
IRISH TAX ASPECTS OF THE ACQUISITION, HOLDING AND DISPOSAL OF IRISH REAL PROPERTY

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IRISH TAX ASPECTS OF THE ACQUISITION, HOLDING AND DISPOSAL OF IRISH PROPERTY FOR FOREIGN INVESTORS

This commentary sets out the main Irish tax aspects involved in the acquisition, holding and disposal of Irish real property on direct investment by a foreign investor.

Unless an Irish regulated fund structure is used there will be an Irish tax cost to foreign investors where directly investing in Irish real property notwithstanding that they are not tax resident. A foreign investor may be entitled to relief under a double tax agreement between Ireland and the relevant foreign country, either by credit or by exemption, depending on the circumstances.

However, investment via an Irish regulated fund structure may be a more tax advantageous method for a foreign investor. Further detail on this is supplied on the next page.

The summary position on Irish tax aspects in respect of direct investment is as follows:

- Rent paid in respect of Irish real property will be subject to Irish taxation. Irish resident companies or non-Irish companies which hold Irish real property through an Irish trading branch are subject to Irish corporation tax at 25% on rental profits. Non-Irish companies receiving rent that is not held through an Irish trading branch are subject to Irish income tax at 20%.
- A 20% withholding obligation applies to the payment of rent to a non-resident landlord but not if the rent is collected by an Irish agent on behalf of the non-resident landlord.
- An Irish agent collecting rent for a non-resident landlord will be personally liable for the tax on the rental profits and therefore would not normally release rents collected by him unless he is satisfied by confirmation from the Irish Revenue or otherwise that he has retained a sufficient amount to cover the tax liability.
- Interest payable which is secured upon Irish real property and payable out of rent will be subject to a separate withholding requirement unless a relevant exemption applies (i.e. the interest is payable to an Irish bank or relevant provisions of any applicable tax treaty can be applied and Irish Revenue authority is obtained).
- Gains or profit on the disposal of Irish real property will be subject to Irish capital gains tax at a rate of 30% (with a “windfall rate” of 80% on certain gains attributable to re-zoning of land) subject to a recently introduced incentive relief applicable for properties bought between 7 December 2011 and 31 December 2013 where the property is held for more than seven years. Any gain arising in the seven year period will be exempt from tax.

- All purchasers of Irish real property paying a consideration in excess of €500,000 are subject to a withholding requirement in respect of the seller's capital gains tax liability at a rate of 15% of the consideration unless the seller provides a clearance certificate from the Irish Revenue. A capital gains tax clearance certificate is automatically available on application to the Irish Revenue if the seller is resident for tax purposes. A non-resident seller will need to agree and pay its capital gains tax liability in order to obtain a clearance certificate.

- Stamp duty is incurred by the purchaser on the acquisition of Irish real property and is charged on the instrument of transfer at 2% of the consideration on transfers of non-residential property. A rate of 1% of the consideration applies to the transfer of shares in a company owning real property.

- The sale and letting of Irish real property may be subject to Value Added Tax (VAT). In certain cases this may be by way of agreement between the seller and purchaser or at the election of the landlord (as the case may be). Where parties choose not to apply VAT there may be a clawback of any VAT previously recovered in respect of the property by the seller or the landlord (as the case may be). VAT will be recoverable if the property is acquired for the purposes of a business that is subject to VAT.

Regulated Fund Structures/"QIFs"

Regulated fund structures can present opportunities to avoid Irish tax on both rental income and gains made on the disposal of Irish real property as such a fund is not subject to Irish tax on its income or gains. While an "exit tax" arises in respect of Irish resident unitholders when payments are made out of the fund and on certain deemed taxable events to the extent unitholders are not Irish resident no such tax arises. A non Irish provides a declaration confirming that it is non-Irish resident will not be subject to this "exit" tax, (which in respect of Irish resident persons applies at rates of up to 33% on distributions from the fund).

So, in effect such a fund is not subject to any Irish tax on its income or gains arising from the holding of property and can be an attractive investment vehicle for international investors in Irish property. It is also feasible to obtain an exemption for VAT on property management services provided to the fund, and there is no stamp duty on transfer of units in the fund.

These structures are suitable for institutional and other "sophisticated" investors. The fund structures can be established as unit trusts, investment companies with variable share capital or investment limited partnerships. The application and establishment of such fund structures are outside the ambit of this commentary but we would be happy to provide more detail.

This commentary is current as at 1 October 2012 and is intended for guidance only. Full legal advice should be obtained in relation to your particular circumstances and commercial objectives.

1. ACQUISITION

1.1. Stamp Duty

Stamp Duty is chargeable on an instrument of transfer of non-residential property, be it a freehold interest or a leasehold interest, at 2% of the consideration (up to 7 December 2011 this rate was 6%). Rates of 1% and 2% are referable in respect of residential property. The party accountable for the stamp duty is the purchaser. The assumption of an existing mortgage or other debt as part of the deal will be recognised as consideration for stamp duty purposes so the gross value of the property will be the base for calculating duty.

If the real property is held in a company, it may be appropriate for the shares in the company to be acquired, rather than the property itself. Stamp duty on the transfer of Irish shares is charged at 1% of their value. The value of the shares would usually be determined by the net asset value of the company and therefore if the company is already heavily leveraged, the actual value attributable to the shares may be relatively small. This may thus result in a rate of 1% on the value of the underlying property less the existing debt.

1.2. VAT

A new VAT regime applies to property transactions since 1 July 2008. Under the new regime there is a distinction between the acquisition of a freehold or “freehold equivalent” interest (i.e. a long leasehold at a nominal rent) and lesser interests (which mostly comprise leasehold interests at market rents). The matter of VAT arising should be addressed in the contract between the seller and purchaser.

In the case of a freehold or “freehold equivalent” interest VAT applies at the rate of 13.5% if the property is considered to be “new”, or if the seller and the purchaser agree that VAT should apply. “New” in this context generally means that the property is less than five years old.

In the case of property which is not “new” a seller would be expected to want VAT to apply if he had incurred and recovered VAT when he acquired the property or on development costs incurred subsequent to acquisition. Otherwise he would face a partial clawback of the VAT recovered. If VAT is incurred on the purchase or development it can be recovered if the property is used for the purpose of a vatable activity.

If the property is held in a company it may be appropriate for the shares in the company to be acquired rather than the property itself. VAT does not apply to the transfer of shares.

1.3. Capital Gains Tax

The acquisition of real property is not a capital gains tax charging event as such for the purchaser. However, it will represent the base from which the purchaser’s exposure to capital gains tax on a subsequent disposal will be measured and therefore is important in that context.

Irish capital gains tax is subject to a withholding procedure applicable to purchasers of Irish real property, or unquoted shares in companies deriving the greater part of their value from Irish real property, where

the consideration exceeds €500,000. The procedure requires the purchaser to withhold 15% of the consideration and pay it to the Irish Revenue Commissioners unless the seller produces a clearance certificate.

A purchaser must ensure either that a clearance certificate is received on completion, or alternatively must withhold 15% of the consideration and pay it to the Irish Revenue Commissioners. A purchaser who defaults in its obligations can be assessed for the 15% withholding that should have been made, and this is the case even if the ultimate liability of the seller for capital gains tax is less than the amount of the 15%.

A seller who is resident in Ireland will be able to obtain a clearance certificate on application to the Irish Revenue Commissioners. A seller who is not resident in Ireland will effectively have to agree and pay its capital gains tax liability on the disposal in order for a clearance certificate to issue.

2. HOLDING

2.1. Tax liability on rent

Rent paid in respect of Irish real property will be subject to Irish taxation on account of it having an Irish source, regardless of the identity or location of the landlord.

An Irish resident company, or a foreign company that holds the real property as part of or on account of a trade carried on in Ireland, will be subject to Irish corporation tax at 25% on the rental profits.

Income tax is applied to rent received by individuals and non resident companies. The standard rate of income tax is 20% with a higher rate of 41% applied to income amounts received by individuals in excess of the standard rate band (but this higher rate does not apply to non resident companies). Social insurance payments and certain levies can also apply.

In computing rental income for tax purposes, deductions are allowed for several payments, including rent payable to a superior landlord, the cost of annual maintenance, repairs, insurance and management and in respect of interest paid on borrowings incurred in the purchase improvement or repair of the property.

There is no general tax depreciation for real property. However, tax allowances are available for the construction cost of certain types of buildings. These include traditional industrial buildings (meaning factory type buildings) certain hotels and tourist holiday cottages, and some commercial and office buildings in specifically tax designated urban areas. Unused allowance is generally passed to the purchaser of a building, and continue to be claimed by that purchaser, whether against business income generated by the purchaser in occupation, or against rental income earned by the purchaser as landlord. On a subsequent sale, the general position is that any value in excess of the written down value is deemed to be income subject to tax, and any value less than the written down value is deemed to be an additional expense. The availability of capital allowances has been severely curtailed over the last few years and generally is only available in respect of new expenditure on traditional industrial buildings such as factories rather than offices, hotels etc.

2.2. Withholding

Where rent is payable to a non resident landlord, withholding applies if it is paid directly to the non resident landlord. The rate of withholding is 20% of the payment. Where the rents are collected by an Irish agent on behalf of the non resident landlord, this withholding obligation does not arise. In its place, the Irish agent becomes personally liable for the tax due on the rent and so effectively will not hand over or utilise the rent on the landlord's behalf without being satisfied that he has funds available to discharge any tax obligation on the rents passing through his hands. An agent may therefore be unwilling to apply rents collected by him to the discharge of borrowings by the landlord or other liabilities of the landlord unless he is satisfied, whether by confirmation from the Irish Revenue Commissioners or otherwise, as to his potential exposure to Irish tax on the rentals.

2.3. Interest

If interest is payable by the landlord in respect of borrowings which are secured upon Irish real property and payable out of the rental, the interest will in all probability be regarded as Irish source interest, and will be separately subject to withholding applicable to interest. This applies in respect of interest paid by a company to any person, or where paid by any other person to another person whose usual place of abode is outside Ireland. There are several exemptions applicable to these general rules. In this context the relevant ones are:

- Interest paid in Ireland on an advance from a bank carrying on a bona fide banking business in Ireland. This would cover an advance from an Irish bank or an advance from an Irish branch of a foreign bank.
- Interest paid by a company authorised by the Irish Revenue Commissioners to pay without deduction of income tax. This is a provision which enables interest to be paid gross where the terms of an applicable double tax agreement exempt the interest from Irish taxation. It requires a form to be certified by the foreign Revenue authority and submitted to the Irish Revenue Commissioners who then authorise the payer to pay the interest gross.

2.4. VAT on Leasing

The starting point is that the letting (leasing) of real property is exempt from VAT. This means that VAT does not apply to the rent. However the downside is that VAT incurred on the purchase of the property or related expenditure is not recoverable. The matter of electing to apply VAT should be addressed in the lease.

In the case of commercial lettings (i.e. non residential) a landlord can elect to apply VAT in which case VAT applies to the rent at the standard rate (23% since 1 January 2012). This route is usually taken where a landlord has incurred VAT on the purchase of a property. The VAT arising on the rent will be recoverable by the tenant if he uses the property for the purposes of a business that is subject to VAT. Most businesses come within this category.

2.5. Capital Gains Tax

If capital improvements are carried out to the real property during the landlord's period of ownership, the cost of those enhancements will represent deductible cost on a subsequent disposal of the property. Such expenditure should therefore be analysed to ensure that any such capital cost is identified, and records retained for future reference.

3. DISPOSAL

3.1. Capital Gains Tax

The sale of Irish real property, or of unquoted shares in companies deriving the greater part of their value from Irish real property, will be subject to Irish capital gains tax, regardless of the identity or location of the person making the disposal. The rate of capital gains tax is 30% of the gain computed on the proceeds of sale less acquisition and enhancement costs, and less the incidental costs of acquisition and the incidental costs of disposal. A "windfall rate" of 80% can apply to gains attributable to re-zoning of land which occurs on or after 30 October 2009. Certain persons such as the providers of Irish Revenue approved life and pension products may be exempt from capital gains tax.

In addition, a special incentive capital gains tax measure was recently introduced in respect of property acquired between 7 December 2011 and 31 December 2013. Provided such property is held for at least seven years the capital gain relating to that seven year holding period will be relieved in full from capital gains tax.

Where the consideration exceeds €500,000, the seller will need to obtain a clearance certificate to ensure that on closing the purchaser does not operate the withholding procedure in respect of 15% of the consideration. An Irish resident seller will be able to obtain a certificate without difficulty. A seller which is not resident in Ireland will need to compute the gain, make a return to the Irish Revenue Commissioners and pay the resultant tax in order for a certificate to issue. This should generally be done between contract and completion, particularly where the estimated tax liability is going to be less than 15% of the consideration. If it is likely to be more than 15% of the consideration, there can sometimes be a cash flow benefit in allowing the deduction to occur, credit for which will be available against the ultimate liability to capital gains tax at the subsequent payment date.

An Irish agent for a foreign seller can be held liable to pay the seller's capital gains tax arising on the sale. An agent will, as a result, generally retain sufficient funds to cover the estimated tax until satisfied that it has been fully discharged.

3.2. VAT

The matter of VAT applying to the disposal should be addressed in the contract. As mentioned under "Acquisition" above, the VAT treatment will depend on whether the property is considered to be "new" and, if not "new", whether the seller wants and obtains agreement for VAT to apply. If the property is not "new" electing to apply VAT should be considered if the seller has incurred and recovered VAT on the acquisition of the property. Otherwise a partial clawback of the VAT recovered could arise. The

purchaser will be entitled to recover VAT arising on the sale if he uses the property for the purposes of a business which is subject to VAT.

If the investment involves holding shares in a company the disposal of the shares will not attract VAT.

3.3. Stamp Duty

As stamp duty is the responsibility of the purchaser, it would not generally be a matter for consideration by the seller, unless the structure of the transaction allows the stamp duty liability to be reduced and the benefit of the reduction is to be split between the two parties as part of their deal.

4. OTHER RELEVANT TAX ISSUES

4.1. Capital Acquisitions Tax

Capital acquisitions tax charges the receipt of gifts and inheritances. The charge is linked to the residence of the donor, and the residence of the recipient, but where Irish situated assets are involved as part of the gift or inheritance, it will be chargeable regardless of the circumstances or location of the donor or recipient.

Where shares in a foreign company are the subject of a gift or an inheritance, a “look through” provision will apply where the company is controlled by five or fewer persons (aggregating connected persons) and the recipient, and persons connected with the recipient, control the company. Where this applies, the part of the value of the shares attributable directly or indirectly to Irish situated assets is deemed to be situated in Ireland, and will thus be chargeable to capital acquisitions tax.

Where assets are subject to a gift or inheritance, any capital acquisitions tax due in respect of that gift or inheritance becomes a charge on the property pursuant to which the Irish Revenue Commissioners can enforce collection of tax against that property.

4.2. Dividend Withholding Tax

This paper anticipates that Irish real property may in certain circumstances already be held, or alternatively it may be determined that it should be acquired through, the medium of a company. If the holding company is resident in Ireland, it will be within the charge to Irish taxation on its profits in the normal way. It will also be subject to dividend withholding tax when it pays dividends or makes other payments that are regarded as constructive dividends for tax purposes. Dividend withholding tax is charged at 20% of the dividend amount, and must be paid over to the Irish Revenue Commissioners by the middle of the month following the payment.

There are several exemptions from dividend withholding tax covering the application of the Parent Subsidiary Directive for EU companies whose shareholdings in an Irish company are at least 5% and also application to individuals resident in Treaty or EU countries and to companies either resident in EU or Treaty countries or resident anywhere provided they are ultimately owned and controlled by persons in Treaty or EU countries or by companies quoted in EU or Treaty countries. Other than the application of

the Parent Subsidiary Directive, these various exemptions are required to be claimed by means of the shareholder making an appropriate declaration to the Irish company, with certification of the background facts by the auditors where the shareholder is a company, and by the appropriate Revenue authority where the grounding of the exemption is residence in an EU Member State or a Treaty country.

FURTHER INFORMATION

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