A Revenue Guide to Rental Income

Revenue

Contents

Introduction

The purpose of this leaflet is to answer as many of the frequently asked questions about Rental Income as possible. It is aimed at the individual who is in receipt of income from lettings, whether it is from a house, flat, factory or office etc. Hopefully it will make the taxation of Rental Income easier to understand and be of assistance in working out Profit Rent and allowable expenses. While this leaflet may not cover all situations more detailed information is available from your own Revenue office.

What types of rental income are there?

- The most common type of rental income is from letting a house, flat, apartment, office, building and from bare land.
- Income from an easement, i.e., if payment is received for the right to erect advertising signs, communication transmitters, or the grant of a right of way or a way-leave.
- Income arising from the grant of sporting rights, such as fishing and shooting permits.
- Payment made by a tenant to defray the cost of work of maintenance or repairs to the premises, which is work not required by the lease to be carried out by the tenant.
- Certain reverse premiums.
- Income arising from a conacre letting.
- Service charges in respect of services ancillary to the occupation of property.
- Insurance recoveries under policies providing cover against non-payment of rent.
- Premiums and other similar sums received on the grant of certain leases, normally on non-residential property, i.e., a shop or warehouse that requires the payment of a premium by the tenant to the landlord. Where a lease of less than 50 years is granted some of the premium charged will be treated as rent. (See page 8).

What expenses can be claimed?

Broadly speaking, in calculating your rental expenses you can deduct expenses so long as they-

- are incurred wholly and exclusively for business purposes, and
- are not of a capital nature.

The following are examples of the type of expenses that may be claimed for:

- Rents payable by the landlord in respect of the property, i.e., ground rent
- Rates or levies payable on the property, i.e., water rates, refuse collection etc.
- Cost of any service or goods provided by the landlord, i.e., gas, electricity, central heating, telephone rental, cable television etc. for which they do not receive a separate payment
- Maintenance, i.e., cleaning and general servicing of the premises
- Insurance of the premises against fire, public liability insurance, etc.
- Management, i.e., actual cost of collection of rents, advertising, etc.
- 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 incurred for the purposes of preparing a rental income account.
- Wear and Tear on furniture and fittings, i.e., carpets, cookers, central heating etc. (See page 4).
- Interest paid on monies borrowed for the purchase, improvement or repair of **certain properties**. This is covered in more detail overleaf.
- Repairs, i.e., decorating and general upkeep of the property. A 'repair' means the restoration of an asset by replacing subsidiary parts of the whole asset. Examples of common repairs which are normally deductible in computing rental profits include:
  - exterior and interior painting and decorating
  - damp and rot treatment
  - mending broken windows, doors, furniture and machines
  - replacing roof slates.

  However, landlords may **not** claim a deduction for their own labour.

- Certain mortgage protection policy premiums with effect from 1 January 2002. Refer to Appendix 1.
- Capital Expenditure on certain properties under the various Incentive schemes.

What is the position with regard to interest paid on borrowings?

Certain restrictions were introduced on the deductibility of interest on borrowed money used on or after 23/4/1998, in the construction, purchase, or repair of rented residential premises in the State, or 7/5/1998 in the case of foreign residential premises. However, the relief for interest on borrowed money was restored for such interest accruing on or after 1 January 2002. There were some transitional arrangements in place in the interim period.

Relief is disallowed as respects interest accruing on or after 6 February 2003 where the let premises was purchased from the spouse of the person chargeable in respect of the rental income. However, the disallowance of interest relief does not apply in the case of legally separated or divorced persons.

What expenses can be claimed for Wear and Tear?

If a premises is let for residential purposes and it is furnished, a claim can be made for a wear and tear allowance based on the cost of the furniture and fittings. It will be necessary to retain an itemised list of expenditure incurred each year.

- With effect from 4 December 2002 the allowance is 12.5% per year over 8 years.
- For the period between 1 December 2001 and 3 December 2002 the allowance was 20% per year over 5 years. Transitional provisions apply allowing the rate of 20% per year over 5 years if the item was acquired under a written contract before 4 December 2002 and the expenditure was incurred before 31 January 2003.
- Prior to 1 January 2001 the allowance was 15% per year for the first 6 years and 10% in the 7th year.

Relief for refurbishment of certain rented accommodation effective from 6 April 2001.

Tax relief can be claimed for capital expenditure incurred, on or after 6 April 2001, on the refurbishment of rented residential accommodation.

The expenditure is allowed as a deduction over a 7 year period, i.e., the expenditure is allowed at the rate of 15% per annum for the first 6 years with the balance, 10% allowed in year 7.

To qualify, the premises must be used as a dwelling and from the date of completion of the refurbishment must be let in its entirety under a **qualifying lease** throughout the relevant period, i.e., 10 years from the date of completion of the work or if later, the date of first letting. A lease is not a qualifying lease if it enables any person to acquire an interest in the premises for a consideration less than the market value. The lessor must comply with the regulations in relation to standards for rented houses, rent books and registration of rented houses.

Where a premises ceases to be a qualifying premises or the lessor passes his or her interest in the premises to another person, the relief will be clawed back from the person who had been entitled to the relief.

Where the lessor passes on his or her interest in the premises by sale or transfer then the person who becomes owner of the premises is treated as having incurred the relevant expenditure.

If relief is given under any other section of the Tax Act, then no relief will be given under this section.

What expenses cannot be claimed for?

- Pre-letting expenses, i.e., expenses incurred prior to the date on which the premises was first let apart from auctioneer's letting fees, advertising fees and legal expenses incurred on first lettings.
- Post letting expenses i.e., expenses incurred after the period of the last letting are not allowable.
- Capital expenditure incurred on additions, alterations or improvements to the premises unless allowable under an Incentive scheme
- A deduction can be made only once. If a deduction has already been made in a person's tax computation, the amount will not be allowed as a deduction in arriving at the person's net profit/loss rent, i.e., you cannot obtain relief more than once for the same expense.
- Expenses incurred in the letting of premises on an uneconomic basis are not deductible.

Expenses incurred between lettings

Expenses incurred in the period between lettings are deductible provided the landlord was not in occupation of the premises during the period and a new lease is granted.

Rent a Room Relief

From 6 April 2001, where an individual rents a room (or rooms) in a "qualifying residence" and the gross rent received, including sums arising for food, laundry or similar goods and services and the income does not exceed €7,620 this income will be exempt from income tax by including it in the individuals tax return. Where more than one individual is entitled to the rent, the limit is divided between the individuals concerned.

The relief is available to individuals only. It does not apply to companies or partnerships. However, it can apply where individuals have the income jointly (for instance husband and wife where there is no partnership), there the limit can be divided between the individuals concerned. Individuals who rent as well as individuals who own their own home may avail of the relief.

A "qualifying residence" is a residential premises in the State, which is occupied by an individual as his/her principal private residence during the year of assessment.

Room rentals coming within the scope of this scheme will not affect the person's entitlement to mortgage interest relief or the capital gains tax exemption on the disposal of a principal private residence.

There is no deduction for expenses made in ascertaining the rental income received and if the income does not exceed the limit in the year then those profits/losses are treated as "nil" for the year of assessment.

This income is not liable to either PRSI or the 2% Health Levy but it must be included on an individuals annual income tax return.

An individual may, if they wish, elect to have any income/losses from this source assessed under the normal rules for rental income, e.g., if there is a rental loss on the room(s). To elect, complete the relevant section on your annual income tax return.

What if a premises is only partly let?

If, part of a premises is let, only expenses incurred on that part of the premises are available for set off against rental income.

For example, if rooms are let in a private house and the income received exceeds the limits of the "Rent a Room" relief, the expenses for gas, electricity, etc., are shared by all the occupants of the house, expenses applicable to that part of the house which is let are only available for set off against profit rent. Expenses should be apportioned based on the occupancy of the house, i.e., the number of rooms occupied by tenants.

How are Premiums on Leases treated for tax purposes?

Certain premiums on leases are taxable. If a premium is paid on the granting of a short lease, i.e., if the duration of the lease is less than 50 years, the following formula is applied to calculate the amount that will be assessed as rent in the first year of letting:

$$\mathbf{P - \frac{(N-1)}{50} \times P}$$

Where **P** = **Amount of the Premium paid**

N = **The length of the lease**

This amount will be assessed in addition to any profit rent.

Example: A premises is let for a period of 18 years at an annual rent of €15,000.
A premium of €50,000 is paid.
Tax will be charged on the following amount:

Premium: €50,000 - $\frac{(18-1)}{50}$ x €50,000 =	€33,000
Rent	€15,000
Total	€48,000

How is profit/loss rent calculated?

The rental profit or loss is calculated by reference to the rent or total receipts to which the person becomes **entitled** to in any tax year (as opposed to the period to which the income relates).

Example:
Mr. White began leasing a house from Mr. Brown on 1 December 2003. Mr. White pays rent of €2,000 in 4 annual instalments on 1st of each quarter. He paid €2,000 on 1 December 2003. His landlord Mr. Brown became entitled to receive the quarters rent on that date, therefore the entire €2,000 is taxable income for 2003. It is important to note that the €2,000 is not apportioned as to make two thirds of it taxable in the tax year 2004.

A separate rental computation is prepared for each property whereby the rental expenses for each property are deducted from the related rental income for the same property in order to arrive at a surplus (i.e. income greater than expenses) or a deficiency (i.e. expenses greater than income) for each property. The total of surpluses and deficiencies are then aggregated to arrive at profits or gains arising in the year, i.e. taxable rent.

What if a loss is made?

A loss will arise if total allowable expenses are more than the rents received. This loss can be set against any other profit rent made by the landlord or carried forward against future rental profits. Such losses cannot be carried back or used to shelter non-rental income.

How is the tax due on rental income collected?

Profit rent is taxed on an actual tax year basis. For individuals taxed under the PAYE system with rental profits that are relatively small it can be arranged to have the tax collected by reduction of their tax credits and standard rate cut-off point. Otherwise, the tax due will be collected under the Self Assessment system. Leaflet IT 10 Guide to Self Assessment gives full details. This is available at www.revenue.ie, from Revenues Forms and Leaflets Service at LoCall 1890 30 67 06 or any Revenue office.

Example Rent account

A residential premises is first let at an annual rent of €15,000. The Insurance premium on the premises is €800 p.a. and Ground rent of €300 is payable. The landlord is responsible for the payment of electricity and central heating which cost €1,200. It was also necessary to carry out repairs which cost €1,900. The premises is furnished and the value of the fixtures and fittings is €7,000. Assessable rents are calculated as follows:

Gross rent		€15,000
Less:		
Insurance	€ 800	
Ground rent	€ 300	
Electricity/Heating	€ 1,200	
Repairs	€ 1,900	
Wear and Tear 7,000 x 12.5%	€ 875	€5,075
Profit rent		€9,925

The taxable rental income is €9,925.

Keeping Records

You must keep full and accurate records of your lettings from the start. You need to do this whether you send in a simple summary of your profit/loss, prepare the accounts yourself, or, have an accountant do it. All supporting records such as invoices, bank and building society statements, cheque stubs, receipts etc., should also be retained. You must keep your records for six years unless your Revenue office advises you otherwise.

What if Rents are payable to a non-resident landlord?

If a landlord resides outside the country and rent is paid directly to him/her or to his/her bank account either in the State or abroad, tax must be deducted by the tenant at the standard rate of tax (currently 20%) from the gross rents payable. **Failure to deduct tax leaves the tenant liable for the tax that should have been deducted.**

Example:

Gross rent per month	€ 1,000
Deduct tax (1000 x 20%)	€ 200
Pay to Landlord (1,000-200)	€ 800

The tenant must also give a **Form R185*** to the landlord to show that the tax has been accounted for to Revenue.

Where an agent, resident in the State, is appointed by the non-resident landlord to manage the property and the agent is collecting the rents, the rents must be paid gross to the agent. The agent is then chargeable to tax on the rents as Collection Agent for the landlord and is required to submit an annual tax return and account for the tax due under Self Assessment. Leaflet IT10 Guide to Self Assessment* provides more detailed information.

Note: The agent appointed need not be a professional person, i.e., it can be a family member or other person prepared to take on the responsibility and undertakes to make annual tax returns and account to Revenue for the tax due.

* (Available from www.revenue.ie, Revenue's Forms and Leaflets Service at LoCall 1890 30 67 06 or your local Revenue office).

How are non-resident landlords taxed?

On receipt of the annual tax return, profit rent, i.e., rent received less allowable expenses, will be assessed. The landlord is entitled to claim relief for expenses, which are usually allowed in arriving at the rental profit. The landlord is also entitled to a credit for the tax deducted by the tenant. Form R185, should be submitted by the landlord with the tax return to obtain credit for the tax retained.

How are foreign rents taxed?

In general, income from foreign property is computed on the full amount of the income arising, irrespective of whether the income has or will be received in the State. In the case of foreign rental income this income is charged under Case III of Schedule D and the same deductions and allowances are available as if the income had been received in the State. Deductions are also normally available in respect of such income for sums in respect of foreign tax paid. This income should be included in an individual's tax return on the Foreign Income panel.

These rules do not apply to a person who is not domiciled in the State or who is an Irish citizen not ordinarily resident in the State. In such cases, income tax is computed on the full amount of the actual sums received in the State from such remittances, etc. without any deduction or relief given.

Rent allowance.

Tax relief, may be claimed by a tenant paying rent to a landlord for private accommodation by completing Form Rent 1.This form is available at www.revenue.ie, Revenue's Forms and Leaflets Service at LoCall 1890 30 67 06 or from any Revenue office. The annual maximum relief allowable is given on Form Rent 1.

Capital Gains Tax.

Where a property that has been let is disposed of, Capital Gains Tax may arise on the disposal. The chargeable gain is calculated by deducting any allowable expenditure from the amount realised on the disposal.

The **allowable expenditure** may include:

- The cost of acquisition of the property and any costs of acquisition such as solicitors/auctioneers fees
- Any costs incurred in improving the value of the property
- Any costs of disposal such as solicitors/auctioneers fees.

Expenditure on costs of acquisition and improvement may be adjusted to take account of inflation. Where a disposal is made on or after 1 January 2003, the indexation relief will only apply for the period of ownership of the asset up to 31 December 2002. No relief is due if period of ownership is less than 12 months.

Further information on Capital Gains Tax generally is contained in Booklet CGT 1, Guide to Capital Gains Tax, and Leaflet CGT2 - Capital Gains Tax - Revised due dates for 2003 and following years. Both guides are available at www.revenue.ie, from Revenue Forms and Leaflets Service at
LoCall 1890 30 67 06 (within ROI only) or from any Revenue office.

This leaflet is for general information only.

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Appendix I

The text of the Article in Tax Briefing, Issue 53 on Mortgage Protection Policy Premiums is as follows:

Allowable deductions under the tax law relating to rental income are provided for in *Section 97(2) TCA 1997*. *Section 97(2)(d)* authorises a deduction in respect of *"the cost of ...management of the premises borne by the person chargeable and relating to and constituting an expense of the transaction or transactions under which the rents or receipts were received, not being an expense of a capital nature"*.

In strictness mortgage protection policy premiums are arguably not part of the cost of management of the premises but relate more to the management of the landlord's financial affairs than to the management of the premises. Such expenditure could also be argued to be capital in nature. However, Revenue recognise that financial institutions insist that such policies are put in place when sanctioning borrowings. Accordingly, Revenue, having reviewed the position, is prepared to treat mortgage protection policy premiums paid as an allowable deduction in computing rental income for income and corporation tax purposes.

The new treatment applies to returns submitted after 1 January 2002. Returns already submitted will not be reopened.

Practitioners should note that this treatment only applies to mortgage protection policy premiums. Such a policy is aimed at covering the full amount left outstanding on a person's mortgage should they die. It is often called decreasing term insurance, as the amount that needs to be covered reduces every time a payment is made, with the result that premiums are lower than those for straight insurance. This type of policy should not be confused with other products often offered by life assurance companies such as mortgage payment protection policies, keyman insurance or endowment policies. These are a form of short/straight term insurance which pay out if an individual becomes unemployed or ill and are not normally linked to a person's life. Revenue does not allow this latter type of policy premium as a rental income deduction.

Practitioners should also note that mortgage protection plan policies linked to a person's life are life assurance policies, the proceeds of which are taxed in accordance with *Section 593 TCA, 1997*.