obligations relating to matters such as taxes and duties.<sup>1</sup> It comprises sectors of the economy most likely to deal in cash, including the property rental sector. Shadow economy activity is often carried out by individuals already in the tax system and often involves under declaration or non declaration of income to Revenue.
- 16.42** In 2012 and 2013, Revenue targeted shadow economy activities across a number of sectors for investigation. The 'rental sector' generated an overall tax yield amounting to €52 million (20% of total yield) over the two years. The cases which generated this yield include all targeted audits where the taxpayer's primary trade is in the property rental sector, whether the case was selected as part of the targeted shadow economy project or otherwise.
- 16.43** Cases selected for review by Revenue include both known and potential rental income cases (for example where rental income is not declared, but third party data or local intelligence indicates a potential source of rental income). Cases are selected at a district level by an audit case selection officer based on an analysis of information available from REAP and locally gathered intelligence.<sup>2</sup> Details for 2012 and 2013 targeted audits are set out in Figure 16.9.

<sup>1</sup> Revenue Commissioners Annual Report 2013.

<sup>2</sup> REAP is a computerised risk profiling system in use since 2008. It rates taxpayers, relative to one another, using Revenue's other systems as well as information from third parties such as the Health Service Executive, the Department of the Environment, Community and Local Government and the Taxi Regulator.

**Figure 16.9 Rental income sector yielding and non-yielding audits, 2012 and 2013**

	2012		2013	
	Number	%	Number	%
<b>Yielding audits<sup>a</sup></b>	523	71	455	72
<b>Non-yielding audits</b>	209	29	174	28
<b>Total</b>	732	100	629	100
<b>Amount yielded</b>				
– total	€27.1 million		€25.1 million	
– per yield case	€52,000		€55,000	

Source: Office of the Revenue Commissioners

Note: a A 'yielding audit' is one where undeclared (or under declared) income is detected.

### 2012 Audit Results

- 16.44** In the 2012 programme, Revenue officials conducted 732 targeted audits on individual landlords and companies in the rental income sector across six regions. The number of cases audited ranged from nine in the Large Cases Division to 186 in the East/South East region. Targeted audits in the range 160 to 170 were conducted across the other three geographical regions.
- 16.45** There was significant variation in yield across geographical regions and divisions, ranging from €0.6 million from Large Cases Division to €7.6 million in the Border Midlands West region. Details are set out in Figure 16.10.

**Figure 16.10 Rental income sector, 2012 audits**

	Number of audits	Yield € million
<b>Special Units</b>		
Large Cases Division	9	0.6
Investigations and Prosecutions Division	39	4.0
<b>Regions</b>		
East South East	186	5.3
Dublin	167	6.0
Border Midlands West	168	7.6
South West	163	3.6
<b>Total</b>	<b>732</b>	<b>27.1</b>

Source: Office of the Revenue Commissioners

- 16.46** The proportion of yielding cases in the targeted cases was over twice that of cases selected in Revenue's random audit programme (where around one-third of cases yield additional tax).

- 16.47** In response to a query, Revenue stated that all of the audit yield in the cases examined does not arise from rental income. On Revenue's registration system, a case is assigned only one sector or industry code (referred to as a NACE code). This reflects the primary income source applicable to the trade or profession, even where the taxpayer engages in multiple trades or activities.<sup>1</sup> In general, issues are identified during the course of an audit that can give rise to a liability under a number of sources of income.
- 16.48** In selecting cases focused on the shadow economy rental sector, statistics are extracted under the codes for renting and operating of own or leased real estate and the management of real estate on a fee or contract basis.
- 16.49** Revenue stated the targeted audit results reflect cases where the NACE code suggests the primary activity of the case relates to rental income but that some of the audit yields include significant amounts associated with other activities. On the other hand, audits classified under other NACE codes may include yield which arises from the rental sector.
- 16.50** The examination reviewed 17 files that were classified as rental income sector audits in 2012 and found that only around 30% of the audit yield arose from property rental activities.

## Conclusions and Recommendations

- 16.51** While declared gross domestic rental income declined by just over 12% between 2009 and 2012, taxable rental income increased by around 12% to almost €1.2 billion. Restriction of reliefs has contributed to an increase in the proportion of gross domestic rental income chargeable to tax from 23% in 2009 to just over 29% in 2012.
- 16.52** Almost €4 billion in unused capital allowances and unused losses was carried forward by taxpayers at the end of 2012, which remain to be offset against future property rental income. Even though some of the taxpayers may no longer be in the property rental business, the tax yield in the property rental sector may not rise in line with recent increases in property rentals until the accumulated amounts carried forward are used.
- 16.53** There has been a significant improvement in the extent to which Revenue matches information relevant to residential rental income from third party sources to its taxpayer records when compared with a previous examination in 2006. In line with a recommendation from the Committee of Public Accounts, the number of sources used by Revenue has increased, as has the rate of matched records.
- 16.54** Revenue uses this third party information as part of its risk assessment process. The outcome of its targeted audits of rental income in 2012 and 2013 suggest that these audits were well targeted, with over 70% resulting in additional yield. Not all of the cases audited were selected due to concerns about rental income – they are classified on this basis because the primary income source recorded for the taxpayer is property rental activities – and all of the yield does not arise from these activities. The audit found that, for a small sample of 'rental sector' audit cases, the proportion of the additional tax yielded from the audits correctly attributable to property rental activities was around 30%.

<sup>1</sup> The statistical classification of economic activities in the European Community, commonly referred to as NACE, is a standard European industry classification system.

**Recommendation 16.1**

In order to enable it to identify the source of tax yield from audits, Revenue should consider requiring officers to record the yield under a number of broad headings (e.g. retail, professional services, rental income) and collate this data. This could assist Revenue in using the outcome of audits, including random audits, to inform its targeted interventions.

**Accounting Officer's response**

Agreed. Planning for the development of a new Revenue Case Management (RCM) system is too far advanced for the recommendation to be considered for the live release but Revenue will consider the recommendation in due course for possible inclusion in later phases of RCM. However, factors that need to be taken into account in considering the recommendation include

- the clarity and reliability of the existing approach which is based on the universal NACE code system
- the cost of implementing the necessary system changes versus the value added
- the very wide variety of reasons for audit yield (the broad headings suggested would not appear to be granular enough to produce the desired results)
- the additional overhead for caseworkers in providing the necessary level of detail required to contribute in a meaningful way to improved case targeting.

- 16.55** Returns from letting agents are submitted manually to Revenue, and not recorded centrally. Therefore they cannot be used as an input to Revenue's risk profiling of taxpayers.

**Recommendation 16.2**

In order to enable it to match records from letting agents with its taxpayer records efficiently, Revenue should consider providing a facility for the electronic filing of returns from letting agents by way of the Revenue On-Line System (ROS).

**Accounting Officer's response**

Agreed. Revenue will consider providing the facility for the electronic filing of returns from letting agents via ROS. This particular return, Form 8-3, is one of a number of third party returns that are required to be filed annually. It seems practical, when considering the ROS filing approach, that Revenue consider a generic ROS filing option for all mandatory third-party returns. This will have resource implications both for ROS and for the systems where the data on these returns will be stored. The timeframe in which such a development can be delivered will be determined following a scoping exercise which will be carried out as soon as resources permit.

As always when considering a new development, Revenue will also examine whether the business process can be streamlined.

