Capital Allowances for Property Purchases and Developments

Philip O'Connor
Director
CA Partners

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Agenda

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1. Capital allowances overview
2. Plant and machinery capital allowances / wear and tear allowances
3. Development projects
4. Purchase claims
5. Who should advise?
6. Opportunities and risks

1. Capital allowances overview

Capital Allowances Overview

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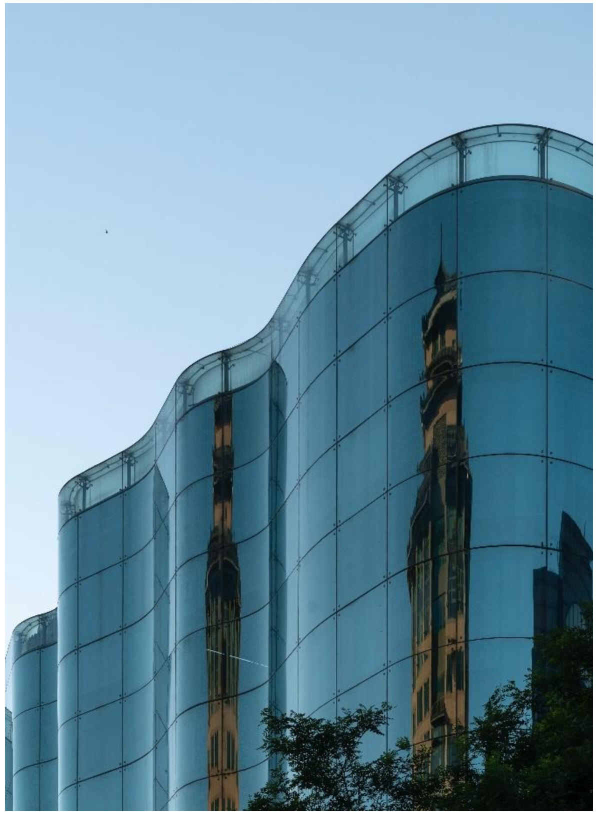
Background to capital allowances for property

- Capital expenditure on buildings not tax deductible
- Capital allowances allow specific building costs to be written off
- Targeted government tax incentives for buildings encourage investment in:
  - ➢ Certain building types
  - ➢ Specific building installations
  - ➢ Some schemes target specific locations
- Both trading companies and investors leasing property can claim
- Provide a rare and valuable tax break for property expenditure



Capital Allowances Overview

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Main types of property tax incentives

- ‘Repair' expenditure can be expensed - 100% in Y1 (for refurbishment projects)
- Accelerated capital allowances (ACAs) for energy efficient equipment – 100% in Y1
- ACAs for childcare and fitness facilities – 100% in Y1 or over 7 years
- **Wear and tear allowances (WTAs) for plant and machinery (P&M) – 12.5% PA**
- Industrial building allowances – 4% per annum (@ standard rate)
- Living City Initiative (LCI) – claimed over 7 years

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Capital Allowances Overview

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How capital allowances save money

	Example 1 No Capital Allowances	Example 2 With Capital Allowances	Tax/cash Savings
Company Profit / Rental Income	€1,000,000	€1,000,000	
Deduct Capital Allowances	None	(€600,000)	
Profit Total	€1,000,000	€400,000	
Tax Paid at 12.5% - saving of €75,000	€125,000	€50,000	**€75,000**
Tax Paid at 25% - saving of €150,000	€250,000	€100,000	**€150,000**
Tax Paid at 40% - saving of €240,000	€400,000	€160,000	**€240,000**

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Capital Allowances Overview

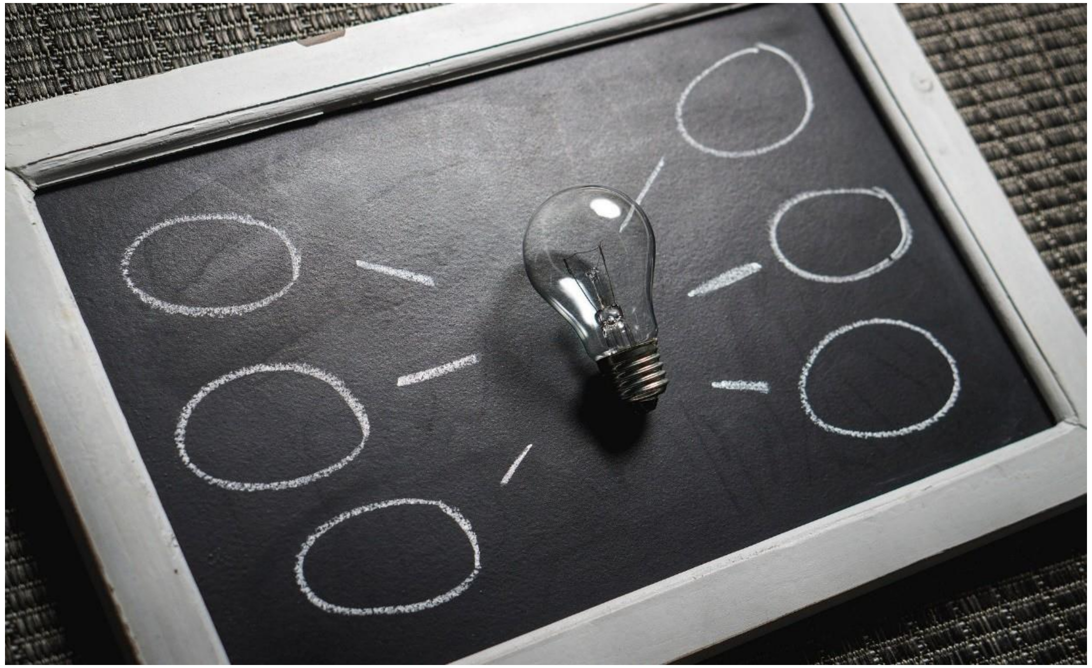
Relevance to members

- Relevant to most society members:
    - All property types are relevant
    - Commercial and residential construction projects and purchases are relevant
- Expectation for members to have awareness of capital allowances
- Members should be able to identify where claims may be possible
- Factor CAs into the life cycle cost for buildings
- Investment appraisals – CAs can add value to purchases and developments

Capital Allowances Overview

Identifying opportunities to claim

- Is there an Irish tax liability?
- Was expenditure incurred buying or constructing property?
- Is the property held as an asset?
- Is there ownership of the qualifying items?
- Is the property used in a trade or rented?
- When did/will the transaction happen?
- What trade is the building used for?

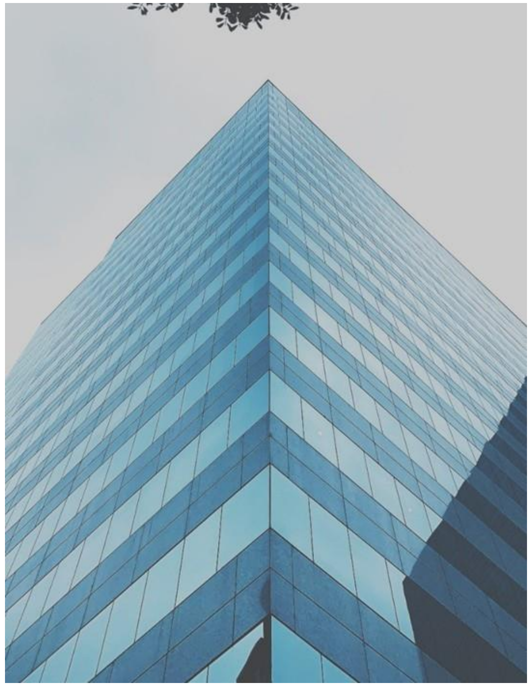


2. Capital allowances – plant and machinery

Capital Allowances – Plant and Machinery

The basics - wear and tear allowances

- Most common form of capital allowance
- In place for over 140 years
- Claims can be made on Irish and foreign property (where liable to Irish tax)
- Commercial and rented residential property relevant
- Applies to property used in a trade <u>or</u> rental property
- Claimed over 8 years (@12.5% per annum)
- Rules for claiming set out in legislation (TCA 1997 s284, s298, s311 and other sections)
- Land costs do not qualify and not all building costs qualify
- Relief only available for **plant and machinery**
- There is no list of what qualifies as plant and machinery
- Identifying what qualifies is based on case law interpretation



Capital Allowances – Plant and Machinery

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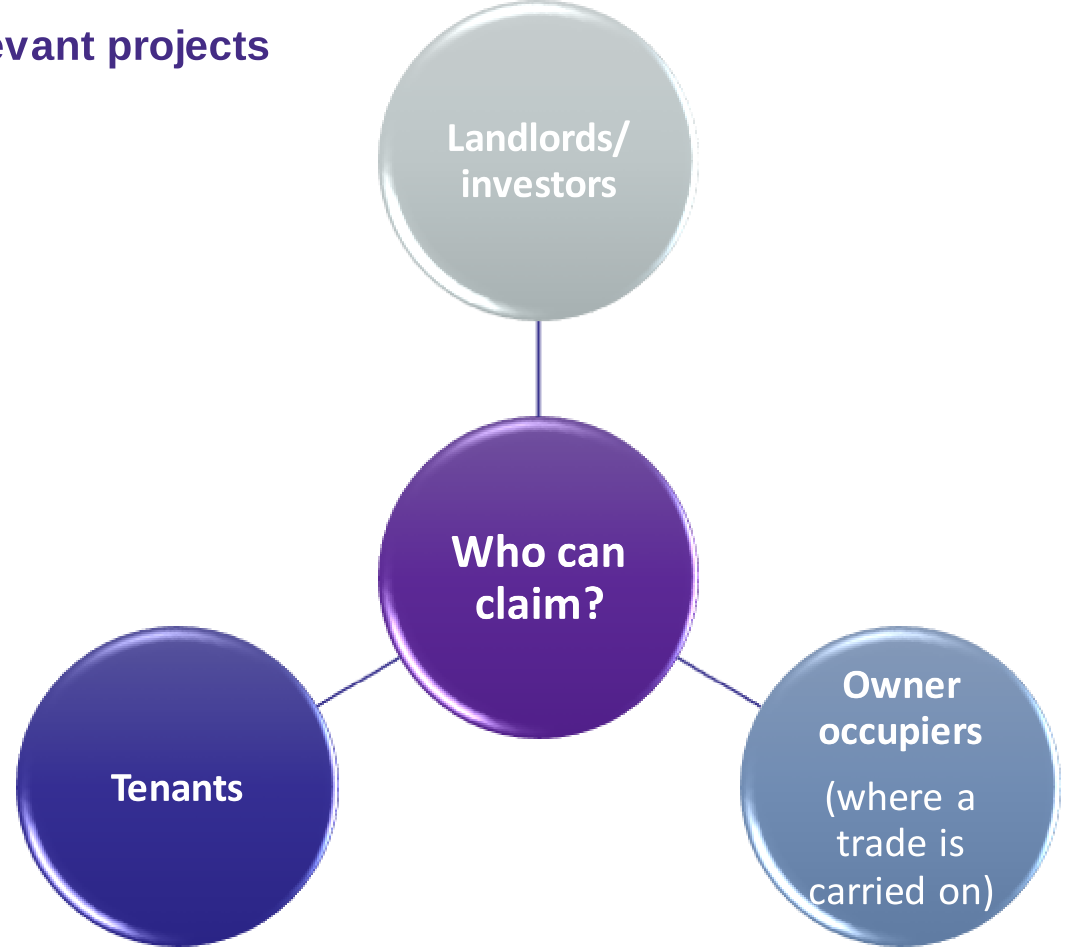
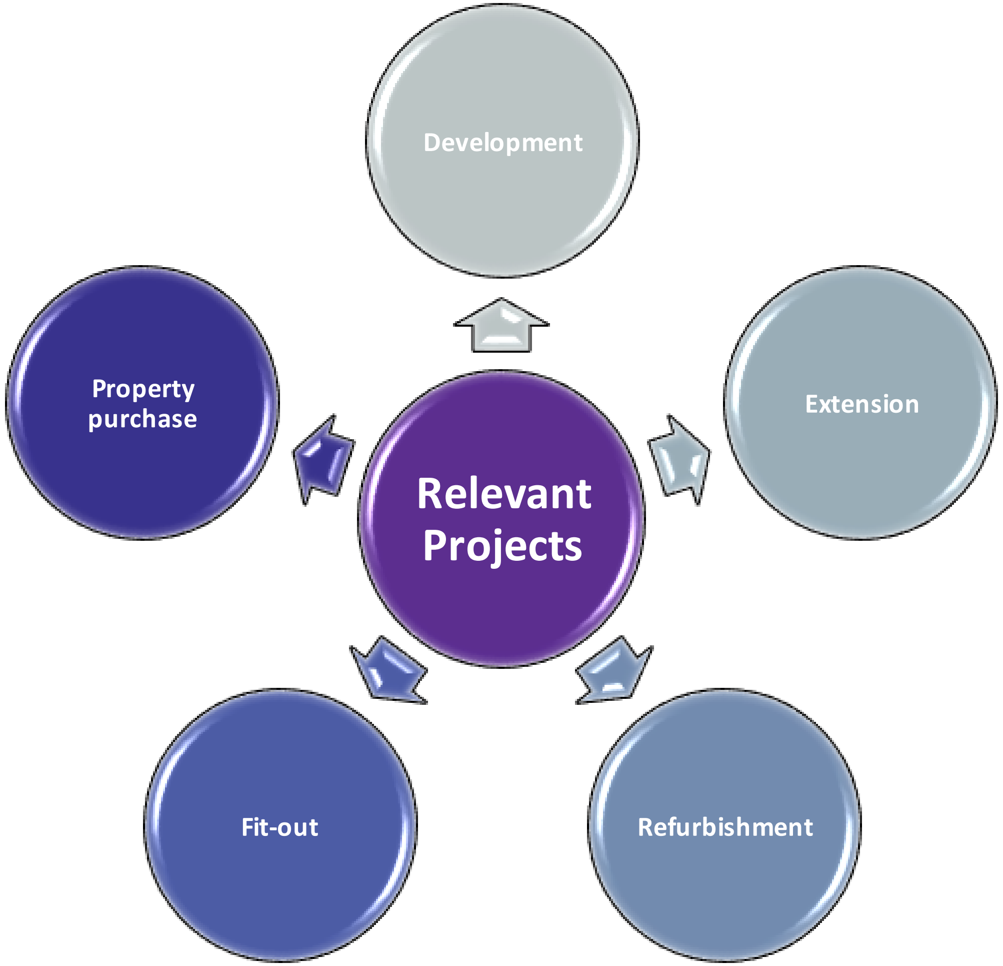
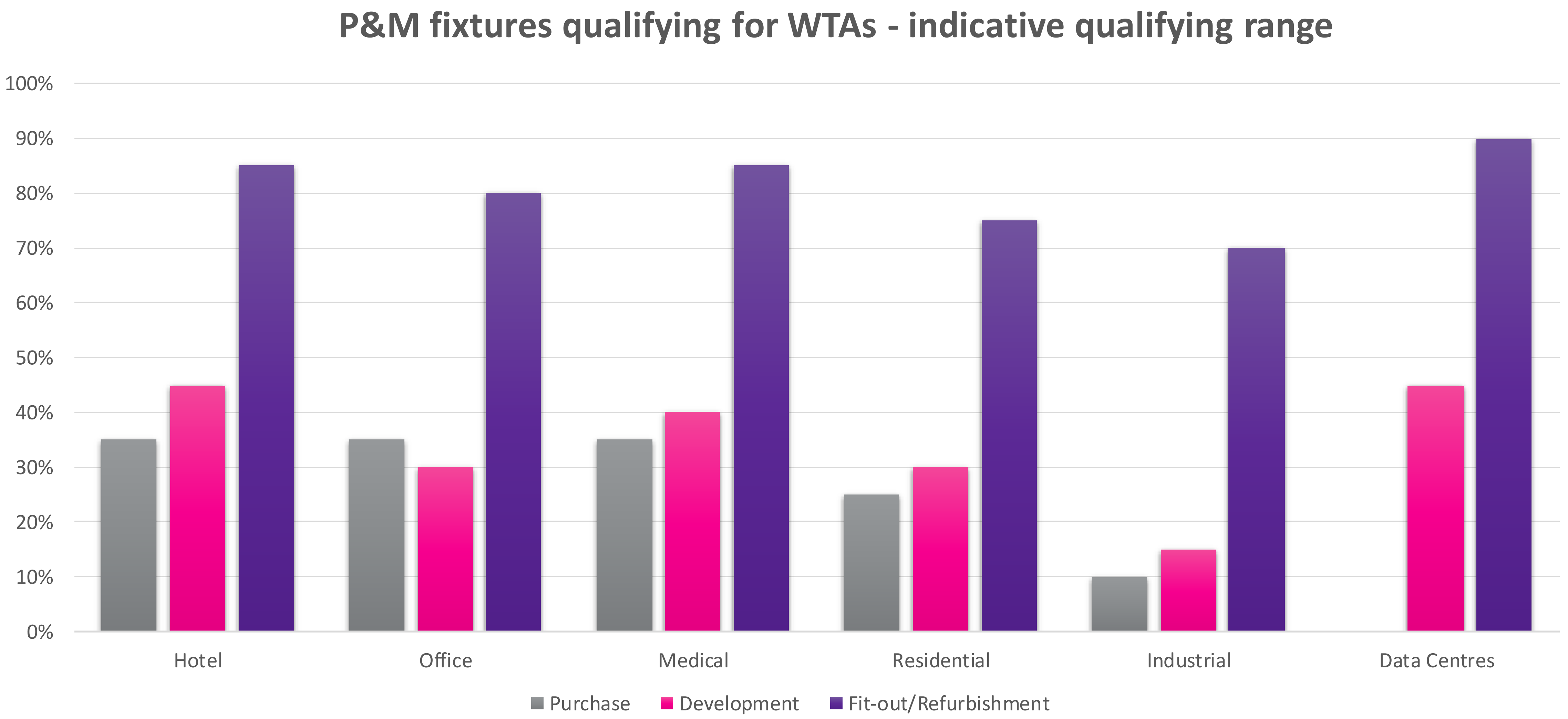
Fixtures claims:

Relevant projects





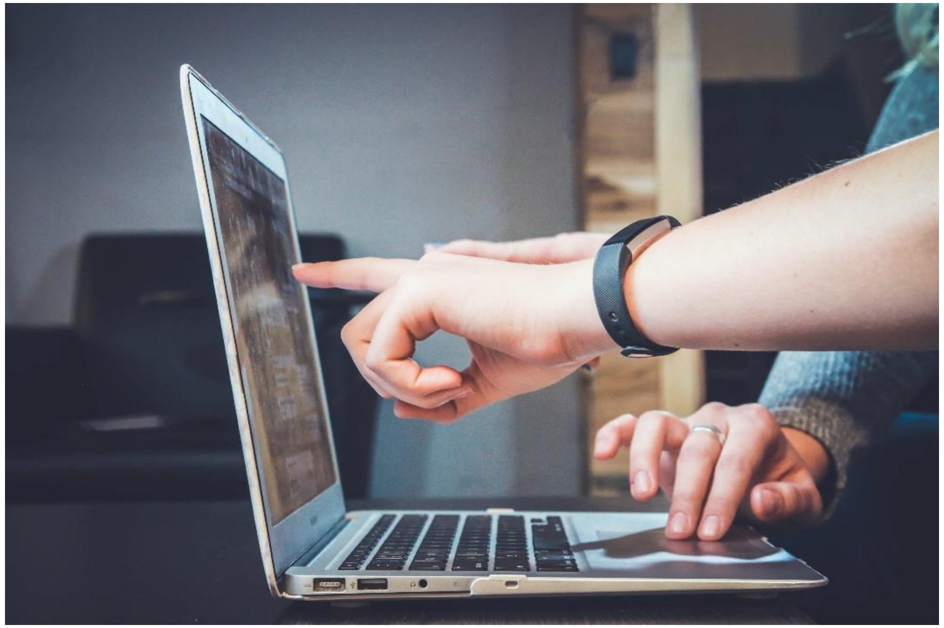
Capital Allowances – Plant and Machinery



Capital Allowances – Plant and Machinery

Practical challenges relating to claims

- Specialist skills required to extract capital allowances from property spend – mix of tax, surveying and property expertise required
- Lack of awareness and disconnect between tax advisers and property professionals and construction professionals
- Claims often left to accountant/tax adviser
- Accountant/tax adviser – general advisers who cannot be experts in all areas of tax
- Accountant/tax adviser – construction / property investment knowledge typically limited
- Other professional advisers – often not aware of capital allowances
- Claims often missed entirely or underclaimed



3. Development Projects

Development Projects

Suggested claim process

1. Initial Planning	2. Source Information	3. Information Analysis / Quantification	4. Submission & Agreement
Due diligence Tax input in the design stage	Collate construction & accounting information	Analyse information Identify & justify P&M claim	Submit claim in tax return
Project team briefing	Property survey(s)	Prepare claim Reconcile to accounts	Revenue Queries?

Development Projects

Case study 1:

Landlord office development

- Project development cost - €39m
- Only landlord core areas fitted out
- Basic services provision to tenant areas

Result: €8.1m WTAs or 21% of development cost

Development Projects

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Cashflow of relief

Year	WTA - Reducing Balance	Annual Claim @ 12.5% PA	Tax Rate	Reduction in CT Liabilty (Tax Savings)
Y1	8,071,157	**1,008,895**	25%	**252,224**
Y2	7,062,262	**1,008,895**	25%	**252,224**
Y3	6,053,368	**1,008,895**	25%	**252,224**
Y4	5,044,473	**1,008,895**	25%	**252,224**
Y5	4,035,579	**1,008,895**	25%	**252,224**
Y6	3,026,684	**1,008,895**	25%	**252,224**
Y7	2,017,789	**1,008,895**	25%	**252,224**
Y8	1,008,895	**1,008,895**	25%	**252,224**
		€ 8,071,157		**€ 2,017,790**

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Development Projects

Case study 2:
€1.9m office refurbishment

- Analysis identified ACAs; WTAs and revenue deductions
- Repair works provided a revenue deduction
- Accelerated capital allowances available for qualifying lighting
- €1.2m qualifying expenditure identified – 72% of project cost qualified

Development Projects

Case study 3:

€23m hotel development

- Examples of plant identified:
  - Feature lighting and chandeliers
  - Swimming pool
- Accelerated capital allowances - €400k

Result: €7.1m WTAs/ACAs or 31% of development cost

Development Projects

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Cashflow of relief

Year	WTA - Reducing Balance (excl. ACA)	Accelerated Capital Allowances @ 100%	Annual Claim @ 12.5% / 100% PA	Tax Rate	Reduction in CT Liabilty (Tax Savings)
Y1	6,725,822	406,708	**1,247,436**	12.5%	**155,929**
Y2	5,885,094		**840,728**	12.5%	**105,091**
Y3	5,044,367		**840,728**	12.5%	**105,091**
Y4	4,203,639		**840,728**	12.5%	**105,091**
Y5	3,362,911		**840,728**	12.5%	**105,091**
Y6	2,522,183		**840,728**	12.5%	**105,091**
Y7	1,681,456		**840,728**	12.5%	**105,091**
Y8	840,728		**840,728**	12.5%	**105,091**
			€ 7,132,530		**€ 891,566**

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4. Purchase Claims

Purchase Claims

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Purchase claims – acquisition of an existing building

- A *just apportionment* of the plant and machinery to the purchase price
- Revenue Commissioners require *a professional valuation* to be undertaken
- Lack of guidance on just apportionment
- The following "apportionment formula" is often adopted

$$\textbf{Apportioned value of P\&M} = \frac{\textbf{P} \times \textbf{A}}{(\textbf{A} + \textbf{B} + \textbf{C})}$$

P = Purchase Price

A = Replacement cost of P&M at date of purchase

B = Building replacement cost at date of purchase, excl. P&M

C = The bare site land value at date of purchase

Purchase Claims

Purchase claims - just apportionment claim approach

1. Analysis of relevant documentation
2. Entitlement/due diligence
3. Property survey
4. Bare site land valuation
5. Reconstruction cost estimate of the building and P&M
6. Just apportionment of land, building and P&M
7. Submit claim in tax return &
8. Obtain tax relief through reduction in tax bill or repayment of tax paid
9. Revenue enquires

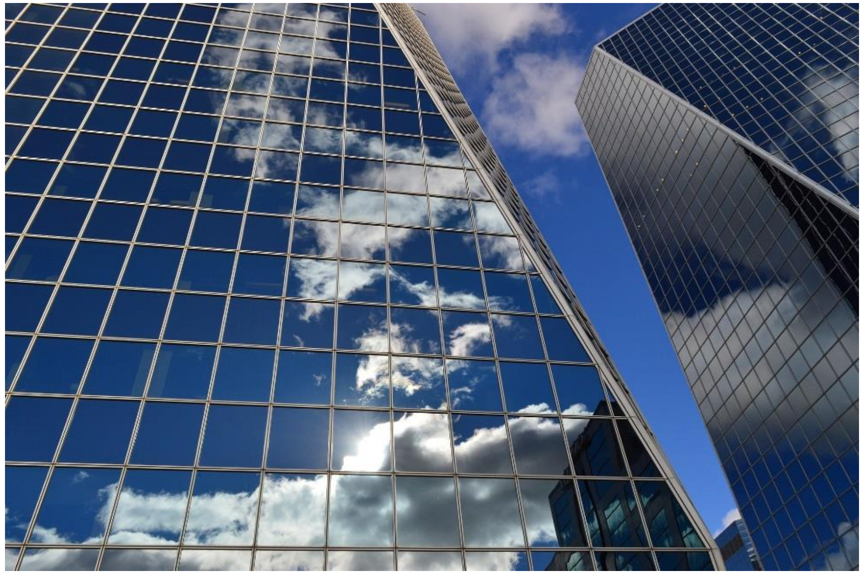
Purchase Claims

Purchase claim case study 1

€4.5m mixed use property acquisition

- Due diligence & detailed apportionment valuation undertaken
- Apportioned value of P&M - €875k (19% of purchase price)
- Saving €219k @ 25% tax rate (over 8 years)

	Professional Valuation	Apportioned Value
Building	€1,600,000	€2,000,000
P&M	€700,000	€875,000
Land	€1,300,000	€1,625,000
Total	**€3,6000,000**	**€4,500,000**
Difference	€900,000	Nil
Purchase Price	**€4,500,000**	**€4,500,000**



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Purchase claim case study 2:

€9.5m Dublin office property acquisition

- Client commissioned non-specialist valuation
- Client claimed €950k WTAs claimed based on notional valuation
- Claim rejected as Revenue intervention found insufficient basis for claim
- We undertook detailed due diligence & *just apportionment* calculation
- Penalties and interest were avoided and additional capital allowances identified
- **€1.7m WTAs** claimed based on a comprehensive *just apportionment* calculation

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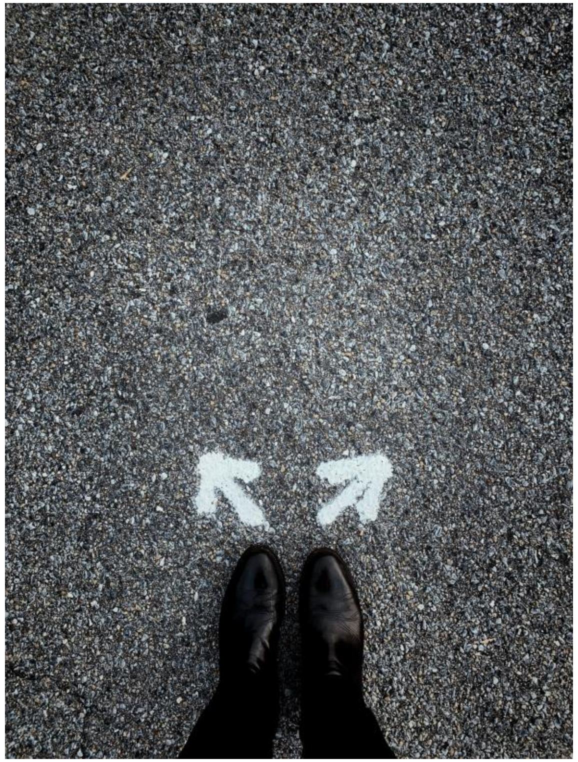
5. Who should advise?

Who should advise?

Who is best to advise?

- Quantity surveyor?
- Agent?
- Tax adviser?
- Chartered taxation surveyor (SCSI/RICS)?



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Who should advise?

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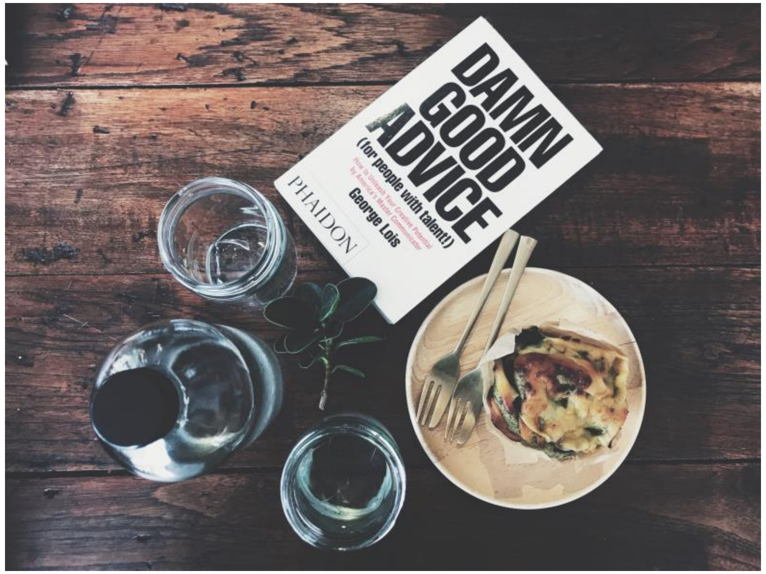
Chartered taxation surveyor (SCSI/RICS)?

- ✓ Designation for members specialising in property tax incentives
- ✓ Construction costing & procurement
- ✓ Construction terminology and building systems
- ✓ Land valuation knowledge
- ✓ Understanding of leases and lease incentives
- ✓ Knowledge of relevant Irish tax legislation
- ✓ Knowledge of accounting fundamentals
- ✓ Detailed knowledge of capital allowances legislation and case law
- ✓ Understanding of interaction with other taxes
- ✓ Understanding of implications of future sale of property



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Who should advise?

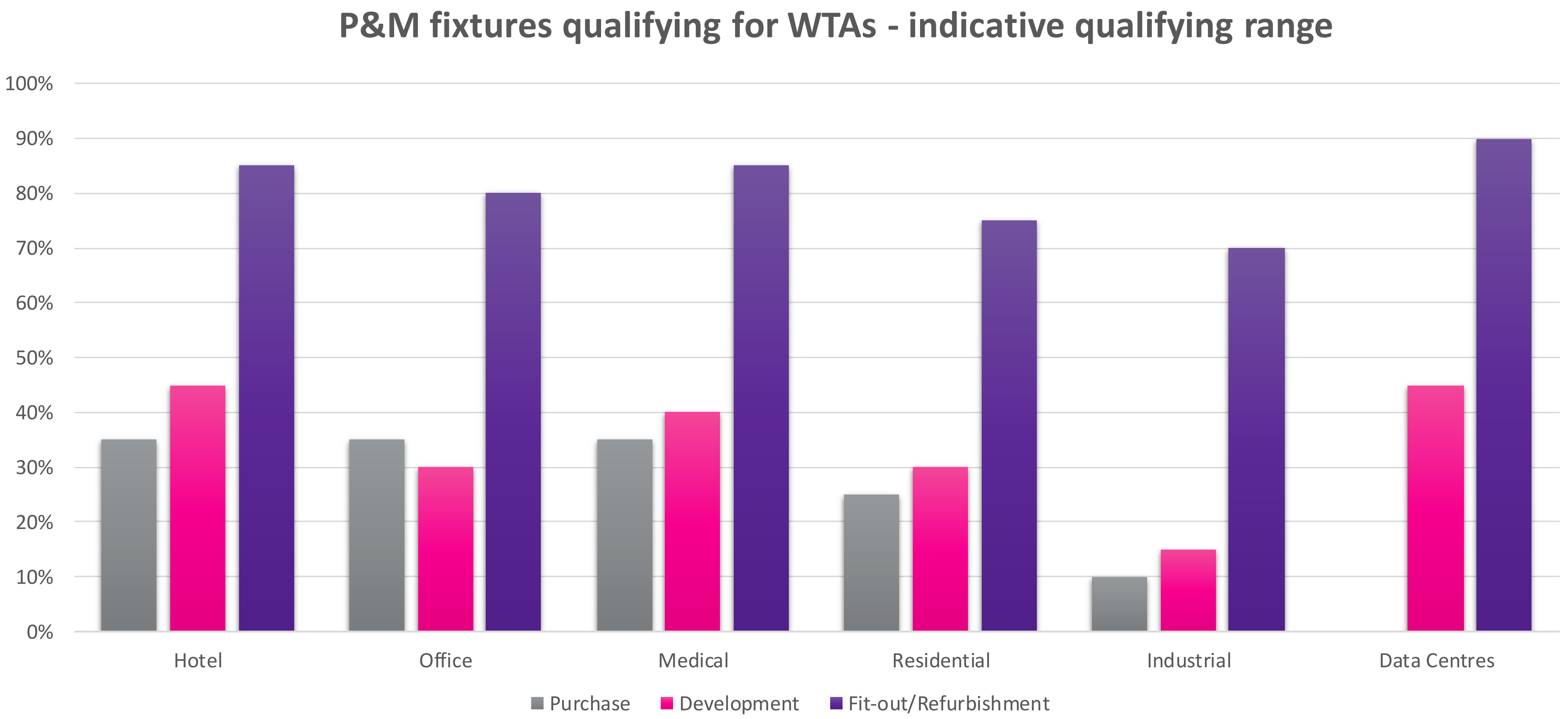
Chartered taxation surveyor (SCSI/RICS)

- Members qualify under the *Taxation Allowances Pathway*
- Aims to ensure members are highly competent and meet high standards expected of the society
- The aim is for members to be suitably qualified to:

1. Demonstrate knowledge of applicable legislation and case law
2. Apply knowledge to undertake analyses and prepare claims
3. Provide robust, reliable and holistic capital allowances advice
4. Have the competence required to deal with Revenue audits

6. Opportunities and Risks

Opportunities and Risks



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Opportunities and Risks

Revenue audits – Key points

- Revenue obliged to ensure taxpayers comply with self-assessment obligations
- Revenue's look into claims to ensure:
  - Claims correspond with legislation
  - Claims are reasonable and thorough
  - Sufficient evidence is provided to substantiate claims
- Entire claims are disallowed if entitlement not satisfied
- Revenue have 4 years to make an "assessment" into a claim
- <u>No time limit</u> if *full and true disclosure* not made or in cases of fraud or neglect
- Ensure claims are robust, justifiable and tax compliant

Opportunities and Risks

Revenue audits – <u>client</u> consequences of getting it wrong

- Self-assessment requirements deemed not met
- Revenue assess the tax that should have been due
- Possible interest and penalties & publication of taxpayer on list of tax defaulters
- Extension of scope of audit to other areas?
- Fraud or neglect by taxpayer? – criminal charges possible

Opportunities and Risks

Key points for successful claims

- Ensure correct skillset used to prepare claims
- Robust, justifiable and comprehensive substantiation for claims required
- Entitlement must be thoroughly investigated prior to quantifying claims
- Members should consider the extent of any advice provided
- Members can refer to SCSI Guidance Document on capital allowances
- Chartered Taxation Surveyor (SCSI) or Chartered Tax Adviser (ITI) should advise

Contact Details

Philip O’Connor BSc (Hons) MRICS SCSI ATT
(Chartered Taxation Surveyor)

T: 01 548 4834

M: 087 7797 639

E: poconnor@capartners.ie

W: www.capartners.ie

CA Partners
Capital Allowances Specialists