Economic Impact Assessment of Potential Changes to Legacy Property Reliefs

Final Report

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Preface

This Economic Impact Assessment Report was prepared by the Tax Policy Unit in the Department of Finance.

Organisations and individuals were invited to submit their views as part of a public consultation process which ran from 23 June to 29 July 2011. Over 700 individual responses were received. This high level of engagement by members of the public and a variety of organisations is gratefully acknowledged.

The Department used an economic model to assist it in understanding the impact on individual investors of potential changes to the reliefs. The model was published on the Department's website alongside the consultation document and is available to download at www.taxpolicy.gov.ie.

Comments and suggestions from colleagues in the Department of Finance, the Office of the Revenue Commissioners, the Central Evaluation Unit in the Department of Public Expenditure and Reform and Fáilte Ireland are gratefully acknowledged.

INDECON International Economic Consultants, who carried out a separate review of certain tax incentive schemes in 2005, also provided an external review of the analysis contained in this Report. Comments and suggestions from Alan Gray and William Batt in this regard are gratefully acknowledged.

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Executive Summary and Conclusions

0.1 A number of legislative and policy proposals have been suggested over the last year to deal with the legacy costs of property based tax reliefs. Budget 2011 and Finance Act (No. 1) 2011 proposed a ring fencing of property based tax reliefs to the rent accruing from the property that gave rise to the reliefs. The Programme for Government proposes to "*reduce, cap or abolish property tax reliefs and other reliefs which benefit very high earners*".

0.2 The proposals in the Budget and Finance Act 2011 would have amounted to an effective termination of reliefs for many individuals. This impact assessment which includes the consultation paper, engagement from over 700 submissions, and the analysis herein, has enabled the Department to understand the possible legacy costs to the State as well as the impacts on individuals and economic sectors of a change in law relating to the use of reliefs.

0.3 The consultation paper identified possible adverse economic impacts on cash flows and solvency relating to individual investors, as well as deadweight costs on the wider economic economy through possible loss of economic activity.

0.4 The consultation process and the analysis of available economic data has provided further evidence as to the potential Exchequer gains, if any, from a termination or restriction of reliefs as well as the possible economic harm to both the State in terms of potential long and short term policy credibility and the wider economy in terms of lost economic activity.

0.5 This document sets out the likely economic impacts that would arise from a change in policy towards the outstanding – or unused - property reliefs. For convenience the effects are grouped under the following headings:

- Individual investors, both professionally advised and non-professional;
- Economic sectors affected by the schemes, including an analysis of healthcare, hotels and student accommodation;
- Financial institutions; and,
- The State.

0.6 The main findings from each of the Chapters are summarised below.

Individual Investors

0.7 Our analysis suggests that there are two key investor groups. The first group is a non-professionally advised investor group broadly defined as covering investors with income below the high earners threshold and who mainly invested in buy to let residential property schemes.

0.8 This investor group are the primary investors in residential buy to let properties (i.e. Section 23 and Section 50 Student Accommodation). These properties are low yielding assets which due to their geographic locations are most at risk of high levels of negative equity and arrears. Given the high levels of debt and negative equity and cross-collateralisation of mortgages, the ability of investors to use rent from non-tax designated properties which heretofore has been shielded from tax due to investments in tax-designated properties in order to pay make mortgage payments is critical to the solvency of this group.

0.9 In seeking to generate additional tax revenues from non-professional investors the State could risk removing a cash flow that is to some extent used for mortgage repayments.

0.10 The other key group can be broadly defined as the professionally advised investor group. This group consists of high income earners which can be broadly defined by the threshold for the application of the high earners restriction. This group therefore already has a diminished use of reliefs due to the restriction. The effect of the high earners restriction on this investor group is substantial and is explored in greater depth later in the report.

0.11 These investors participated alongside non-professional investors in residential schemes albeit with far greater individual expenditure and were the primary investors in accelerated capital allowances schemes that financed commercial operations including hotels and private hospitals.

0.12 This group may be able to sustain further restrictions on the use of property reliefs but the cash flow is likely to be diverted from productive uses such as enterprise and job creation. In some situations, as documented in this report, investors may face insolvency where their primary businesses are collateralised into mortgage payments in respect of investments in tax incentive schemes. This assessment has already uncovered examples of the possible threat of business failure and job losses through increased tax liabilities arising from the high earners restriction. A termination of property related reliefs may compound this effect.

Private Healthcare

0.13 Capital allowance schemes in the healthcare sector existed in respect of private hospitals, nursing and convalescent homes, sports injury clinics and childcare facilities. The viability of facilities funded by investors that sought to benefit from tax incentives may be impacted due to the financial structures that underpin the investments.

0.14 The financial structures that funded private healthcare facilities, as well as investments in the hotels sector, relied on tax indemnities provided by the business operator to the tax investors which protected investors against a change by the State in respect of unused capital allowances. In some cases the indemnities provide for cash payments by the operator to the investor to compensate for loss of tax reliefs. In other cases the indemnities provide for an immediate buy-back of the facility by the operator from the investor.

0.15 These indemnities reduced the funding costs and facilitated greater investor participation but the guarantees offered by the operators placed all of the risk of a ‘change in law’ relating to unused capital allowances on the operator.

0.16 Our analysis indicates that private healthcare facilities may not have the cash flows to fund a compensation of lost reliefs or a buy-back of the facility. This creates a real and verifiable threat to the financial viability of a number of private hospitals and nursing home facilities. It is not clear if the underlying business would continue to trade under new ownership but what is clear is that there is a threat to the viability of the operators of existing facilities.

0.17 A liability on an operator associated with the exercise by tax investors of their contractual rights under a tax indemnity could result in the closure of a facility if it could not meet its liability. Any closure or capacity reduction in a private facility would have an immediate cost implication for the public system due to the displacement of private and public patients from private facilities into the public system.

0.18 While the Exchequer would stand to gain from a restriction or termination of capital allowances, the incremental gain over the tax revenues already generated by the high earners restriction is limited.

0.19 In two case study examples in this report our analysis indicates that in the event of a closure of a healthcare facility the loss of tax revenue from income tax (and other taxes) would be greater than the gain from the termination of the allowances even in the absence of the high earners restriction.

Section 50 Student Accommodation

0.20 Our analysis of Section 50 student accommodation schemes has revealed a sector with high levels of excess supply. Investors have experienced deterioration in property values and are restricted in the yield that can be generated due to excess supply and competition from non-purpose built residential accommodation.

0.21 Investors in private off-campus student accommodation must only rent to students during the academic year but must compete with all forms of rented residential accommodation as students are not restricted in their accommodation choices to just specialist student accommodation. Repossessions by credit institutions have put further pressure on yields as credit institutions seek to generate cash flow from impaired assets.

0.22 Notwithstanding substantial declines in valuations and extreme levels of negative equity investors face a barrier to exit from the sector due to restrictions on the types of tenants and the existence of a claw-back if a change of use or sale of the property occurs.

0.23 Almost 42% of all claims in 2007 for tax relief under the student accommodation scheme came from investors with income less than €100,000. This group accounted for 37% of claims by cost. Student accommodation claims represented 7% of total claims made by investors with income of less than €100,000 in 2007 making it the third most popular scheme for this group behind the urban and town renewal schemes.

0.24 Fifty-eight percent of claims and 63% of the total cost of claims in 2007 came from the individuals with income in excess of €100,000 with 19% of total claims and 43% of total cost coming from the investors with income in excess of €275,000.

0.25 There are risks to investors' solvency if unused reliefs are terminated. The risks faced by investors are similar to those faced by investors in all buy-to-let schemes but may be more acute due to their restricted conditions of use. Professionally advised investors who account for the greater cost are already restricted in their use of reliefs by the high earners restriction.

Hotels Sector

0.26 The hotels sector is currently faced with high levels of excess supply and possible insolvency. Excess investment occurred during the 2000s driven in part by the existence of tax incentive schemes, as well as by the planning system. New rooms added during the 2000s outpaced sector demand with almost 22,000 new rooms added over the period, a 58% increase on the level at the start of the period. The level of excess capacity is estimated at 7,000 although it has begun to fall.

0.27 'Change of Use' or tax indemnity clauses in legal contracts similar in kind to those used in the healthcare sector were also used in the hotel sector. If investors were to lose their unused capital allowances legal actions may be taken against the hotel operators to enforce their rights. This may result in a liquidation of the hotel or a transfer of assets to the investors. Whilst a number of operators may cease trading, the ability of the facility itself to remain in existence depends on its underlying viability and not the presence or otherwise of capital allowances.

Financial Institutions

0.28 The March 2011 stress test by the Central Bank of Ireland identified potential loan losses in a number of lending sectors. Within the residential sector the buy-to-let sector was identified as the riskiest sector with lifetime loan losses forecast by BlackRock Solutions at 17.2% in the baseline scenario and 26.2% under a stressed scenario.

0.29 The BlackRock forecasts formed the basis for the Central Bank's assessment of three year losses upon which the capital requirements for each of the credit institutions were established. Forecasts for loan losses in the buy-to-let sector did not consider the potential impairment or loan defaults in the sector arising from a termination of tax incentives. Depending on the performance of the remaining loan portfolios of the credit institutions additional loan losses arising from a restriction of tax reliefs and personal insolvency may impact on financial institutions' balance sheets although this impact is likely to be small.

The State

0.30 The proposals in Finance Act 2011 sought to restrict the use of property reliefs through a ring fencing approach and targeted a yield of €60 million in its first year. It is now clear that the proposals would have amounted to an effective termination of reliefs given the limited rental yield associated with the properties that gave rise to the reliefs. It would appear that if these measures were to be enacted the actual yield to the Exchequer would be in excess of the amount targeted though the potential adverse costs to the State, individual investors and economic sectors would also be significant.

0.31 Despite the potential gain to the State from a termination of reliefs, long term and immediate costs would occur including possibly in terms of reputational effects which may impact on fiscal and other economic instruments of the State. It is difficult to quantify the effects of these reputational costs but deadweight loss would arise if the State's ability to remedy market failures through fiscal policy or otherwise were impacted.

Over-arching Themes

0.32 While the various property relief schemes contributed to significant economic regeneration and employment, in general they outlived their usefulness and contributed to excess supply in certain sectors, namely residential housing and hotels. In the future, tax relief schemes should not be extended again and again without a thorough ex ante cost benefit analysis on each occasion.

0.33 There is a need to engender certainty about the 'future' in terms of any proposed policy changes. A policy response on the legacy property based tax relief schemes should avoid anything that further hinders the natural return of the property market to equilibrium.

0.34 Significant evidence has emerged of a distinction between small and large investors and the schemes they invested in. Investors described in this report as 'professionally advised' or 'professional' could be broadly described as investors with income generally in excess of €100,000 – most of whom will be captured by the High Earners Restriction – and were the primary investors in accelerated capital allowances schemes. Schemes that offered accelerated capital allowances were less accessible to investors who didn't have recourse to professional advice and thus investors of lower income who are referred to as non-professional investors generally invested in Section 23 residential buy to let properties. A separate treatment of Section 23 and accelerated capital allowances reliefs is therefore recommended.

0.35 Levels of investor indebtedness in the buy to let sector needs to be considered in formulating policy proposals. Significant levels of negative equity and arrears are materialising in that sector and any measures that further constrain individuals' cash flows should be carefully considered. The proposals outlined below seek to avoid adding to existing insolvency levels.

0.36 While it is clear that professionally advised investors have used property based reliefs to reduce their overall effective tax rate, recent measures by the State including the High Earners Restriction have clawed back some of the annual costs associated with tax reliefs. The change to the high earners restriction in Budget 2010 will bring further gains to the Exchequer. Whilst the outturn yield from this measure will not be known with certainty until mid-2012, policy proposals should factor in the possibility that this measure has already contributed to the over-arching policy goal of achieving a minimum effective tax rate of 30% for high earners.

Proposals relating to Non-Professional or 'Small' Investors and Section 23 Property Owners

0.37 The individual and aggregate costs to the State from the small/non-professional investors are limited (approx 25% of total costs). The Department has modelled that these costs will be claimed gradually and spread out over a horizon that may extend into the next decade at a low cost per annum. Against this the Department's investor cash flow modelling work has demonstrated that the risk of mortgage default for small investors is real and significant. The admittedly small annual costs to the State are of significant benefit to small investors in continuing to service mortgages.

0.38 An anomaly has recently arisen whereby individuals that are not high earners fall within the threshold of the high earners restriction due to the mechanism of a clawback that exists if a Section 23 property is sold before its 10 year holding period. Individuals that seek to deleverage either at their own initiative or under the instructions of their credit institution should not fall within the remit of the high earners restriction and in the process incur a tax liability far in excess of reliefs used during their ownership of the property. This is a technical issue and should be dealt with immediately in Finance Bill 2012 by a change in legislation.

0.39 Reliefs to small investors should not be restricted. This can be achieved by not introducing any restriction to Section 23 reliefs. This is expected to greatly assist individuals in continuing to meet mortgage payments. It is possible that this policy could be reviewed in 2015 with a view to establishing the outstanding legacy costs at that point and the evolution of arrears and defaults in the buy to let sector in the intervening years.

0.40 Large investors who hold Section 23 reliefs will be captured by the High Earners Restriction in any event. As described below, if it is deemed that the expected higher yield from the High Earners Restriction in 2010 is insufficient it is possible to generate additional yield from High Earners through a levy on the income sheltered by property related reliefs that are actually used, or through a modification to the high earners restriction.

Proposals relating to Professionally Advised Investors and Accelerated Capital Allowances:

0.41 A key characteristic of professionally advised investors is that many of them are employers and business owners. The impact on them of restricting reliefs depends on their individual circumstances. This group may be better able than the small investors to sustain further restrictions in reliefs but cash flow is likely to be diverted from productive uses such as enterprise and job creation and could impact negatively on their core businesses and employment.

0.42 It is very important to remember that the State has already restricted the ability of the professionally advised investor group to use their tax reliefs through the high earners restriction. It is possible that a significant amount of money ear-marked from the restriction of property reliefs will be raised in any event from the high earners restriction. The fact that the impact of the 2010 changes to the high earners restriction (which increased the effective income tax rate for those subject to the full restriction to 30%) won't be known until data becomes available in 2012 makes making firm recommendations now difficult.

0.43 The 'change of law clause' – or 'tax indemnity' - may impact on the viability of private hospitals and hotels rather than on the tax investors. Restricting reliefs that could lead to closure of private hospitals would cost the State money rather than save money and could impact on service levels in the public system due to the displacement of patients.

0.44 Ideally it may be worth waiting for data on the additional yield achieved in 2010 from the change to the high earners restriction before implementing any further policy responses in relation to the legacy property relief schemes. However scope may exist to restrict the reliefs to the tax life of the relevant scheme. In effect this would amount to a 'use it or lose it' clause on reliefs and would cap the long terms costs associated with capital allowances.

0.45 It should be noted that individuals captured by the High Earners Restriction will eventually use their reliefs once their income levels or the total number of reliefs available to them falls below the threshold level for the restriction. Thus individuals with restricted reliefs will continue to shelter income after the tax life of their schemes. This however is unavoidable as restricted reliefs from property schemes cease to be classified as property as they are aggregated together with all other restricted reliefs and rolled forward together. Furthermore it is the explicit purpose of the high earners restriction that individuals are restricted in their ability to use reliefs but will be able to use them over time. This explains why the restriction hasn't triggered any tax indemnities heretofore.

0.46 It may be possible to modify the high earners restriction to restrict the use of property reliefs in a given year. The high earners restriction is currently silent on what reliefs are restricted. A possible proposal would be to introduce a property specific restriction.

0.47 Another possibility would be to introduce a levy on the income that is sheltered from property based reliefs by individuals with income in excess of a threshold, be it €100,000 or €125,000. This will allow the reliefs to be used as expected – though at a reduced rate as per the high earners restriction – and instead levy the individual's income. In the absence of data on the impact of the high earners restriction in 2010, this approach is regarded as preferable to any modification of the high earners restriction.

0.48 With only limited data available, it is hoped that this combination of measures along with the high earners restriction will achieve a similar yield to that targeted in Budget 2011.

1. Introduction

1.1 The legacy property tax reliefs can be described in terms of two broad categories, reliefs relating to rented residential property (commonly referred to as "Section 23" reliefs) and reliefs which allow for accelerated capital allowances in respect of investment in industrial buildings (referred to as "accelerated capital allowances").

1.2 The National Recovery Plan 2011-2014 first proposed that €400m could be saved over the life of the Plan by phasing out the use of property-based tax reliefs in their entirety.

1.3 Budget 2011 announced more limited measures than those proposed in the National Recovery Plan aimed at abolishing property-based legacy reliefs for passive investors only. It assumed annual savings of €60m in 2011.

1.4 It was also proposed that an impact assessment would be undertaken into the effects of a proposed "guillotine" on all reliefs after 2014.

1.5 Sections 23 and 24 of the Finance Act 2011 made the introduction of the measures subject to a commencement order which could only be enacted following the publication of an impact assessment.

1.6 The proposed measures were targeted only at non-owner occupiers, i.e. landlord investors in Section 23 properties and passive investors in industrial buildings. Residential owner occupier relief would be unaffected. The measures can be summarised as follows:

- Section 23 tax relief would be restricted in use to rental income from the Section 23 property only and unused relief after a ten year period would be lost.

- Accelerated capital allowances would be restricted to be offset only against income from the property that gave rise to the accelerated allowances and may not be carried forward beyond 7 or 10 years, depending on the period over which the allowances were initially given.

- In addition, where a Section 23 property is sold within the 10 year relevant period, the new owner would get no relief.

1.7 Following the general election, the new Programme for Government "*Government for National Recovery 2011-2016*" commits to reducing, capping or abolishing property tax reliefs (and other tax shelters which benefit very high income earners).

1.8 In line with this the Department of Finance has undertaken an economic impact assessment into the effects of potential changes to the legacy property tax reliefs.

1.9 Organisations and individuals were invited to submit their views as part of a public consultation process which ran from 23 June to 29 July 2011. Over 700 individual responses were received. This high level of engagement by members of the public and a variety of organisations is gratefully acknowledged.

1.10 The Department's analysis has benefited from detailed data provided by the Revenue Commissioners on claims made for Section 23 type relief and accelerated capital allowances for the years 2004-2009. Some data on investor income levels were provided for the years 2007 and 2008. The Department has also undertaken detailed economic modelling on the impact on individual investors of terminating the reliefs and the potential costs of unused reliefs that have yet to be claimed by investors.

1.11 The impact assessment process has enabled the Department to better understand the benefits that may accrue to the Exchequer in terms of additional tax yield as well as consequences for investor groups and the wider economy arising from possible changes to the treatment of legacy reliefs.

1.12 This Report presents the final economic impact assessment report and contains the conclusions and recommendations that have emerged following the public consultation and economic analysis and modelling.

Structure of the Economic Impact Assessment Report

1.13 The next chapter describes the history of the schemes and discusses the proposed changes set out in the Budget 2011, Finance Act 2011 and the Programme for Government.

1.14 *Chapter 3 looks* at data from Revenue on claims under the property incentives from 2004 to 2009 and identifies emerging issues from an internal data analysis.

1.15 *Chapter 4* discusses the outcome of the public consultation process and includes a summary matrix containing a representative sample of submissions received.

1.16 *Chapter 5* looks at the economic impacts on individual investors. The impacts on non-professional investors and professionally advised investors are separately examined.

1.17 *Chapters 6 - 9* examine particular economic sub-sectors affected by the schemes including an analysis of healthcare, hotels and student accommodation.

1.18 *Chapter 10 assesses the possible impact of changes to the schemes on financial institutions.*

1.19 *Chapter 11* assesses the potential gains to the State in terms of additional tax revenue and outlines potential costs that may arise in respect of a policy change.

2. Review of the Legacy Property Relief Schemes

History

2.1 The legacy property incentives can be characterised as falling within two broad categories – Section 23 Relief (so-called as it was first introduced by section 23 of Finance Act 1981) in respect of residential property, and accelerated capital allowances in respect of industrial buildings.

2.2 In the case of Section 23 properties investors deduct the full amount of qualifying relief against rental income from the Section 23 property in the first year of letting. Where the amount of relief exceeds the rental income of the property the excess relief can be set off against other Irish rental income. Any unused relief is treated as a rental loss for the year and can be carried forward against any Irish rental income arising in later years until fully used up. In addition, to avoid a claw-back of reliefs the property must continue to be let for a period of 10 years from the first letting.

2.3 In respect of industrial buildings capital allowances can be earned over an accelerated period of time relative to the standard period thus increasing the net present value of the allowances to investors. For the majority of the non-area based property reliefs on industrial buildings the reliefs were for either 7 or 10 year periods. The area based reliefs were spread over a longer period. Others, including investments in childcare facilities could be recovered in their entirety in the first year.

2.4 Passive investors and lessors of industrial buildings may use their annual capital allowances against passive partnership trading income or rental income, as appropriate. Other than in the case of investment in hotels,[1] holiday camps or registered holiday cottages (where excess capital allowances cannot be set against other income), excess capital allowances may be used against other income up to a maximum of €31,750. Thereafter unused capital allowances may be carried forward into subsequent years but may only be used against the income from the business which gave rise to it.

2.5 In 2005 the Department of Finance commissioned Indecon Economic Consultants and Goodbody Economic Consultants to undertake detailed reviews of the various property-based reliefs.[2] The Goodbody study examined the area-based renewal schemes while the Indecon study examined the remainder.[3] The studies were both published and are available on the Department's website.[4]

2.6 With the exception of the capital allowances schemes for childcare facilities, private hospitals and private nursing homes Indecon recommended that the schemes be discontinued either with immediate effect or through limited transitional arrangements. The Goodbody study made similar

[1] No restriction applies in the case of investment in certain 3 star (or better) hotels in some border, midland or western counties.

[2] Many of the reviewed schemes were at the time 'expiring schemes', i.e. schemes for which transitional arrangements were already in place for their termination.

[3] The 'area-based renewal schemes' examined by Goodbody Economic Consultants consisted of Urban Renewal, Rural Renewal, Town Renewal and the Living Over a Shop Scheme. Indecon looked at the remainder of schemes which related mostly to industrial buildings and accelerated capital allowance type reliefs.

[4] http://www.finance.gov.ie/viewdoc.asp?DocID=3749&CatID=76&StartDate=01+January+2006

recommendations in respect of each of the area based reliefs with the exception of the 'Living Over The Shop Scheme' for which it recommended continuation.

"*In many cases, while the schemes have had a benefit our analysis suggests they have served their purpose and there is absolutely no case for further government incentives and there is absolutely no case for future government incentives. Continuing to approve new projects would contribute to oversupply and represent a clear waste of scarce public resources.*

In a number of cases on-going government support for the activity is needed (for example in the case of third level buildings) but the tax incentives are an extremely high cost and a wasteful mechanism to achieve the objectives. In a limited number of cases (private hospitals, nursing homes and childcare facilities) increased private sector investment is needed to address the economic and social needs"

Box 1: Extract from the Indecon Review of Tax Incentive Schemes

Source: Budget 2006: Review of Tax Schemes, Volume 1, Indecon Review of Tax Incentive Schemes

2.7 In Budget 2006, following the review of the property relief schemes, the Minister for Finance announced the termination, subject to certain transitional arrangements, of each of the schemes proposed for termination by Indecon and Goodbody.

2.8 A full list of the property schemes for which relief was claimed in 2009 is set out in Table 1 below.

Schemes	Start Date
Both Residential (S23) and Industrial Buildings Schemes	
Urban Renewal	1998
Town Renewal	2000
Rural Renewal	1998
Living over the shop	2001
Student Accommodation	1999
Industrial Buildings Schemes Only	
Seaside Resorts	1995
Multi-Storey Car Parks	1995
Living Over The Shop	2001
Enterprise Areas	1994
Park And Ride	1999
Holiday Cottages	1968
Hotels	1994
Nursing Homes	1997
Housing For The Elderly/Infirm	2002
Hostels	2005
Guest Houses	2005
Convalescent Homes	1998
Private Hospitals	2002
Sports Injury Clinics	2002
Childcare Facilities	1998
Mental Health Centres	2007
Caravan And Camping Sites	2008
Holiday Camps	1994
Third Level Buildings	1997
Special Palliative Care	Scheme not commenced
Mid-Shannon Corridor Tourism Infrastructure	2008

Table 1: List of Schemes

Source: Department of Finance

Government decisions to close down the reliefs

2.9 In the period since Budget 2006 virtually all of the schemes referred to in Table 1 above have been terminated subject to transitional arrangements for certain schemes where projects were already in the pipeline. The only scheme still open to new entrants is the Mid-Shannon Corridor Tourism Infrastructure Scheme, which is subject to State Aid approval from the European Commission.[5]

[5] The date for the submission of applications was extended to 31 May 2012 subject to EU State Aid clearance & expenditure can qualify to May 2015.

Budget 2011 and Finance Bill 2011

2.10 Budget 2011 proposed that as of 1 January 2011 the use of relief was to be restricted to income earned from the property which gave rise to the relief. This was to apply to rented residential and accelerated capital allowance schemes. In addition, any unused relief remaining after the expiry of 7 or 10 years (depending on the scheme) would be lost. Finally, where that period had already elapsed as of Budget day, unused relief would be immediately lost. Amongst other measures was a proposed 'guillotine' on all reliefs to be introduced by 2014. The Budget also proposed that an impact assessment would be undertaken into the effects of the phased abolition of the property based measures and the 'guillotine' measures.

2.11 Following the Budget announcement, affected parties presented a number of concerns to the Department of Finance including:

- The proposed restriction on the use of reliefs to the property that gave rise to the reliefs would effectively act as an immediate guillotine of reliefs;

- Investors and businesses may be faced with insolvency due to an unforeseen tax liability on income that had heretofore been sheltered from taxation;

- The risk of insolvency to investors and businesses that may arise due to warranties/indemnities that were granted by investment promoters to investors that protected investors against the risks of a change in the tax treatment of their investments; and,

- The use of reliefs has already been curtailed for those affected by the high earners restriction.

2.12 In order to properly consider these and other issues the measures proposed in the Budget and Finance Act 2011 required that an economic impact assessment be undertaken in advance of the commencement of the measures.

Programme for Government

2.13 The Programme for Government (Government for National Recovery 2011-2016) committed to "reduce, cap or abolish property tax reliefs and other tax shelters which benefit very high income earners".

2.14 This impact assessment will enable the Department to better understand the benefits that may accrue to the Exchequer in terms of additional tax yield as well as consequences for investor groups and the wider economy arising from possible changes to the treatment of legacy reliefs.

Restrictions on High Income Earners

2.15 Budget 2006 introduced a measure which imposed a minimum effective income tax rate of 20% on individuals with adjusted income levels above €500,000. Those with adjusted income levels between €250,000 and €500,000 would pay an effective income tax rate that gradually increased towards 20% as their income approached €500,000. The measure works by restricting individuals' use of specified tax reliefs in any one tax year. An individual could claim the higher of €250,000 or 50% of their adjusted income in specified reliefs.

2.16 Budget 2010 introduced changes to the restriction on the use of specified tax reliefs. It reduced the upper adjusted income threshold for the payment of a minimum effective tax rate to €400,000 and applied a minimum effective income tax rate of 30% for those affected. The adjusted income threshold at which individuals became subject to the restriction was reduced to €125,000 from €250,000. In addition, the changes reduced the amount of specified reliefs that could be claimed in any one tax year to the higher of €80,000 or 20% of the individual's adjusted income.

2.17 Outstanding reliefs not claimed in a year as a result of the high earners restriction can be rolled forward and, where possible, claimed in subsequent tax years. The effect of this measure may have increased the volume of outstanding reliefs that had not been claimed by the time of Budget 2011. We return to this issue in the discussion on the economic effects later.

3. Analysis of Revenue Data

3.1 This Chapter presents an analysis of claims and income data provided by Revenue pertaining to property reliefs.

3.2 The Department has had access to two data sources from Revenue, the first relates to claims made by investors under the various incentive schemes. This covers both income and corporation tax claims for the period 2004 to 2009.

3.3 The second data series relates to income levels of investors across each of the schemes for the years 2007 and 2008. The income data relates to all income sources including PAYE income and covers property income. Income is provided on a gross income basis and therefore does not include deductions or credits that individuals may avail of in determining taxable income.

3.4 The proposals in Budget 2011 were targeted at passive rather than active investors. The data provided by Revenue categorises tax claimants under both income and corporation tax as either owner occupiers or investor/lessors. This categorisation is provided for both residential (primarily Section 23) and industrial buildings (accelerated capital allowances).

3.5 For residential buildings owner-occupiers are not in receipt of rental income from the properties. They are therefore excluded from our analysis of residential buildings schemes. Owner occupiers are also excluded from the industrial buildings analysis. However not all individuals that described themselves as owner-occupiers in their filings to Revenue qualify as active investors. Instances arise where passive investors in partnership with an owner-occupier may be categorised as owner-occupiers. For the purposes of this study investor/lessors are defined as passive investors.

3.6 Another point to note about the data is that in respect of Section 23, the data only identifies new claims made for relief, rather than the ongoing use of tax relief. Thus if an investor were to make an investment in 2005 that would generate total tax reliefs of €100,000, the entirety of the €100,000 would be attributed to 2005. The Section 23 data therefore measures the total possible amount of 'lifetime' tax relief and cost to State associated with that claim, but does not indicate how much of that amount is used in any given year. Claims in respect of capital allowances relate to claims actually made in a given year.

3.7 Finally the data does not give information on regional distributions of investments. While it would be of use to the Department in its impact assessment to see where investments are located, the geographical indicator available to Revenue refers to the location of the person claiming the tax relief and not the address of the property. The latter information was never sought or provided in the tax returns. The analysis below does not examine the location of tax claimants.

Claims and claimants over time

3.8 The following table (Table 2) sets out the total number of claims across all schemes from 2004 along with the total value of the claim and the total maximum lifetime cost of the claim to the Exchequer. The costs of Section 23 claims will not be incurred by the State in the year in which the claim is made, but rather be accrued over a number of years until used up against rental income. For comparison purposes owner occupiers are included.

	2004	2005	2006	2007	2008	2009	Total
Including owner occupiers							
Number of claims	7082	10594	13106	15049	14793	13379	74003
Value of claims (€,m)	586	968	1204	1167	1013	858	5796
Cost of claims (€,m)	246	383	476	455	391	339	2289
Excluding owner occupiers							
Number of claims	5912	8679	10507	11879	11588	10590	59155
Value of claims (€,m)	530	821	998	972	849	718	4989
Cost of claims (€,m)	223	332	398	386	327	285	1951

Table 2: Total number, value and maximum cost of claims 2004-2009

Source: Department of Finance analysis of Revenue data
**All data nominal and not expressed in present value terms*

3.9 The Table above (Table 2) shows that since 2004, when investors began filing claims specific to property reliefs, there have been approximately 74,000 claims across 25 schemes. Excluding owner occupiers this relates to almost 60,000 claims with a value in terms of total reliefs of almost €5bn, with a possible long term cost to the Exchequer of €1.95bn (assuming income tax claims made at higher rate of tax). This is displayed graphically below.

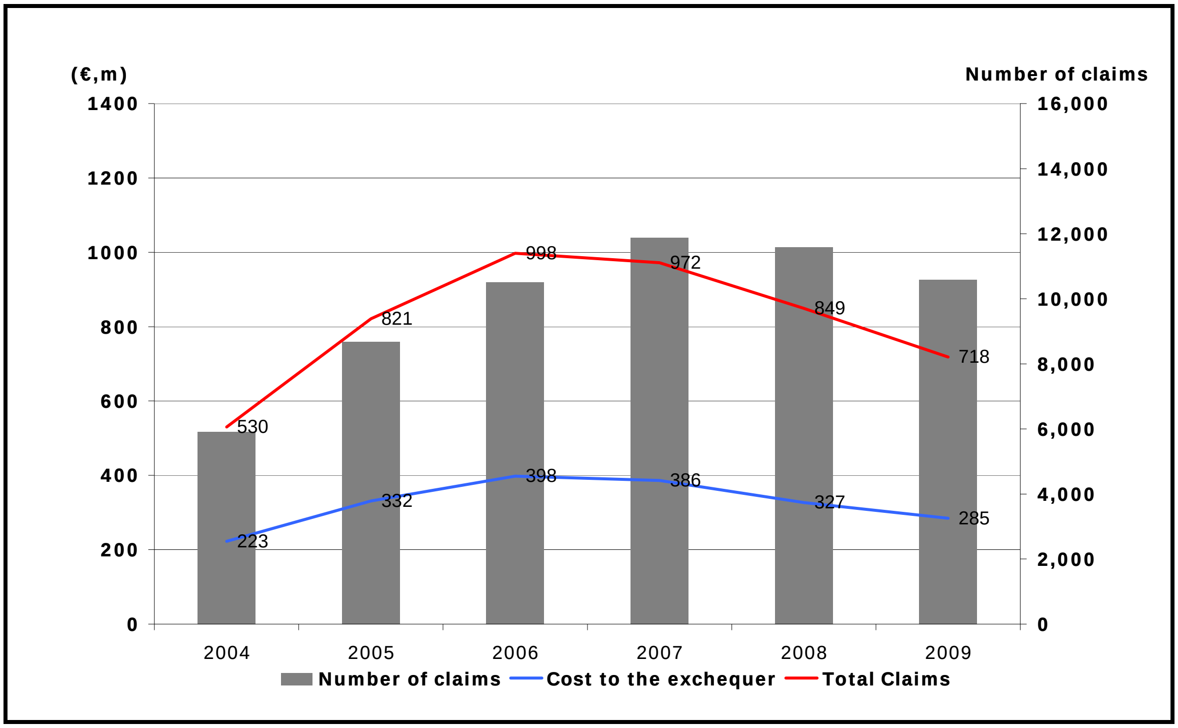

Figure 1: Total number, value and maximum cost of claims 2004-2009 (*)

Source: Department of Finance analysis of Revenue data

** Total value and cost of claims on the left axis and number of claims on the right axis*

3.10 There is considerable variability across the schemes in terms of intensity of investment as described by both number of claims and the value of claims. In terms of value the most heavily invested schemes were urban renewal, hotels and student accommodation with almost €3.2bn of claims made in respect of these schemes alone, equating to over 50% of all claims. The graph below illustrates the value of claims by schemes.

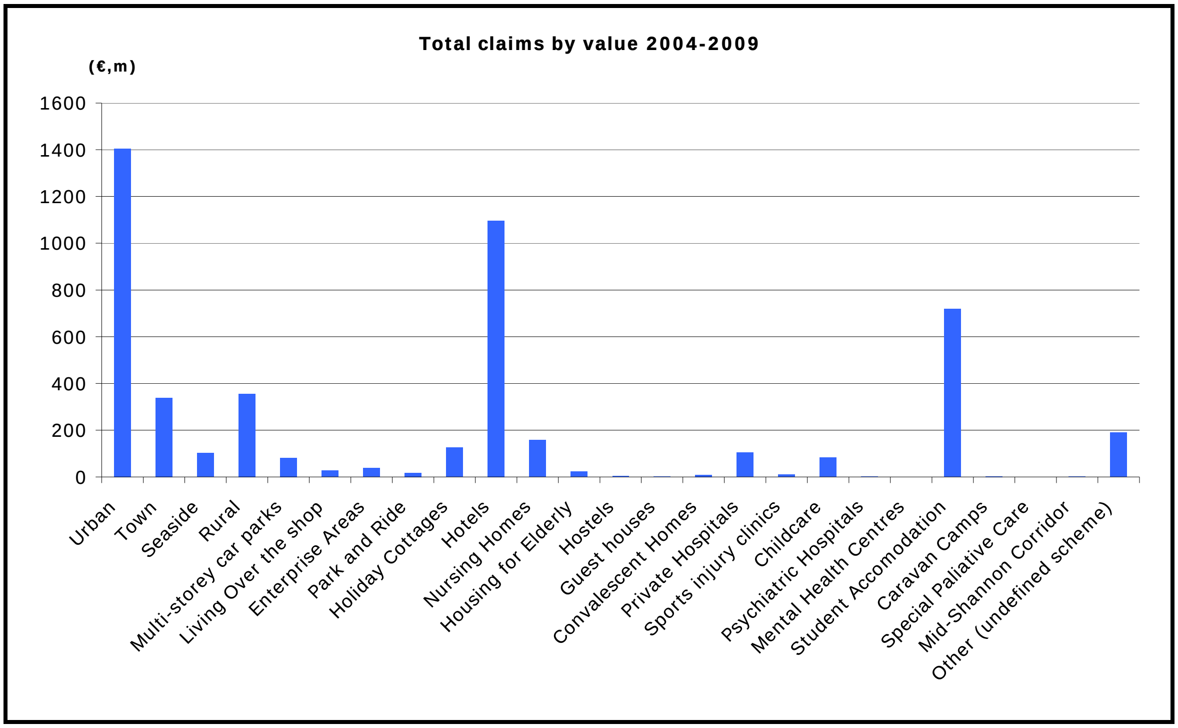

Figure 2: Total claims by value, 2004-2009

Source: Department of Finance analysis of Revenue data

3.11 In terms of share of claims, when rural and town regeneration and the relief for student accommodation are included along with the urban renewal and hotels, approximately 84% of all claims by value fall within these schemes. Figure 3 below illustrates this outturn. By looking at the total value of claims under each scheme it is possible to deduce the popularity of each scheme by number of investors and hence number of claims.

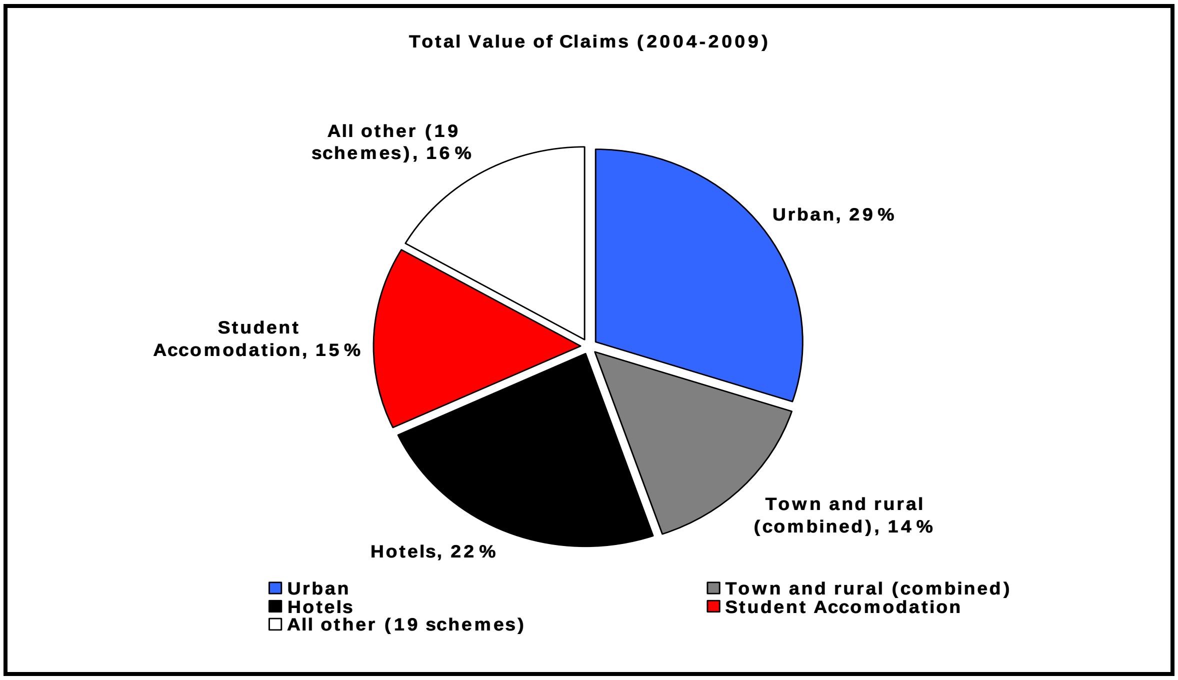

Figure 3: Relative share of total value of claims (2004-2009)

Source: Department of Finance analysis of Revenue data

3.12 Figure 4 below demonstrates the importance of the urban regeneration scheme which accounted for just over 15,700 claims or 27% of total claims received. In relation to the total value of claims, the relative importance of hotels in terms of numbers of claims has declined to less than half the number of claims made under the urban scheme. This indicates that the proportionate spend in the hotels schemes was greater than the area based schemes such as urban regeneration.

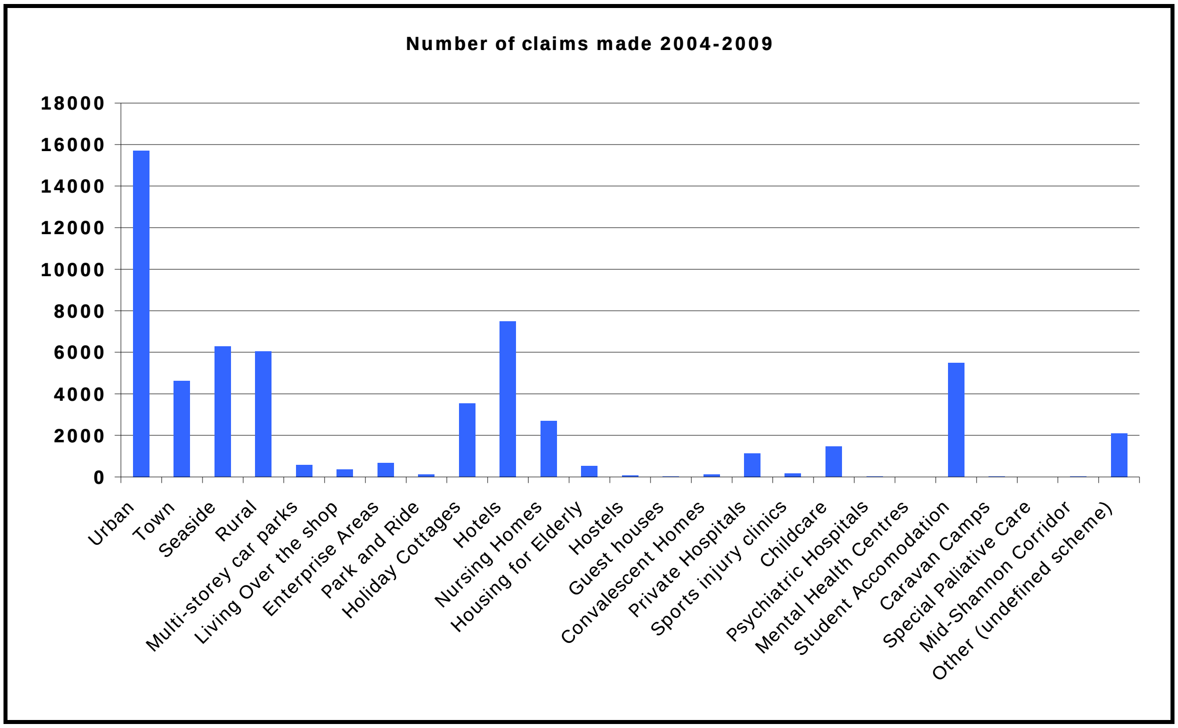

Figure 4: Total number of claims made by scheme, 2004-2009

Source: Department of Finance analysis of Revenue data

3.13 In terms of the total exposure to the Exchequer in terms of foregone tax, it is not surprising that the most costly schemes are those that have the highest value of claims, namely urban renewal and hotels. The graph below illustrates relative share for each scheme in terms of number of claims and total cost to the State. There is an almost one for one relationship between share of number of claims and share of Exchequer cost for the urban renewal whereas. However for hotels the share of cost is close to 50% higher than the share of number of claims suggesting a higher intensity of spend per investment. This pattern also occurs for student accommodation and is reversed for the rural renewal schemes with divergence arising in the seaside investments.

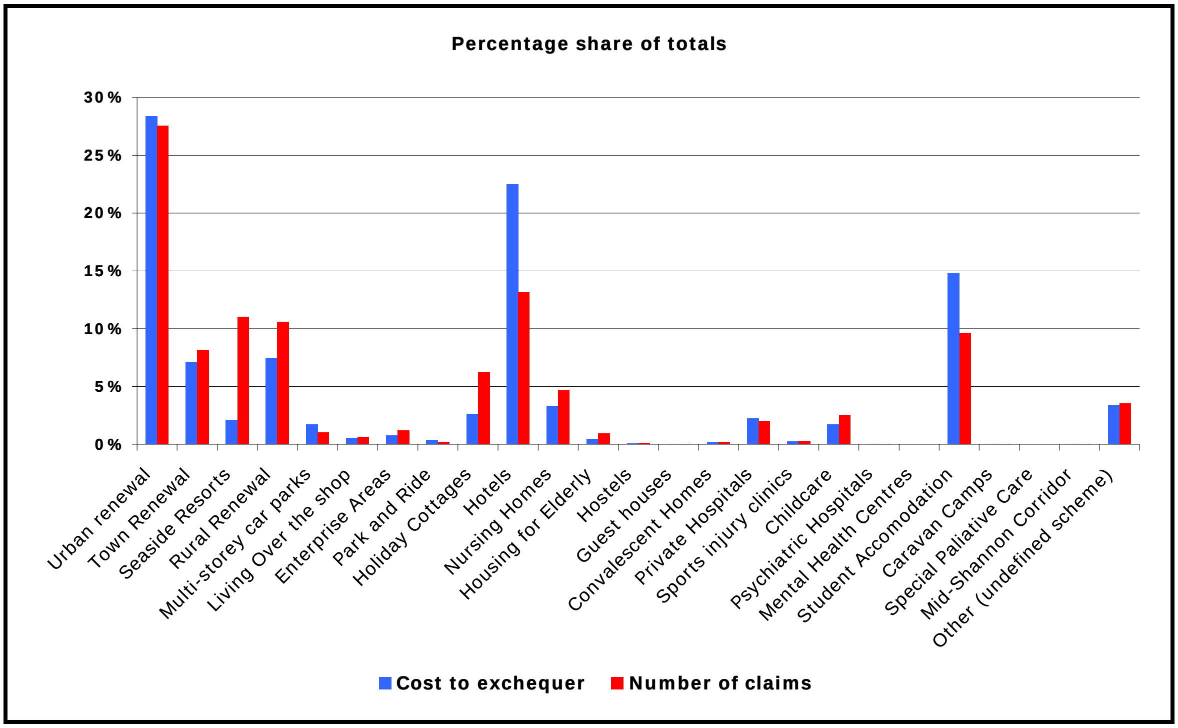

Figure 5: Percentage share of number and cost of claims by scheme 2004-2009

Source: Department of Finance analysis of Revenue data

3.14 It therefore appears that a small number of schemes accounted for most of the claims, in volume and value, with a similar profile in terms of the Exchequer cost. Given that there are commonalities amongst a number of schemes in size of investments, the Department's Consultation paper proposed that the Department would limit its focus to just a core set of schemes where those schemes are seen to be representative of other schemes. The views of respondents were sought on this issue.

3.15 A further area of interest is the profile of investors that participated in the property schemes and the types of schemes that investors of various income levels participated in. Revenue provided data for 2007 and 2008 that matches income tax filings to claims for property reliefs. It identifies the income level of a tax unit for the year that a tax unit filed an initial claim for property relief. The table below (Table 3) shows the share and cost of claims by tax unit within five income groupings in 2007.

Income level	Number of claims	Cost of claims
Less than €100,000	43%	10%
€100,000 - €150,000	17%	9%
€150,000 - €200,000	11%	8%
€200,000 - €275,000	9%	9%
Greater than €275,000	20%	64%

Table 3: Percentage share of claims and maximum cost by income band in 2007

Source: Department of Finance analysis of Revenue data

**includes owner occupiers*

3.16 The most interesting statistic from the table above is that roughly 43% of all claims in 2007 came from the 'less than €100,000' income grouping but that the cost of claims from this group accounted for only 10% of total cost. By contrast the most expensive group were the group with income in excess of €275,000 who accounted for 64% of overall cost but only 20% of total claims.

3.17 It is useful to map the income levels into schemes to determine how each scheme is populated in terms of income cohorts. Two graphs are presented below that show the most popular schemes, in terms of number of claims, for the two largest income groupings. The first graph relating to claimants in the 'less than €100,000' category. It can be seen that approximately 72% of all claimants in 2007 claimed for an investment in one of the area based schemes (including seaside), with the most popular investment being under the rural regeneration scheme which accounted for approximately 7% of total Exchequer costs in the 2004-2009 period and 10% of costs based on investments in 2007.

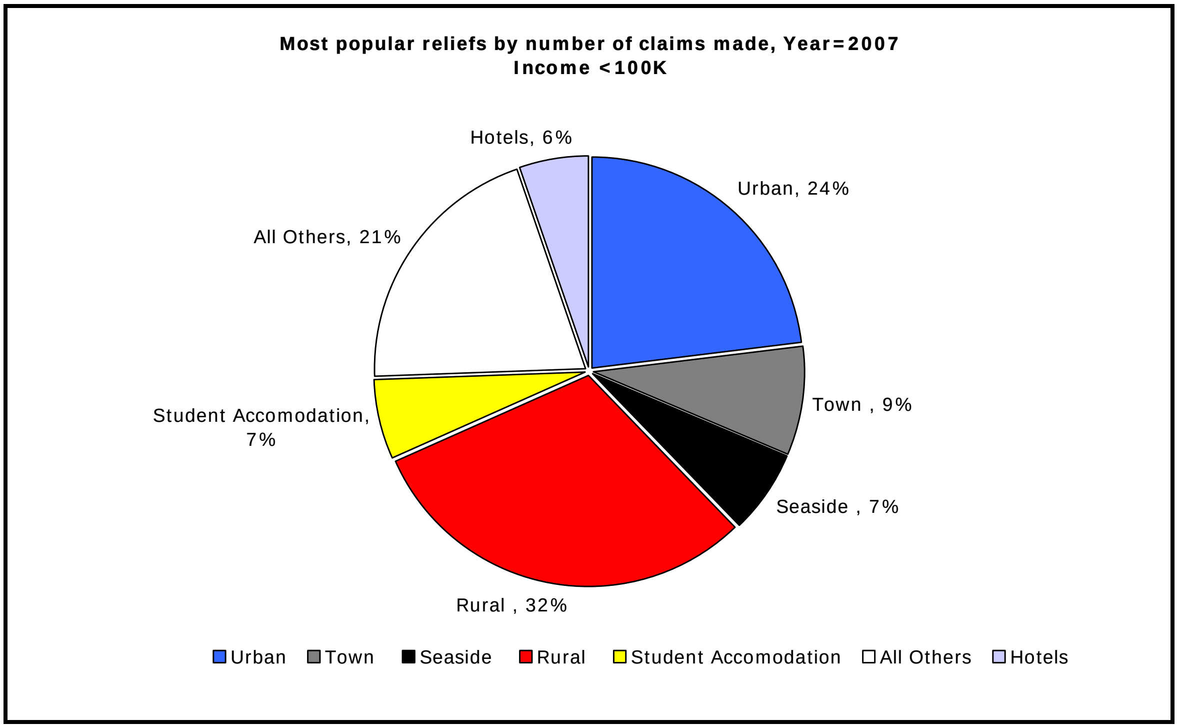

Figure 6: Most popular schemes for income levels below €100,000 in 2007

Source: Department of Finance analysis of Revenue data

3.18 In the 'greater than €275,000' income grouping, there is a similar share of take-up in the urban renewal scheme, with the other area based schemes declining in share of claims. The rural renewal scheme which accounted for 32% of claims made in the 'less than €100,000' income grouping declines to a 4% share with the town renewal scheme dropping to a similar level, albeit with a much smaller proportionate decline. The hotels scheme has had the most take-up amongst this group with almost one in four claims filed for this scheme.

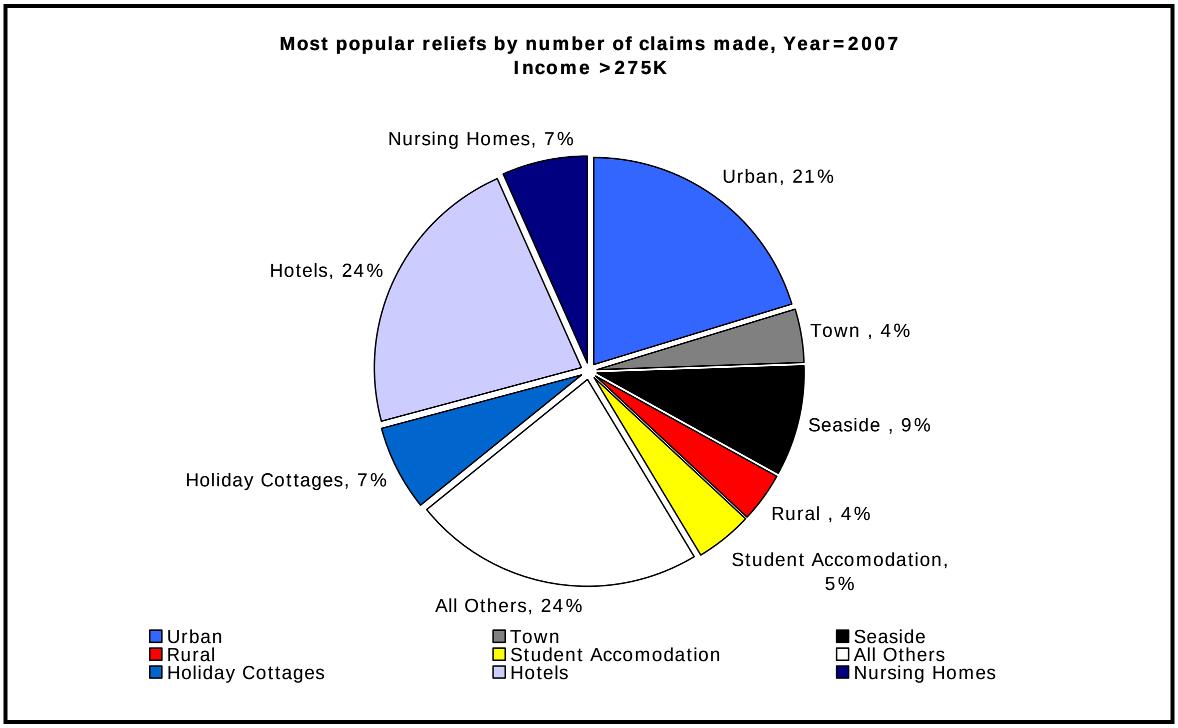

Figure 7 Share of total claims made by scheme for claimants of greater than €275,000 in 2007

Source: Department of Finance analysis of Revenue data

3.19 It is possible to identify certain schemes that represent popular schemes for different income groupings. The area based schemes along with hotels and student accommodation feature prominently for both the lower income grouping and the higher income grouping with investments in nursing homes of importance in investments by tax units with incomes greater than €275,000. These findings may support a view that there is merit to narrowing the focus of the study to a small number of schemes.

Conclusions

3.20 There are some limits in the data. The data do not permit us to perfectly identify the extent of passive investors in the industrial buildings schemes. The data does not identify the extent of tax reliefs used in a tax year, rather it identifies only the number and size of new claims made in a tax year and thus the total potential loss in tax revenues to the State. In respect of income tax information, the data links the income levels of tax units rather than individual claimants. Despite this a number of interesting patterns emerge.

3.21 Passive investors made close to 60,000 claims during the 2004-2009 period, with close to €5 billion in claims made which equate to approximately €1.9 billion in potential tax costs. As stated throughout this consultation paper, the €5 billion in claims - which can be used to shelter up to €5 billion in income from various sources - is not time bound.

3.22 Two thirds of the total tax cost to the State comes from urban renewal, hotels and student accommodation. When the town and rural renewal schemes are included, this group of five schemes account for over 80% of the total tax cost to the State. These five schemes also account for 69% of the total number of claims and the inclusion of the seaside brings the share of total claims to 80%.

3.23 The take up of tax relief schemes is highest amongst tax units with incomes of less than €100,000 with 45% of all claims coming from this grouping. This income group mainly participates in the area based schemes. Their counterparts in the 'greater than €275,000' income grouping had a higher intensity of investment in the hotels scheme with a lower participation in some of the area based schemes.

4. Outcome of the Public Consultation Process

4.1 The Department of Finance undertook a public consultation process as part of the economic impact assessment of the potential effects of amending, curtailing and/or abolishing the legacy property reliefs. The consultation was initiated with an invitation for submissions on 23 June 2011. The closing date for receipt of submissions was 29 July 2011.

4.2 The Department issued a consultation paper setting out the proposed measures curtailing legacy property tax reliefs which were provided for by Finance Act 2011, a preliminary analysis of data provided by the Revenue Commissioners from tax returns and a range of consultation questions. Interested parties were invited to consider the analysis in the consultation paper in formulating answers to the consultation questions and could present their own evidence in formulating responses. Parties were also invited to use and comment on the Department's economic model for assessing the effects of possible changes on investors, which was published alongside the consultation paper.

4.3 During the consultation period, the consultation paper was posted on the Department of Finance tax policy website (www.taxpolicy.gov.ie). The Department wished to engage with as many interested parties as possible, and issued a press release to announce the consultation. A briefing session was held for the media and the paper was distributed to all public representatives.

4.4 The Department received 743 written submissions during the consultation period. Submissions were received by post or via e-mail through the Consultation Mailbox on the Department of Finance's Tax Policy Website. Respondents included members of the public (individual investors), business organisations, representative organisations, private companies and professional advisors. It should be noted that we have not verified the identities of the respondents. Each submission has been counted as a separate response, with the exception of obvious cases of duplication.

4.5 The Department expressly stated in its consultation document that views put forward may be published on the Department of Finance's website and would potentially be subject to release under the Freedom of Information Act.

General Overview of Responses

4.6 A total of 743 responses were received from a diverse cross-section of individuals and organisations.

4.7 The majority of respondents (656) responded in a personal capacity, whilst the remaining (87) responded on behalf of an organisation/body/group. Throughout this report, 'Respondents' is used to refer to both individuals and groups.

4.8 The submissions varied greatly in length and scope. They ranged from a cut-out pro forma letter which issued in national newspapers, to a few short sentences on specific points to more detailed responses over several pages addressing a range of issues.

4.9 A general summary of the responses and key points in submissions is given below. All points made have been noted, and as many as possible are referenced in this Report, even if the volume of responses which were received meant that it has not been possible to explicitly refer to each comment received or suggestion made. The majority of submissions did not respond directly to the consultation questions, however all responses were carefully considered and are fully reflected in the analysis which is presented in the remaining Chapters of this report.

4.10 In total 743 responses to the consultation were received with only one submission endorsing the Budget 2011 proposals to restrict property-based tax reliefs. The overwhelming majority of respondents expressed their concern and opposition to the proposed restrictions. It should be noted that due to the self-selecting nature of consultation exercises, the findings presented here relate only to those who responded to the consultation and cannot be generalised to be seen as representative of the wider population.

4.11 A general summary of a sample of the submissions received from organisations and individuals during the course of the public consultation process is provided in an anonymised matrix format in the Appendix to this report.

Geographic Spread

4.12 The majority of respondents (631) included their location, but relatively few indicated where their investments were located. The following table gives a geographical breakdown by county of those respondents who stated their address. The greatest number of submissions came from Dublin (238) followed by Cork (154) with the fewest emanating from Laois (1), Leitrim (2), Offaly (2) and Donegal (3).

County	Number of Respondents
Carlow	9
Cavan	9
Cork	154
Clare	11
Donegal	3
Dublin	238
Galway	24
Kerry	14
Kildare	19
Kilkenny	7
Laois	1
Leitrim	2
Limerick	15
Longford	5
Louth	16
Mayo	8
Meath	25
Monaghan	4
Offaly	2
Roscommon	3
Sligo	6
Tipperary	14
Waterford	8
Westmeath	10
Wexford	5
Wicklow	19
Total that stated location	631

Table 4: Geographical distribution of respondents

Source: Department of Finance analysis of Public Consultation response

Schemes Invested in

4.13 The majority (487) of respondents did not indicate which type of schemes they had invested in or were concerned with. Of the remaining submissions 128 respondents stated they had invested in residential property, but did not indicate whether the scheme was one of the renewal schemes (Urban, Rural or Town), Living over the Shop, Park and Ride or Student

Accommodation schemes. 7 respondents stated that they had invested in commercial property, but again did not indicate which schemes. 17 respondents indicated their participation in more than one type of scheme. The specific schemes mentioned most by respondents were Student Accommodation, Holiday Cottages, Nursing Homes, Qualifying Hospitals, Hotels, Urban Renewal, Town Renewal and Childcare Buildings.

Responses from individual investors

4.14 Almost half of the responses (294) from individual investors were in the form of a pro forma sample letter to the Minister for Finance published by the Institute of Professional Auctioneers and Valuers (IPAV) in national newspapers and on their website. These respondents either submitted a cut out of the sample letter or reproduced the letter text in full on their own letterhead. The letter is reproduced in Box 2 below.

Mr Michael Noonan TD
Minister for Finance
Upper Merrion Street
Dublin 2

July 2011

Re: Provision in relation to Section 23 Type Relief and Other Capital Allowances for Passive Investors contained in Budget 2011

Dear Minister,

I take this opportunity to make a submission outlining my serious concerns on the proposed changes announced to property reliefs in Budget 2011.

The people affected by these changes are tax compliant ordinary individuals, like myself, who were encouraged to invest in schemes in specific areas in order to rejuvenate these areas. They also seemed an attractive way of building up a pension fund at the time.

Like many others, I responded to the incentives introduced and paid a premium to acquire the tax relief attached to the properties although the project itself yields low rental income. These developments would not have occurred without the tax incentive offered. I obtained bank borrowings to make this investment and I made it in the belief that the allowances over the periods of time as set out in the legislation would be available to me. The withdrawal of these reliefs will mean that I will now suffer great financial distress.

The purchase of these properties was made by me and other investors in good faith. The proposed changes will further depress property prices, will increase repossessions by financial institutions, and will bankrupt investors thereby increasing the financial burden on the already stressed taxpayer. It will also be a breach of faith by the Government which is honour-bound to allow the reliefs to finish their normal lifespan.

I urge you to revisit these proposals in the upcoming Budget and to restore the reliefs and allowances as originally provided for under the Taxes Consideration Act [sic] in the Finance Bill 2011.

Yours sincerely

____

Address:
____

Box 2: Institute of Professional Auctioneers and Valuers (IPAV) pro-forma letter

4.15 In summary the letter reproduced above urged that Section 23 Type Relief and other Capital Allowances be allowed to continue to operate for their original lifespan. It noted inter alia that the withdrawal of the reliefs would further depress property prices, increase repossessions by financial institutions, and would bankrupt investors thereby increasing the financial burden on taxpayers.

4.16 A further 61 respondents used the pro forma letter as the basis for their submissions. These submissions asked that the measures relating to property-based tax reliefs provided for in Finance Act 2011 not be introduced. Additional points stressed in support of not introducing the proposed restrictions included:

- The payment of premium purchase prices due to the tax incentive offered;
- The absence of rental income over the past few years;
- The effect of the reduction in property prices; and,
- The existence of 100% loans on the original purchase prices.

4.17 The 301 investors who responded in a personal capacity submitted individual responses. A substantial number of these submissions included details of personal circumstances and, to a greater or lesser degree, details of the investments involved. The majority expressed concerns about the possible effects of the restrictions proposed in Budget 2011 and Finance Act 2011 on them.

4.18 In a small number of cases submissions were received from numerous investors in certain property developments e.g. 29 submissions related to one Section 50 student accommodation development.

4.19 The majority of responses from individual investors who indicated their investment type related to Section 23-type investments followed by Section 50 student accommodation investments.

Responses from Organisations/Groups

4.20 As stated earlier, 87 submissions were received from a variety of organisations and groups. A small number of companies used the sample

IPAV letter (referred to previously) as their submission. The chart below shows the level of response by organisation type and highlights that the largest response was from "professional advisors" (33%). This category comprised of tax, legal, accountancy, investment advisors and management consultants. A significant response (24%) was also received from "scheme operators" e.g. medical, hotel, educational or childcare organisations that operate facilities which qualify for various property-based relief schemes.

4.21 "Representative organisations" i.e. bodies representing business, professional groups, industry sectors, and trade unions accounted for 21% of group respondents. Property related professions such as auctioneers, estate agents, mortgage brokers and property developers make up the "property interests" category in the chart and submitted 19% of group responses. The "miscellaneous" category (3%) includes service providers to the property industry e.g. engineers.

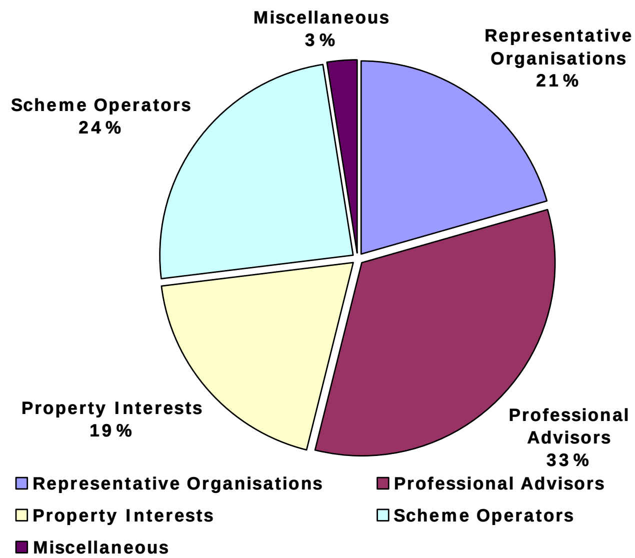

Figure 8: Response by Organisation Type

Source: Department of Finance Analysis of Responses to Public Consultation

Response to Consultation Questions

4.22 In order to assist respondents with formulating their responses the consultation paper posed seven questions for respondents to consider. A total of 114 (15%) of all respondents addressed these questions directly and a summary of the responses to each question follows.

Question 1: Based on the evidence presented in the paper do interested parties agree that there is merit in limiting the scope of the study to a small number of core or representative schemes?

The majority of those who responded felt that the study should not be limited and that there is a need to study as many schemes as possible. The reasons cited for this included:

- A “one size fits all” approach is not appropriate as there are many different scenarios and a variety of investors many of whom face events outside their control e.g. receivership or liquidation; and
- There are a variety of schemes, which differ in terms of legal structure and indemnity agreements.

Alternative suggestions included studying the income of affected taxpayers and their current tax burden rather than the nature of the scheme or allowance.

Box 3: Summary of responses to consultation paper question number 1

Source: Department of Finance analysis of Responses to Public Consultation

Question 2: Which schemes may be candidates for the ‘focused study’, and why?

Of those who agreed with a focused study the most popular scheme “candidates” were urban renewal, hotels, student accommodation and rural renewal respectively.

Box 4: Summary of responses to consultation paper question number 2

Source: Department of Finance analysis of Responses to Public Consultation

Question 3: What issues other than those described herein should be taken into account in determining which schemes to study in greater depth?

Responses varied but the issues generally cited for consideration in determining the schemes to study in depth included: -

- The potential downstream effects on the economy e.g. risk of loan defaults, insolvency, effects on financial institutions, NAMA, and further instability in the property market;
- The effects on investors who may have been unable to absorb their reliefs previously and the viability of small investors.
- The extent of used and unused relief, and the remaining duration of schemes;
- The depressed property market and incomes;

- The High Earners Restriction, particularly the 2010 changes;
- The societal impacts and need for specific analysis of health related and other "public good" schemes; and,
- The potential for reputational damage if schemes were restricted.

Box 5: Summary of responses to consultation paper question number 3

Source: Department of Finance analysis of Responses to Public Consultation

Question 4: What do parties believe are the economic arguments for restricting or terminating the legacy property reliefs?

The majority of those who responded stated there was no economic argument for restricting or terminating the reliefs. Reasons given in support of this view included that the negative economic impact would outweigh any perceived benefit and that the High Earners Restriction is already achieving the aim of restricting the reliefs.

The most common responses from those who cited an economic argument in support of restricting or terminating the reliefs included:

- The need for an increased tax take in the economic downturn, the urgency of addressing the national deficit and the case for eliminating future investments under these schemes in the current economic conditions;
- An over reliance on one sector e.g. property should not be permitted again; and
- The need to prevent oversupply in the property market.

Box 6: Summary of responses to consultation paper question number 4

Source: Department of Finance analysis of Responses to Public Consultation

Question 5: What do parties believe are the economic arguments against restricting or terminating the legacy property reliefs? Responses should focus on risks to economic activity rather than individual circumstances.

The majority of those who addressed the consultation questions provided responses to this question. Common arguments cited included:

- The potential for personal financial distress leading to loan defaults, consequential negative impacts for financial institutions and NAMA and possible tax default;
- The negative impact on the wider economy due to business closures and insolvencies resulting in unemployment and loss of tax receipts would place increased costs on the State;

- Other measures such as the High Earners Restriction have already restricted the use of the reliefs and reduced their cost to the State:
- Further damage to a depressed property market, which has experienced a significant decline in incomes;
- The reliefs are required to fund tax-based investments and those with interest only mortgages are at particular risk;
- The potential for damage to investor confidence in other State incentive schemes and possible questions over the reliability of Ireland's taxation framework, which could impair our international reputation;
- The negative effects on investments in particular schemes such as hospitals, nursing homes, etc., could place demands on the State to provide alternative care facilities;
- The existence of indemnities, which might be called in by investors, and potentially result in business closures; and,
- Investors may have to sell properties, which would trigger claw-back provisions.

Box 7: Summary of responses to consultation paper question number 5

Source: Department of Finance analysis of Responses to Public Consultation

Question 6: Should the Department consider separate treatment of Section 23 and Accelerated Capital Allowances?

The majority of those who responded favoured separate treatment. General comments in support of this related to differences in the kinds of developments supported by Section 23-type reliefs and Accelerated Capital Allowance Schemes, the different benefits and the nature of the investors.

Box 8: Summary of responses to consultation paper question number 6

Source: Department of Finance analysis of Responses to Public Consultation

Question 7: What alternative policy proposals would interested parties suggest to minimise the costs to the State?

The most common responses related to the use of the High Earners Restriction. Many respondents felt that this measure was sufficiently impacting on the property-based tax reliefs, particularly since the 2010 changes. Suggestions included awaiting an analysis of the 2010 tax returns to assess the additional gains prior to introducing any restrictive policies. A number of responses suggested the following:

- Phasing out the reliefs over a longer period or gradually reducing the amount claimed over time;

- Lengthening the number of years that the relief could be claimed over; and,
- Introducing a cap on the amount of relief.

Box 9: Summary of responses to consultation paper question number 7

Source: Department of Finance analysis of Responses to Public Consultation

4.23 The remaining Chapters of this report, which draw on the responses to the public consultation, examine in detail the impact of a restriction or termination of reliefs on:

- Various investor types;
- A number of economic sectors (as suggested by responses to the consultation paper); and,
- The State.

5. Impacts on Investors

5.1 This chapter looks at the economic impacts on individual investors. The impacts on non-professional and professionally advised investors are separately assessed.

Classification of Investors

5.2 The consultation paper presented data on various investor groups differentiated by their income levels. Investors (as measured herein by 'tax units') with income less than €100,000 accounted for 44% of total claims received but only 27% of the total cost to the State of claims. This indicates that middle (and lower) income investors made a large number of claims each of relatively low cost to the State. By contrast, investors with income in excess of €275,000 accounted for only 20% of the number of claims received but almost 44% of the total cost of claims.

5.3 The chart below presents data on the amount of claims and the value of claims received by Revenue in 2007. A linear relationship, as illustrated by the trend-line in the graph below, appears to exist between four of the five income groups with the 'less than €100,000' income group accounting for a high number of claims in terms of amount and value whereas the '€200,000 to €275,000' group accounts for a low number of claims under both metrics. The outlier is the 'greater than €275,000' group who account for the second highest number of claims received and the highest value of claims.

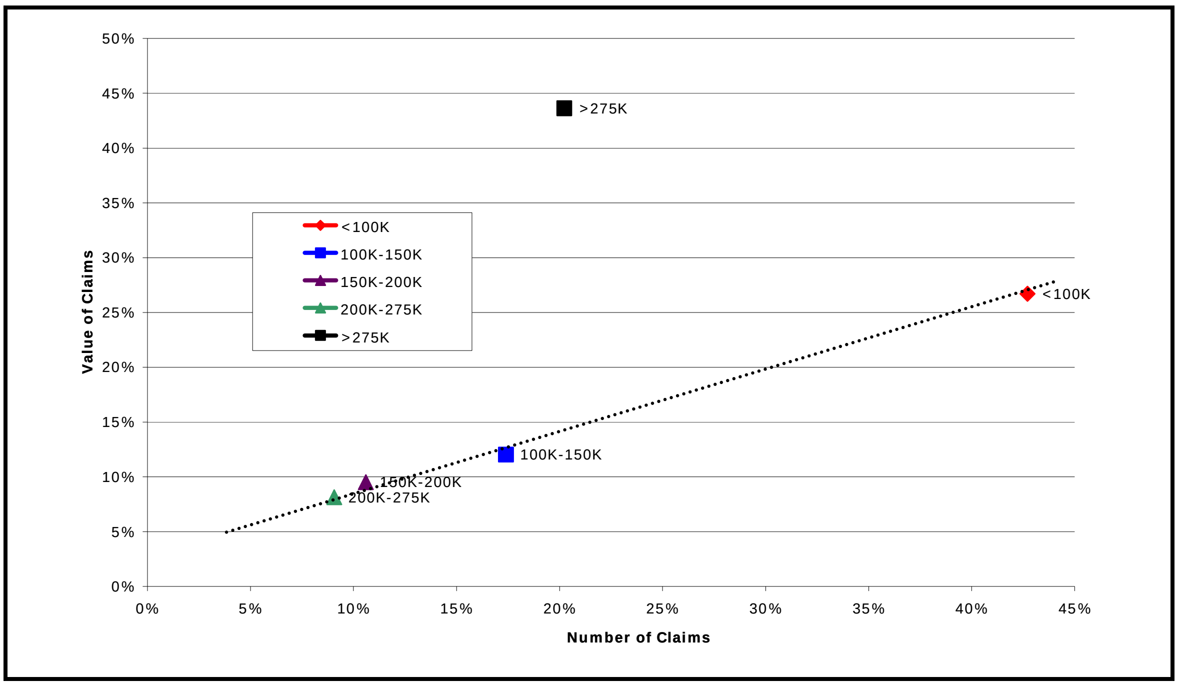

Figure 9: Share of claims and value of claims by income group, 2007

Source: Department of Finance analysis of Revenue data

5.4 An analysis of the type of schemes populated by the various income groups shows that 80% of all investments by the 'less than €100,000' income group occurred in the mainly buy-to-let (i.e. Section 23) space of Urban, Town and Rural Renewal as well the Seaside and Student Accommodation schemes. This is unsurprising as these were the types of schemes for which participation didn't normally depend on detailed tax planning and contractual advice unlike some of the industrial buildings schemes such as Hotel and Healthcare (e.g. private hospitals) schemes.

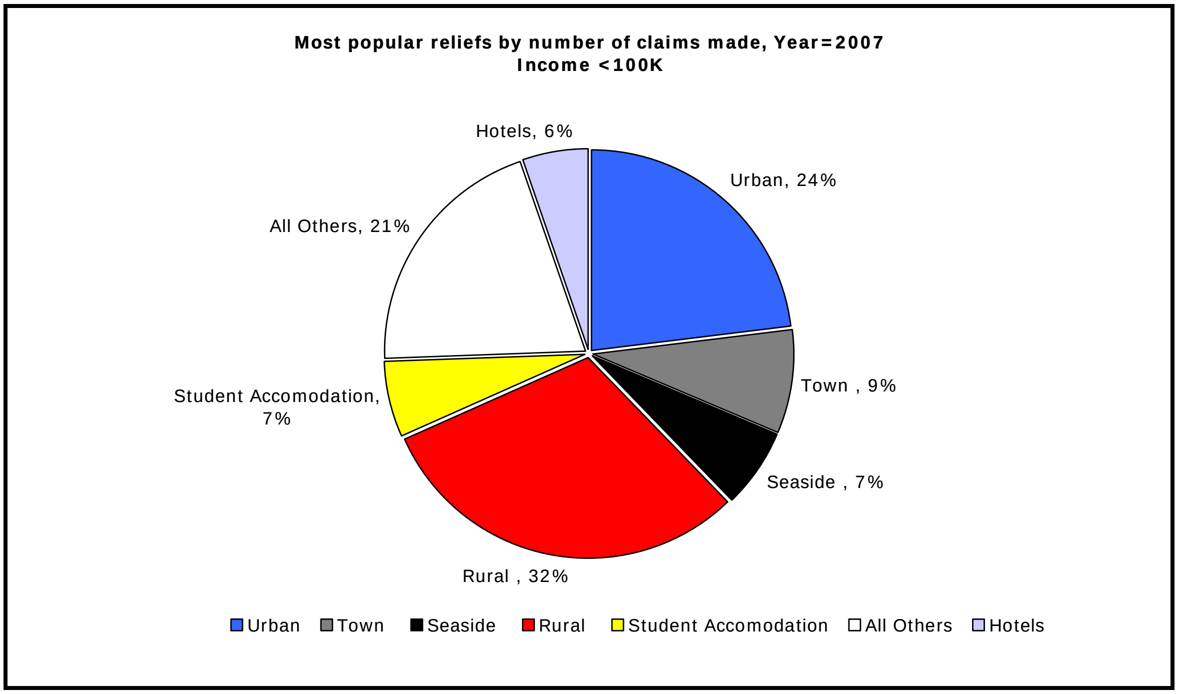

Figure 10: Most popular schemes for income levels below €100,000 in 2007

Source: Department of Finance analysis of Revenue data

5.5 The wealthier investor groups participated to a greater extent in the industrial buildings schemes with 25% of all investments by the 'greater than €275,000' group occurring in the hotels schemes. The schemes generally required higher upfront investments but with a quicker remuneration – for instance over seven years in the case of a hotel and private hospital. In contrast residential buy to let tax incentives (i.e. the Urban, Town and Rural Renewal Section 23 scheme) were not time bound and may be remunerated over a much larger time period.

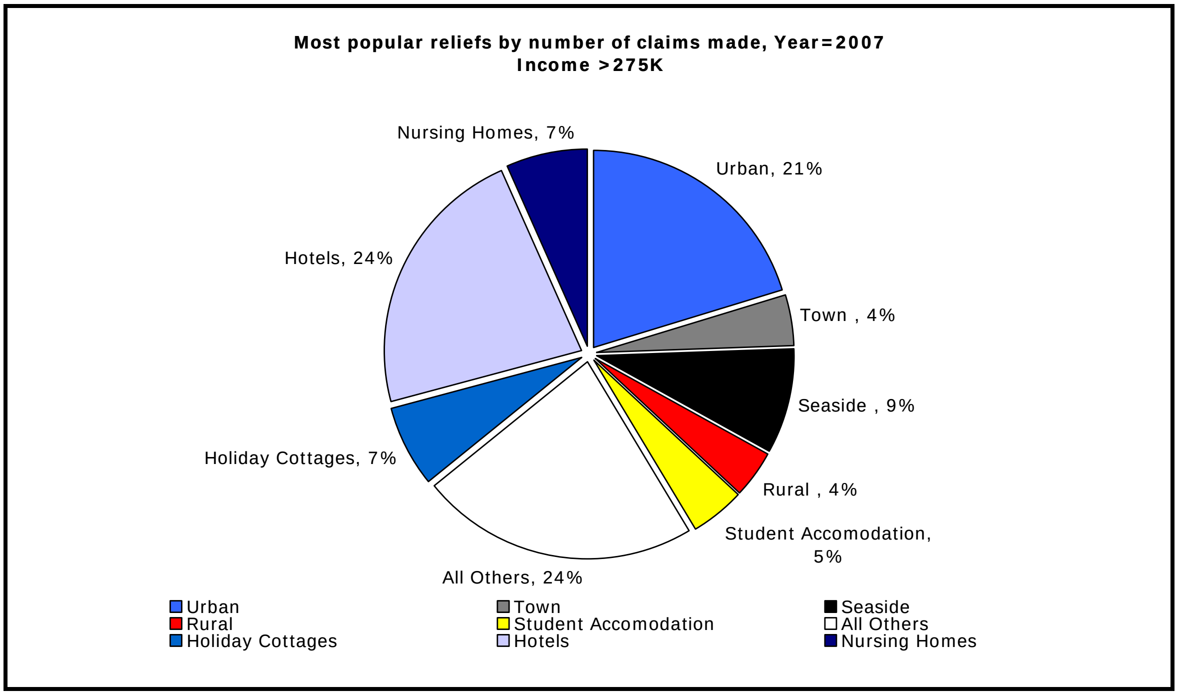

Figure 11: Most popular schemes for income levels greater than €275,000 in 2007

Source: Department of Finance analysis of Revenue data

5.6 In our analysis of the effects of a termination or restriction of reliefs on investors it is useful to group investors by their characteristics. Investors can be differentiated by their income levels – indeed the State regards those with incomes in excess of €125,000 as 'high earners' – or by the types of schemes that they participated in, possibly by using a residential property (i.e. Section 23 and Section 50) and industrial/commercial buildings distinction. In broad terms the distinctions largely overlap as wealthier individuals tended to favour the industrial buildings schemes and the lower income groups tended to favour the buy-to-let residential schemes. While the data does demonstrate that wealthier individuals also invested in S23/S50 property, they tended to do so on a much larger scale through multi-unit purchases as against the single unit investments of the lower earner group. In addition they also tended to invest in industrial buildings investments within a 'renewal area' whereas the lower income group participated mostly in buy-to-let residential units.

5.7 It is the Department's view that that it is reasonable to describe individuals with incomes in excess of €100,000 as professionally advised investors and those with incomes below €100,000 as non-professional investors. Professionally advised investors therefore are those investors that are mostly subject to the high earners restriction, that invested in industrial buildings schemes and who made large scale investments in residential property. Their motivation for investment was to minimise their tax liability across a large property portfolio.

5.8 Non-professional investors are not subject to the high earners restriction, mostly invested in residential or 'tax designated' buy to let properties and did not normally hold a portfolio of multiple 'tax designated' properties. Their motivation for investment was to make a small investment in the property market and to shelter a modest rental income from a small number of non-tax designated properties. This was facilitated by sheltering the rent from a non-tax designated property – due to the purchase of a tax designated property - and using this rent to cover the mortgage costs of the tax designated property.

5.9 The consultation paper described the possible effects of the changes in the Finance Act. Across both the professionally advised and non-professional investor groups the concern was the risk of insolvency. The consultation paper helped our understanding of the extent and scale of this concern.

Non-professional investors

5.10 As described above, non-professional investors mainly invested in the buy-to-let space. Tax designated properties were sold at a premium to other 'non-tax designated' properties. The premium reflected part of the capitalised value of the tax benefit such that part of the benefit of the associated tax shelter accrued to the vendor. Benefits also accrued to the State in terms of taxes and the development of private rental accommodation in areas targeted for regeneration and renewal. Given that stamp duty is levied on the purchase price, to the extent that the Tax designated property sold at a premium to a similar non-tax designated property, a proportion of the premium would have also accrued to the State.

5.11 Given that the 'tax designated' properties were located in areas that didn't offer high yields in terms of rent, the rationale behind the investment was a potential capital gain and a tax shelter on rent from another property. The collapse in the property market has meant that the capital appreciation rationale has not materialised. Investors are therefore faced with paying a mortgage on a property which may be in negative equity and with a poor yield performance. The low yield on the property may not be covering the mortgage payments, thus the contribution the tax-sheltered rent from non Section-23 may have become an essential mechanism in servicing the mortgage.

5.12 The Table below attempts to illustrate the potential negative equity for investors that purchased a residential buy to let property in years 2004-2007. The data uses the CSO residential property price index and models an expected loan-to-value in 2011 based on a property purchased for €300,000 with a 100% 20 year mortgage at 3% per annum. Capital payments are assumed to have been made by the investor although it was common practice in the buy-to-let sector for investors to enter 2-5 year interest only mortgages. It is also assumed that the 'tax designated' property which is part of an Urban, Town, Rural or Student Accommodation scheme declined in price at the same rate as all properties of its category. However it is likely that 'tax designated' properties have declined by a greater proportion than non-tax designated properties.

	National - all	National - house	National – aparts.	Excl Dublin - all	Excl Dublin - houses	Dublin - all	Dublin - houses	Dublin – aparts.
Property purchased in January 2005								
Price change to Aug 2011	-26%	-23%	-45%	-22%	-21%	-34%	-29%	-45%
LTV in Aug 2011	99%	95%	134%	95%	93%	110%	103%	134%
Property purchased in January 2006								
Price change to Aug 2011	-34%	-31%	-49%	-30%	-29%	-42%	-38%	-50%
LTV in Aug 2011	118%	114%	154%	111%	109%	133%	126%	-56%
Property purchased in peak month (Sept 2007)								
Price change to Aug 2011	-43%	-42%	-55%	-40%	-39%	-50%	-48%	-56%
LTV in Aug 2011	150%	145%	188%	141%	139%	170%	164%	192%

Table 5: Levels of negative equity

Source: Department of Finance analysis and modelling

Assumes: Property purchased €300,000 with a 100% 20 year mortgage at 3% per annum
Property price changes use the CSO Residential Property Price Index

5.13 As can be seen from our analysis, individuals that purchased an apartment in January 2006 may have a loan to value ratio of 154% while their counterparts in 2007 may have a loan to value ratio of 188%. Negative equity for 'tax designated' properties may well be higher than the generality of properties given the location of 'tax designated' properties and the uncertainty regarding the remuneration of tax incentives.

5.14 The following is an extract from the submission of a non-professional investor.

"I am the owner of one Section 50 property and 50% of a 3-bed semi detached house with my sister. Both are mortgaged and in negative equity and negative cash flow. Finance Act 2011 would add a tax bill to my already negative cash flows. Unfortunately I cannot retrospectively change my decisions of the past. My purchases cannot be unwound. My debts cannot be repaid. I have no exit strategy available. I am stuck with my current situation of negative equity and negative cash flows on these 2 properties. I am surviving to date by using past borrowings/savings to service my interest payments. Soon I will also have to repay capital. I have borrowed money to pay for the Section 50 relieved property and I must repay that debt even [if] the relief is abolished. This is clearly a most unreasonable retrospective tax policy reversal.

Smaller owners, mostly highly indebted, simply cannot survive the forthcoming bigger negative cash flows resulting from the combination of recent (75% interest relief restriction) and proposed tax changes (If implemented without some modification).

Government doesn't seem to understand the fact that there wouldn't be more tax revenue generated – only more bankruptcies and tax defaults and debt foreclosures and bank write downs and government bailouts and recapitalisations.

Box 10: Response by a non-professionally advised investor

Source: Response to consultation

5.15 As stated in the extract, aside from the levels of negative equity, individual investors have experienced a number of recent constraints on cashflows including a transition from interest-only to interest plus capital mortgages after initial introductory period for buy-to-let mortgages. The buy-to-let sector has been identified as the sector with the highest proportion of mortgage arrears. This is discussed in greater detail in our assessment of the impacts on financial institutions.

5.16 The effect of a termination of reliefs from buy-to-let investments in Urban, Town, Rural and Student Accommodation schemes would be to tax the rent on the non-tax designated properties in an individual's property portfolio. Our understanding of investor cash flows is that Section 23 properties do not in many cases yield sufficient rent to cover mortgage payments. Thus an investor's portfolio depends on the rent derived from 'non-tax designated' properties which heretofore has not been subject to tax. By taxing this cash flow the investor's overall cash flow will decline and jeopardise their ability to repay debt in respect of their properties.

5.17 The Department has developed a model to identify the impact of possible tax relief restrictions on individual investors in Section 23 schemes (though a similar logic applies to the impacts on investors in industrial buildings schemes).

5.18 Outlined below is a stylised case of investor cash flows from the model (Table 5). The example is of an individual with gross rent from non Section 23 property of €20,000. The model introduces a Section 23 property with an associated loan of €300,000 over 15 years at an interest rate of 3.23%. The investor has annual rent of €6000 per annum.

5.19 The model assumes that investors are taxed on all of their income at 41% with PRSI contributions of 3% and a USC of 7%. It also assumes non-mortgage interest deductions of €1000 per annum per property. Consistent with recent budgetary changes mortgage interest deductions are allowed at 75%. The high income earner restriction is not accounted for in the modelling. It is also assumed that investors have mortgages on Section 23 properties only and not on non Section 23 properties although the model can provide this functionality. Consistent with the historical relationship it is assumed that the tax benefits accruing from the Section 23 property amount to 90% of the purchase price. Finally there is an assumption that the Section 23 property was purchased in 2008 and the changes in policy arise from 2012 onwards.

5.20 Some respondents to the consultation viewed the interest assumptions as being too low and suggested that investors are unlikely to have borrowings on only one property. Whilst these comments are valid, conservative estimates of interest payments and leverage as used in the assumptions sufficiently illustrate the economic impact.

5.21 The investment in a Section 23 property enables the investor to shelter their rental income from tax. In our example we see that while the after tax net income falls when a Section 23 investment is introduced this investor has now added a property to his or her portfolio while also maintaining a positive stream of cash flow. It can be seen that a mortgage could be structured in a way that overall cash flow remains positive provided that the difference between gross rent and bank payments is positive. The investor has capitalised the future gains from the tax shield to expand his/her property portfolio.

	2010	2011	2012	2013	2014	2015
Status quo – non Section 23 only						
Gross Rent	20000	20000	20000	20000	20000	20000
Bank payments (on S23)	-	-	-	-	-	-
Tax	(7790)	(7790)	(7790)	(7790)	(7790)	(7790)
Net Income (no S23)	18210	18210	18210	18210	18210	18210
Status quo – addition of a Section 23 property						
Gross Rent	26000	26000	26000	26000	26000	26000
Bank payments (on S23)	(25261)	(25261)	(25261)	(25261)	(25261)	(25261)
Tax	-	-	-	-	-	-
Net Income (with S23)	739	739	739	739	739	739

Table 6: Cash flow benefits of property reliefs on 'stylised' investor

Source: Department of Finance modelling

5.22 The impact of the introduction of the proposed 2011 budgetary changes on this investor is described below. A tax liability is imposed on the non-Section 23 rent from 2012 onwards. In addition the relief that would otherwise be earned on the Section 23 property is also guillotined from 2014.

5.23 The introduction of the tax liability brings the investor from a situation with a small positive cash flow to a significant negative cash flow. Parties who suggested in the response to the consultation that our assumptions are too conservative argued that the negative cash flow would be higher. The net point is the same. An investor who loses Section 23 relief may be faced with either making mortgage repayments or tax payments but not both.

	2010	2011	2012	2013	2014	2015
Effect of proposed budget changes						
Gross Rent	26000	26000	26000	26000	26000	26000
Bank payments	(25261)	(25261)	(25261)	(25261)	(25261)	(25261)
Tax	-	-	(7601)	(7767)	(7790)	(8147)
Net Income	739	739	(6862)	(7028)	(7051)	(7408)

Table 7: Effect of Budget 2011 on 'stylised' investor

Source: Department of Finance modelling

5.24 As stated above the individual and aggregate costs to the State from the non-professional investors are limited (less than 20% of total costs) despite their relatively large number. However the individual effect on each investor of an unforeseen tax liability may be large and create personal solvency issues for individuals. Currently investors may subsidize their mortgage on a tax designated property with tax-shielded rent from non-tax designated property. Restricting reliefs by (for example) ring fencing relief to non-performing tax designated properties may lead investors to default as investors may be faced with a choice between paying tax on the non-tax designated property or their mortgage on the tax designated property.

5.25 It is understood from the consultation that in an effort to restructure the loans of indebted borrowers, financial institutions have required debtors to sell parts of their portfolios. To the extent that these 'forced' sales relate to tax designated properties which have not been held by the investor for ten years, a tax claw-back would arise. The introduction of a tax liability into an individuals' cash-flow statement which creates a risk of default on a buy to let mortgage may result in further forced sales and 'clawbacks'.

5.26 Section 23 investments were used in some instances by the self employed and the elderly as a form of pension. Clearly the capital appreciation aspect is a risk unrelated to the State – although the 'premium' paid may be – however to the extent that the expected pension income was expected to be tax-shielded rent, these actions will directly affect retired or soon to be retired individuals.

Professional Investors

5.27 Investors of income in excess of €100,000 are described as professionally advised investors. The main distinction between those described as non-professional and those described as professionally advised is that the latter are currently subject to the high earners restriction. Given that investors of this income level are the primary investors in accelerated capital allowances schemes which typically require heavy investment and professional assistance in participating in such a scheme, the distinction appears reasonable.

5.28 As of tax year 2010 the high earner's restriction is to apply to individuals with adjusted income in excess of €125,000 and caps the maximum specified tax reliefs that may be claimed annually to the higher of €80,000 or 20% of adjusted income. The restriction is designed to ensure an effective rate of income tax of 30% for individuals with adjusted income in excess of €400,000 and a gradual increase in the effective income tax rate to 30% for individuals as their income increases towards €400,000.

5.29 These individuals are already restricted in their ability to use property reliefs. While data is not yet available on the additional revenue generated in 2010 from the high earners restriction, the view from a number of respondents to the consultation is that it is likely to be in excess of the estimated additional yield of €55m as forecast in Budget 2010 when the high earners restriction was changed.

5.30 Whilst these investors have benefited in the past from tax relief, the high earners restriction has substantially increased their tax contributions with the highest earners paying an effective income tax rate of 30% in 2010.

5.31 The following examples from the submission by the Irish Tax Institute illustrate the increased contributions by professionally advised investors arising from the high earners restriction.

	Allowances due for 2009	Allowances claimed in 2009	Allowances due in 2010	Allowances claimed in 2010	Total unused reliefs in 2009 and 2010
Taxpayer A	817,469	480,323	817,469	162,267	992,348
Taxpayer B	87,852	87,582	87,852	80,000	7,852
Taxpayer C	125,109	125,109	125,109	80,000	45,109
Taxpayer D	296,524	296,524	296,524	160,128	136,396
Taxpayer E	264,919	264,919	264,919	80,000	184,919

Table 8: Impact of 2010 change to the High Earners Restriction

Source: Anonymised case files from the Irish Tax Institute

5.32 As the cases above illustrate some individuals will see substantial restrictions on their ability to utilise tax reliefs with Taxpayer A unable to use almost €1m in reliefs over years 2009 and 2010.

5.33 Claims from professionally advised investors accounted for 57% of all claims in 2007, with over half of these (and almost 30% of overall claims) coming from individuals with income in excess of €200,000. Overall they accounted for 73% of the total cost of claims in 2007 with over half of the total cost coming from individuals with income in excess of €200,000.

5.34 As the data shows, these investors were similar in numbers to the non-professionally advised investors but were heavier investors in terms of the investment size and tax cost. It is also understand from the consultation that they tended to be heavier investors in terms of the number of tax-scheme properties that each investor participated in.

5.35 A key characteristic of these investors and one which drives directly to the economic impact on this group is that these investors include employers and business owners who may have leveraged their business assets in order to participate in tax incentive schemes or who are using the income from their businesses to subsidise their ongoing involvement in tax designated properties.

5.36 The rationale for investing in tax incentive schemes differed from individual to individual. For some it was a tax efficient way of sheltering income. For these the nature of the investment (i.e. property) was irrelevant and would have utilised any scheme proposed by their advisors as efficient. For others, in particular self employed individuals and business owners it was a means of investing in property for the purpose of a store of wealth. The tax shelter resulted in additional purchases beyond what was necessary on a pure ‘store of wealth rationale’.

5.37 The impact on investors depends on their individual circumstances. Some professionally advised investors may be in a position to sustain a further restriction in tax reliefs whereas others may become insolvent from a further restriction. The key issue here is overall cash flow which itself is determined by the individual’s level of indebtedness.

5.38 Given that professionally advised investors are less likely to be salaried employees and are more likely to be business owners the potential for cross securitisation of the primary assets of the business with loans in respect of tax incentive properties may have direct feedbacks to the viability of the primary business. This point is illustrated below with two anonymised examples from the submission by the Irish Tax Institute of high earners.

Example 1: Publican employing 11 staff in midlands town

Turnover in the business is down 25% on 2007.
The amount invested in Section 23 property in 2006 was €0.9 million.
The loan for the investment is secured on the Section 23 property and on the pub premises.

The individual cannot afford to pay additional ongoing tax liabilities amounting to c. €39,000p.a. while servicing the loan.

Example 2: Professional services company employing 8 staff in the midlands

Turnover in the financial year ended 31/12/2009 was down 40% on 2007 levels.
The principal invested €0.95m in a holiday home scheme property.

The principal will not be able to fund the significant additional tax liability and his bank commitment in respect of the holiday home investment. The principal sees no way of dealing with both obligations. His business and the jobs he provides would be at risk if the [Budget 2011] proposals were enacted.

Box 11: Impact on professionally advised investor

Source: Anonymised response to Consultation

5.39 These examples illustrate the threat to the viability of some small businesses arising from investments by the principal in tax incentive properties. The Department acknowledges that not all small businesses owners that invested in these schemes will necessarily resort to the closure or sale of the primary business to service debt. In some situations the business may remain in operation but cashflow that could be reinvested in the business would be diverted to debt servicing or tax payments. Whilst this may appear as a transfer from individuals to the State, it also creates a deadweight loss as funds that could otherwise be used for business activity and job creation are diverted instead to tax payments. Of course it can be argued that the State could use the tax revenue to create jobs elsewhere in the economy.

5.40 In some situations the viability of a primary business may already be at risk due to additional tax payments arising from the high earners restriction. The existence of capital allowances facilitated higher levels of leverage than an individual's – or a firm's – underlying cash flows would sustain. This was due to the associated 'tax shield' provided by the relevant tax incentive.

5.41 The Department is aware of instances where business owners invested heavily in tax-incentivised regeneration projects in the vicinity of their primary businesses. In one situation a family run business, the business's assets and the business owners are all committed legally and financially to the repayment of loans in respect of the regeneration project undertaken by the family. The financial model relied upon was based on the existence of capital allowances. Without the capital allowances the level of debt is unsustainable and the solvency of the individuals and the business is at risk. One case study is described below. For confidentiality reasons a number of details have been anonymised.

Case Study: Family Run Business
The family own a number of businesses in different retail activities that operate within the regeneration area.

The businesses in total employ over 100 employees.

"[We] were heavily affected by the High Net Income Individuals provision when it first came in [2007] when it restricted the use of allowances over €250,000 to fifty percent. [Our] tax liability increased approximately twelve fold. [Our] businesses are burdened with high rents. Because [we] have not been able to pay [our] vastly increased taxes on time, interest charges have been imposed which adds to the problem. On top of this, last year the High Net Income Restrictions were extended further, restricting the use of allowances to 20% and the threshold of €250,000 was lowered to €80,000. <u>The effect of this is to increase [our] tax liability about 30 fold</u> over the level that prevailed before the restrictions. (emphasis added)

Box 12: Impact on professionally advised investor

Source: Anonymised response to consultation

5.42 This example above illustrates the potential consequences of the State changing the dynamics of a financial forecast, in particular by removing the capital allowances from the forecast. It also illustrates the law of unintended consequences of how individuals or firms respond to incentives. It may not have been expected that tax incentives would have been used to increase leverage levels however the increased debt levels were assumed based on what was perceived to be a commitment from the State.

Conclusion

5.43 There are two key investor groups that participated in the tax incentive schemes a professionally advised group and a non professional group. They are distinguished by the income levels, the size of their investments, the schemes they invested in and their motivations for investment.

5.44 The State has already restricted the ability of the professionally advised investor group to use specified tax reliefs to reduce their tax liabilities. It is expected that changes to the restriction introduced in 2010 will have significantly increased the Exchequer's yield from professionally advised investors.

5.45 The non professional investors primarily invested in residential buy to let properties in Urban, Town and Rural regeneration (Section 23) Schemes. These investors are likely to be heavily indebted with constrained cash flows. There are high levels of arrears in the buy to let sector and higher risks of mortgage default. Any restriction of tax reliefs to these investors is likely to further constrain cash flows and may lead to personal insolvency in some cases.

6. Impact on Sectors

6.1 Chapters 8, 9, 10 and 11 look at the economic impact of a restriction or termination of tax reliefs on a number of sectors that benefited from tax incentives. The purpose of the analysis is to identify economic impacts beyond those faced by individual investors, for instance the impact on businesses and sectors that were the subject of a tax incentive.

6.2 The consultation paper sought the views of interested parties on whether certain core or representative schemes should be examined in a focused manner. The data presented in the consultation paper indicated that the Section 23 schemes (i.e. Urban, Town and Rural Renewal) along with Section 50 student accommodation and hotels capital allowances accounted for just under 80% of the total cost of claims and a similar amount in terms of the number of claims when the Seaside Section 23 scheme is included.

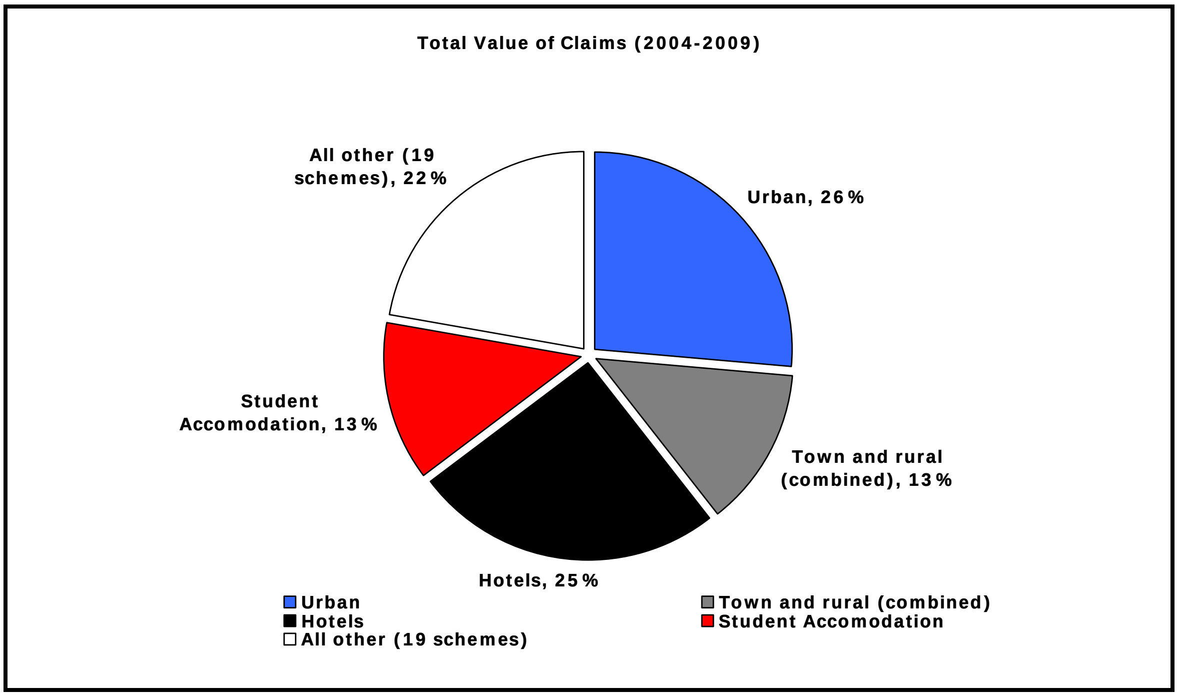

Figure 12: Total value of claims 2004-2009

Source: Department of Finance analysis of Revenue data

6.3 The consultation paper sought to understand if parties agreed with the view that an analysis of the economic impacts in a small number of schemes or economic sectors may capture the generality of economic effects arising from the measures proposed in the Finance Act. It is clear from the consultation responses that there is support for an examination of the following schemes:

- Healthcare schemes (private hospitals, nursing homes, sports injury clinics and childcare facilities);

- Hotel schemes;
- Section 50 Student Accommodation;
- Urban, Town and Rural Renewal; and,
- Financial Institutions

6.4 The following chapters set out the economic impacts that may occur in these sectors. The impacts on investors in Urban, Town and Rural Renewal schemes were considered within Chapter 5 in the discussion on the impacts on investors in residential buy-to-let schemes.

7. Healthcare

Introduction

7.1 Capital allowance schemes in the healthcare sector included private hospitals, nursing homes, sports injury clinics and childcare facilities. The Department received a number of submissions from the healthcare sector including from:

- Three private hospital groups;
- Two Nursing homes;
- Childcare facilities;
- A sports injury clinic; and,
- Individual investors in the sector

7.2 As part of its overall review of the property based tax incentives in 2005, economic consultants Indecon considered these healthcare schemes and made specific recommendations for their continuation. Whilst the current review relates to the economic impacts of a change in the use of capital allowances by investors, it is informative to recall Indecon's over-arching views on incentivising private sector involvement in the healthcare sector.

> *"In many cases whilst the schemes had a benefit our analysis suggests they have served their purpose and there is absolutely no case for further government incentives and there is absolutely no case for future government incentives. Continuing to approve new projects would contribute to oversupply and represent a clear waste of public resources……*
>
> *"<u>In a limited number of cases (private hospitals, nursing homes and childcare facilities) increased private sector investment is needed to address the economic and social needs</u>" (emphasis added*)

Box 13: Extract from Indecon Report

Source: Budget 2006: Indecon Review of Property Based Tax Incentive Schemes

7.3 Our review of the sector identified the existence of complex financial structures used in funding private hospitals and in some instances nursing homes. The financial structures lowered the operator's funding costs but also placed the full risk of a termination of capital allowances on the operator rather than the tax investor. A credible threat to the viability of a number of hospitals exists if these contractual provisions are enforced.

Private Hospitals

7.4 The private hospitals scheme provided for annual allowances in respect of qualifying expenditure at a rate of 15 percent for 6 years with the final 10 percent used in year 7. For expenditure to qualify the hospital must:[6]

- Have the capacity to afford medical facilities or surgical services year round;

- Provide a minimum of 70 in patient beds, out-patient services, operating theatres and on-site diagnostic and therapeutic services and have facilities to provide at least five specialist services, ranging from accident and emergency to oncology and cardiology;[7]

- Provide 20% of bed capacity to public patients and a discount of 10% to the State in respect of the fees charged for the treatment of public patients.

7.5 In its review of the capital allowances schemes in 2005, consultants Indecon concluded that the scheme had increased capacity in healthcare and stated "*much of the extra investment in the sector would not have taken place in the absence of the tax incentive*"[8]. Indecon noted the cost reductions to public patients in qualifying hospitals as required under the scheme and added that by increasing the supply and competition for private patients the scheme also has the potential to reduce the costs for private patients.

7.6 Indecon's view was that there was an ongoing need for investment in private hospitals in order to free up beds in public hospitals which were being used by private patients. It concluded that capital allowances for private hospitals should continue subject to certain amendments.

7.7 The existence of capital allowances was fundamental to investment in private hospitals. For operators they lowered the costs of capital whereas for investors they enabled an individual to 'acquire' tax relief with no involvement in the operation of the facility that they funded. Key to this relationship was the existence of an indemnity or warranty provided by the operator to the investor in relation to the capital allowances. A typical funding structure is described in the Box below.

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[6] Fulfilment of the conditions necessary for qualification for the allowances has to be certified annually by the appropriate health board.
[7] Expenditure also qualifies in respect of private hospitals providing acute services on a day-case basis with accommodation for such services of not less than 40 beds.
[8] Page 133 of Indecon report

A typical funding structure involved a consortium of investors without an interest in the day to day running and operation of the hospital providing for the construction and fit-out of the hospital and maintaining ownership of the facility. The tax investors arranged an interest only loan with a financial institution for the construction and fit-out of the facility. Rent paid by the hospital operator to the investors was structured to match the ongoing interest payments in respect of the loan. Thus no net benefit arose in respect of the rental income received by the investors.

At the end of a pre-determined period of not less than the seven year tax life of the scheme the operator of the hospital would purchase the hospital from the owners at a pre-determined price that equated to the principal owed by the owners on their loans. The investors thus repaid the principal amount on their loans. During the period of the investment the investors availed of capital allowances to offset other tax liabilities.

A tax indemnity – or warranty – provided by the operators of the hospital to the investors protected the investors against a change in law in respect of the capital allowances. This exposed the operators to the potential liability faced by investors if their reliefs were to be withdrawn by the State. The indemnities enabled operators to raise greater third party private funds by lowering risk to the investors however it placed all of the risk on the operator rather than the investor. The size of the liability faced by an individual hospital depends on the individual contract with their investors and the amount of unclaimed capital allowances outstanding.

Box 14: Typical private hospital funding scheme

Source: Department of Finance Description based on consultation

7.8 As the box illustrates, no net benefit arose in respect of the rental income earned by the investors. This is a crucial point in the context of the proposal to ring fence reliefs to the property that gave rise to the reliefs. As no net rent arises under these structures if the State were to ring fence the use of reliefs to rent from the facility to which they are related it would essentially terminate the capital allowances for these investors with immediate effect.

7.9 The hospital operators were able to construct a new facility with no up-front cost. Instead a lease and purchase arrangement was entered into with third party investors who benefited from the availability of capital allowances that they could use against other rental income.

7.10 The Department has seen a number of contracts between promoters and investors which included tax indemnities. The benefit to the operators of such clauses was that it enabled them to raise greater third party private funds by lowering the cost of funding to the investors. However rather than sharing risk with the investors, the effect was to expose the operators to 100% risk.

7.11 While one may question the wisdom of offering an open-ended indemnity against a change in tax law, the presence of these clauses does appear to be widespread in the private hospitals that benefitted from tax incentives. Any change in the treatment of the outstanding capital allowances would therefore have to be funded by the hospitals themselves. This therefore changes the dynamics of the Exchequer-investor tradeoff and instead changes it to an Exchequer-hospital tradeoff as a transfer of wealth would go from the operators to the State rather than from the investor to the State as described in the consultation paper.

7.12 The impacts of a change in legislation on the hospitals themselves will depend on a number of factors. The number of years that the hospital had been in existence – and therefore the amount of capital allowances that the investors will have already used, and the exact risk sharing mechanism that exists between the hospital and the investors which itself will depend on the individual contract between the hospital and its investors. The differing impacts across hospitals are best illustrated by a comparison of two private hospital schemes that the Department has analysed as part of the consultation.

7.13 Hospital A was developed and completed in recent years. Investors in this hospital would therefore have used a limited amount of capital allowances. In the event of a termination of reliefs the resulting compensation payments from the hospital to external investors could represent a significant proportion of the total expected capital allowances.

7.14 By contrast Hospital B which was also supported by a tax incentive scheme opened in the mid-2000s. Clearly some investors may have been restricted in their ability to use some of their allowances due to the high earners restriction. However the potential claim that investors may have against the hospital in the event of a change in law would be significantly smaller than Hospital A - as a share of initial investment - given that most of the expected capital allowances should have been claimed by Hospital B's investors against a small proportion for Hospital A.

7.15 The risk of hospital closures is discussed in the case studies below but if this eventuality were to arise a number of issues emerge for the Exchequer. These include:

- Direct Exchequer costs to the public health system due to reductions in capacity in the private system (including loss of capacity provided by private facilities to public patients under the conditions of tax incentive scheme) as displaced patients from the private system would relocate to the capacity constrained public system. This issue of displaced demand is an issue that makes a clear distinction between the private hospitals schemes and some of the other capital allowances schemes – e.g. hotels – where significant excess capacity exists to service possible displaced demand and where the State is not a supplier of services;

- Threats to the viability of a public hospital owned and operated by the same (not for profit) operator as a co-located private hospital for which a tax indemnity exists;

- Loss of tax revenues which in some cases may exceed the annual capital allowances (see case study discussion below); and,

- A loss of employment in the private facilities.

7.16 Two case study examples are set out below that illustrate the likely impacts and costs on private hospital groups and the Exchequer that would arise from a change, termination or ring-fencing of reliefs.

Financing for Hospital A was secured from third party private investors who in return received an indemnity from Operator A against various changes in the tax treatment of the accelerated capital allowances. The operators estimate that the resulting compensation payments from the hospital to external investors would range from €30m up front or €55m phased over the life of the scheme (approximately €7m per annum).

It is not clear how this liability would be funded by the hospital. It is clear that cash flows would not support the liability in the short term. In addition it appears unlikely that funding could be secured from a financial institution. The existing financing is split between bank loans and tax investors however the bank financing was dependent on the existence of tax investors. It should be noted also that it was due to the difficulty in securing equity funding that motivated the establishment of the capital allowances scheme. It would appear therefore that additional equity funding to meet the liability would be difficult to secure. In the absence of cash flows, further debt financing or equity financing it is not clear how a liability due under the tax indemnity would be funded.

Based on recent outturn operating performance, the operators would appear to be unable to pay their liabilities under the terms of the indemnities out of its operating surplus.

Operator A estimates that annual direct (medical) and administrative costs amount to €70m per annum. It is worth comparing the maximum possible savings to the State of €7m per annum (ignoring revenue that would in any event be generated by the High Earner's Restriction, against potential costs that the public system would incur if the remaining private healthcare system could not provide the capacity to meet the extra demand arising from displaced demand from Hospital A. Assuming symmetry of costs (including scale effects) between the private hospital and public facilities, if as little as 10% of demand moved to the public sector – which (unrealistically) assumes that the private system could accommodate 90% of displaced demand – would offset the entirety of the maximum possible annual savings from terminating the legacy reliefs.

Operator A also estimates that the annual PAYE and PRSI contributions to the State in respect of the hundreds of staff employed at the private hospital amount to €10m per annum. While it would be expected that in the event of the closure of the private hospital some of the staff would migrate to other private hospitals or to the public system, the extent of this is unknown. It is however certain that some of the payroll taxes would be lost to the Exchequer.

It appears that the costs to the Exchequer, if the private hospital facility were to close as a result of the compensating payments in respect of the tax indemnity, would outweigh any gains from terminating the legacy tax reliefs. No assumptions have been made regarding the financial viability of the public hospital.

Box 15: Case Study – Private Hospital A

Source: Department of Finance Description based on consultation

Hospital B comprises of facilities which collectively employ over 500 people. The hospital cost approximately €195m of which €170m was qualifying expenditure raised from investors under the tax incentive scheme. As with other private hospitals financed under the scheme an indemnity exists between Operator B and the tax investors regarding the existence of the accelerated capital allowances.

Assuming each of the investors is taxed at the 41% rate the potential cost to the State of the €170m in qualifying expenditure is €69.7m or just under €10m per annum over the seven years of the schemes. Again this assumes that investors are able to use the entirety of their annual allowances, an outcome that may be unlikely given the existence of the high earners restriction and lower overall rental yields in the economy against which capital allowances are offset.

The annual benefits to the Exchequer in terms of ongoing PAYE and PRSI contributions in respect of the employees at the hospital are estimated at €9m per annum. Ignoring any other costs to the Exchequer that would accrue if the hospital were to close – e.g. costs to the public healthcare system from the displacement of patients and the implications of the loss of hundreds of jobs at the facility, the annual PAYE/PRSI contributions almost net equate to the maximum annual cost to the State of the capital allowances. If more than 10% of allowances are restricted by the high earners restriction then there would be a net loss to the State if the hospital were to close.

The key question is therefore whether the hospital would be likely to close due to a change in legislation. Whilst the liability that would be faced by the hospital through compensatory payments under the indemnity would be limited given that investors by now should have benefited from most of their anticipated capital allowances, it is expected that ignoring the effects of the high earners restriction the liability may be at least €10m. It may be higher if the hospital is also liable for unused capital allowances arising from the high earners restriction.

Based on a review of this hospital's recent performance the Department would regard the risks of closure that would arise if, for example, the 2011 Finance Act proposals were introduced as being materially to the downside.

Box 16: Case Study – Private Hospital B

Source: Department of Finance Description based on consultation

Nursing Homes

7.17 The Department received submissions from representative bodies in both the nursing home and childcare sectors, as well as from a number of private investors in these schemes.

7.18 Nursing Homes Ireland (NHI), whose members care for nearly 20,600 residents – accounting for almost 75% of all long term nursing home beds in State – and employ more than 21,000, referred to the Indecon study in 2005 which recommended the continuation of the nursing homes scheme to increase capacity in the State. In citing a recent study by the ESRI NHI state that there is a requirement for an additional 13,324 long term care places in the State by 2021 over the 2006 levels which equates to almost 900 beds per annum in additional capacity needs.

7.19 Based on an analysis of the NHI submission it appears that the funding model for nursing homes reflected that used for private hospitals. Deals were structured such that rent paid by the promoters/operators to the investors covered the interest obligations on the investor's loans thus no net rent accrued to the investors. Put and call (i.e. buy-back) obligations committed the operators to purchase the building from the investors at a pre-determined price on a pre-determined date. Tax indemnities were also a key feature of the funding structure.

7.20 The Department therefore views the likely economic impacts on nursing homes as mirroring those described above in respect of private hospitals, particularly for the most recent entrants into the tax schemes.

7.21 Submissions received from individual investors reflect impacts that may be faced by investors that are not protected by way of a tax indemnity. For these investors the individual impacts will be as described in the analysis of individual investors above, in particular in relation to insolvency and possible loan defaults. The impact of loan default arising from unforeseen tax liabilities are discussed in our analysis of the effect on financial institutions below.

8. Hotels Sector

Introduction

8.1 The consultation document identified the hotels sector as a possible sector for analysis. Responses to consultation supported an analysis of the hotel sector as a stand alone sector.

8.2 Capital allowances were originally introduced for hotels in the 1960s. Accelerated capitals allowances, which allowed capital allowances to be claimed over seven years – at 15% per annum for the first six years and 10% for the final year - were introduced in Finance Act 1994.

8.3 Budget 2002 proposed that the accelerated regime would end with allowances to be claimed over the standard duration of 25 years – at 4% per annum – for industrial buildings. But the scheme was actually extended in Finance Acts 2003, 2004 and 2005 for a transitional period provided certain conditions which primarily related to the lodging of planning permissions were met. Finance Act 2006 extended the transitional period to 2008 with 100% capital allowances in respect of qualifying expenditure that occurred in 2006, 75 percent in respect of 2007 and 50 percent in respect of 2008.

8.4 Capital allowances for expenditure on hotels may only be used against other Case V (rental) income and thus cannot be used against other (non-rental) income. This applies only to passive investors and an exception applies to investments in hotels in the border-midland-western (BMW) region where excess capital allowances may be offset against non-rental income.

8.5 The Table below outlines the total number of claims received and the size of those claims over the period 2004-2009, as well as the overall cost to the State arising from those claims. It is important to realise that as this is a capital allowances scheme, these are actual annual claims for capital allowances. Claims equating to 15% of qualifying expenditure are submitted annually for the first six years and 10% for the final year. Thus the figures below relate to annual usage of capital allowances. As described above for residential Section 23 schemes, the total claim is reported in year one and then carried as a loss thereafter along with all other losses. Section 23 claims therefore cannot be monitored.

	2004	2005	2006	2007	2008	2009	Total
Total claims	498	800	1235	1610	1731	1613	7487.00
Size of claims (€,m)	73.02	126.10	196.94	237.40	250.76	212.18	1096.41
Exchequer Cost (€,m)	30.67	51.72	80.56	95.48	95.98	84.15	438.57

Table 9: Outturn data on hotels claims 2004-2009

Source: Department of Finance from Revenue Data

8.6 The hotels scheme thus accounted for approximately 13 percent of all claims made and 22 percent of the total cost of claims. In terms of the cost of claims the hotels scheme was the second highest after the urban renewal scheme.

8.7 The share of total claims and value of claims as a proportion of all claims for years 2004-2009 are set out below. As can be seen its share of claims grew from approximately 8% to 15% during the period with the overall value of those claims accounting for close to 30% in 2008 and 2009.

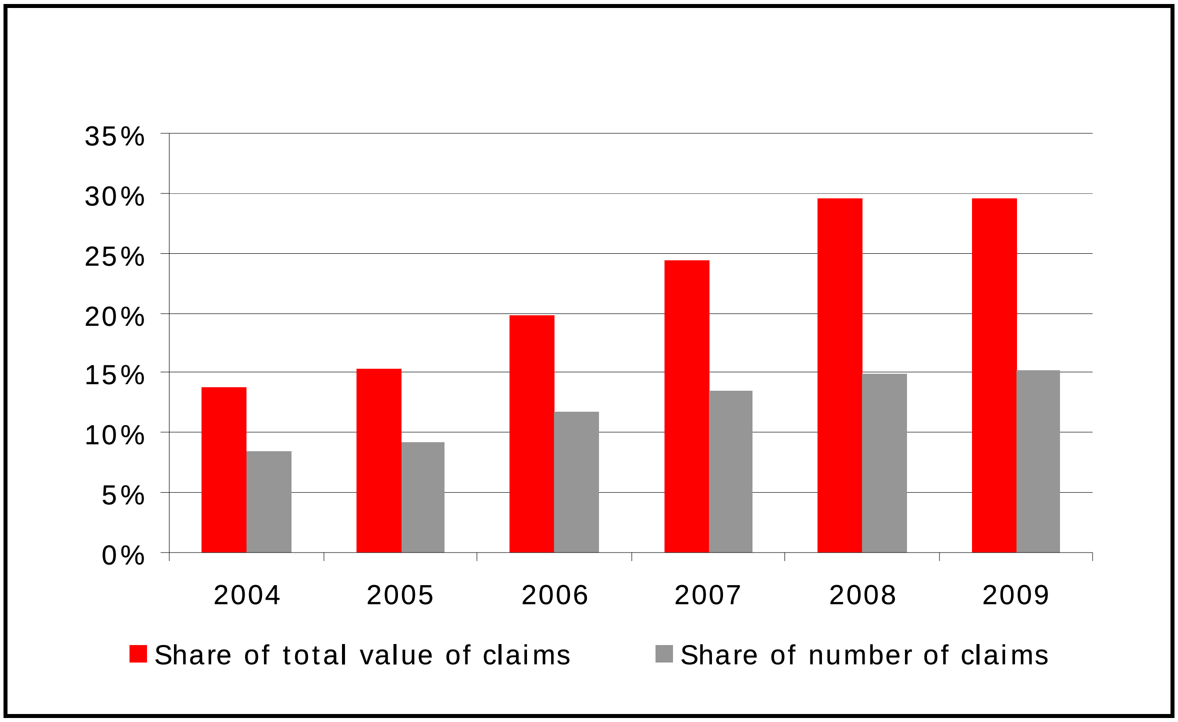

Figure 13: Hotels Schemes share of total claims by value and number

Source: Department of Finance analysis of Fáilte Ireland data

8.8 It should be noted that the actual cost to the State for the years 2007-2009 may be smaller than inferred above due to the introduction of the high earners restriction in 2007. The high earners restriction, which applied to individuals with adjusted income in excess of €250,000, restricted the individual's ability to use specified reliefs including hotel capital allowances. According to 2007 data this would have affected in excess of 45% of claimants for hotel capital allowances. This adjusted income threshold for high earners was reduced to €125,000 in tax year 2010 which would have further restricted the use of specified reliefs in that year.

8.9 The final year for which qualifying expenditure was allowed was 2008.Therefore all claims are expected to have been fully drawn down by 2014 at the latest. Claims to be received in 2013 and 2014 will relate to the tail end of investments made in years 2007 and 2008 and are at a reduced amount of 75% and 50% for those years respectively. It should also be noted that claims that began in 2005 would have, in the absence of the high earners restriction, been fully claimed for in 2011. The outstanding claims for years 2012-2014 relate to new investments in years 2006, 2007 and 2008 with the latter two at reduced rates. However the high earners restriction has meant a significant proportion of allowances have been unused since 2007.

8.10 For instance in 2007 individuals with income in excess of €275,000 claimed for €192m. All of these individuals would have been affected by the high earners restriction. In its analysis of the High Earner's Restriction 2007,[9] the

[9] http://taxpolicy.gov.ie/wp-content/uploads/2011/04/HighEarnersReport2007.pdf

Revenue Commissioners noted that only €52m was actually used in respect of hotel capital allowances by individuals affected by the restriction. A similar pattern was reported in years 2008 and 2009. This suggests that the restriction is succeeding in its objective.

8.11 In terms of income distribution in 2007 the group of tax units with income in excess of €275,000 accounted for 45% of all claims for hotel capital allowances and 69% of the total cost of claims. Overall 83% of claims were received from tax units with incomes in excess of €100,000 who collectively accounted for 91% of the total cost to the Exchequer. The evidence clearly indicates that the hotel schemes were used predominantly by high income individuals to shelter other income from tax. The data for 2007 is summarised in the tables below.

Income level (2007)	Share of claims	Share of cost
Less than €100,000	17%	9%
€100,000 - €150,000	15%	7%
€150,000 - €200,000	11%	7%
€200,000 - €275,000	13%	8%
Greater than €275,000	45%	69%

Table 10: Investments in hotels schemes by income level

Source: Department of Finance analysis of Revenue data

**subject to rounding*

Supply and Demand in the Sector

8.12 According to Fáilte Ireland's Training and Employment Survey the Irish tourism and hospitality industry employed an estimated 160,000 people in 2009. Employment in the industry recorded a decline of 34% in 2009 compared with 2007 and 20% with 2008.[10]

8.13 The hotel sector employed an estimated 52,000 individuals in 2009. Just over three quarters of hotel staff were employed on a year round basis. Employment in the hotel sector declined significantly in 2009 (down 19%) compared to 2008 when there were almost 65,000 employees. It is understood that employment declined further in 2010.

8.14 There are 883 hotels in the State, a decline from the peak level of 915 in 2009. The annual numbers of hotel premises in the State from 2000-2011 are illustrated in the Figure below. The Department understands that the decline in 2006 arose from a delay in registrations by hotels rather than an actual decline in the number of hotels. The 2006 figure is therefore 'normalised' by assuming that there was no change in the number of premises relative to 2005.

[10] Fáilte Ireland Training and Employment Survey 2009

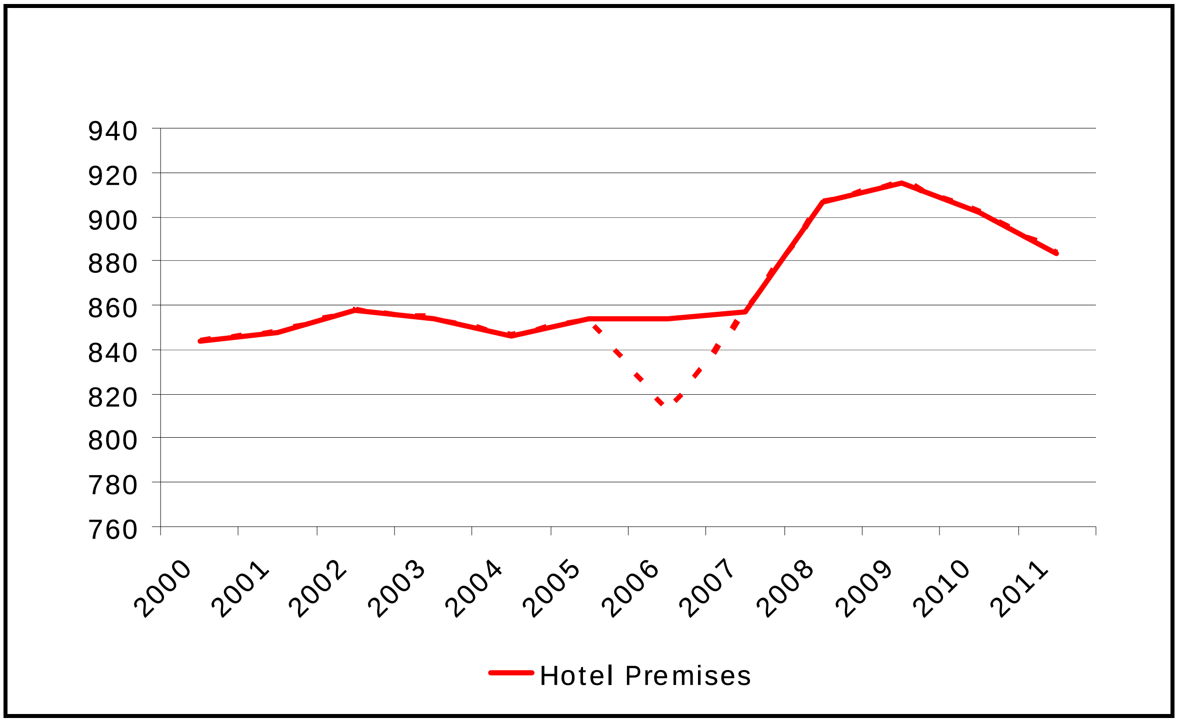

Figure 14: Number of hotels premises 2000-2011

Source: Department of Finance analysis of Fáilte Ireland Register

Note: Due to timing issues relating to the submission of registrations in 2006 a reduction in numbers was recorded for that year. The series for 2006 has therefore been normalised by assuming that there was no change relative to 2005. In the graph above the broken line represents the actual registrations for 2006.

8.15 Overall the number of hotels remains above the 2007 level of 857. In terms of the amount of room capacity in the system, there are approximately 59,000 rooms in the State, a reduction on the peak level of 60,200 in 2010. Of particular interest are the growth rates in years 2007 and 2008 when total room numbers increased year on year by 12% with a further 5% increase recorded in 2009. It is clear that the growth rates accelerated as the capital allowances scheme came to a close in 2008. Whilst the hotels scheme provided an accelerated allowance for capital expenditure incurred up to and including 2008 it is possible a lag arises between the qualifying expenditure and the actual registration. This would explain the recorded increase in 2009 despite the closure of the scheme in 2008. Also of interest is the increase in hotels from 2003, the year in which the scheme was originally envisaged to terminate. A further 17,000 rooms were added from 2003 to 2009, representing a 40% increase in volume. The trend in room numbers and the annual percentage change from 2000-2011 are illustrated below.

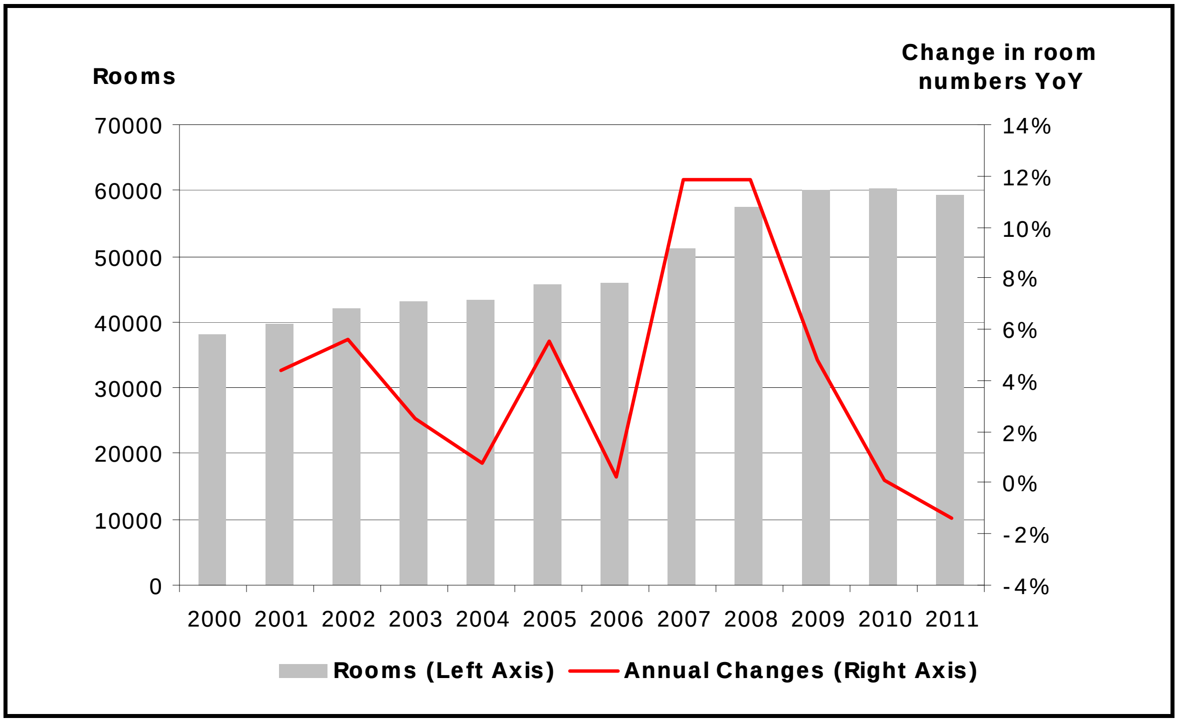

Figure 15: Number of hotels rooms and annual changes

Source: Department of Finance analysis of Fáilte Ireland data

8.16 In a recent report on the hotels sector Fáilte Ireland analyse the levels of supply and demand in the sector.[11] The report identifies significant excess capacity of approximately 7000 rooms. Fáilte Ireland's analysis suggests that a viable room occupancy level, in national terms, is in the mid-60% range once sustainable room rates are achieved. Since 2008 the hotel sector has only achieved occupancy rates in the mid-50% range. However this was only achieved following heavy rate discounting.

8.17 The analysis concluded that by 2015 demand will recover to 2008 levels based on core projections. In the absence of capacity reductions, returning to 2008 demand in 2015 equates to a projected room occupancy rate nationally of below 60% which Fáilte Ireland view as not commercially viable. It adds that with 7,000 fewer rooms, the projected occupancy rate would be at a more commercially sustainable level of circa 65%. Fáilte Ireland state "*the sooner these rooms are closed, the faster the sector's return to commercial sustainability*".

8.18 It appears that the rationalisation of the industry has begun with 840 fewer rooms in the State in 2011 compared with 2010. PWC noted in a report on European Capital cities that the year on year reduction of approximately 300 rooms is the first instance of supply reductions in Dublin City.

8.19 The PWC report however offers some optimism in relation to demand with occupancy growth in Dublin City of 6% year on year in 2011 and a more

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[11] Recent Developments in the Hotel Sector and Medium Term Outlook, Fáilte Ireland, November 2010

modest 2.8% growth in 2012, taking the overall rate to 73.2%. The report also forecasts growth in average daily rates and revenue per available room in both 2011 and 2012.[12]

8.20 In a separate analysis,[13] Horwath Bastow Charleton (HBC) estimated that room occupancy levels nationally in 2010 reached 59% but that average room rates had fallen by 25% over three years. Data in the HBC report suggest that profitability in the sector in Ireland had fallen 9% in 2010 relative to 2009 and 54% relative to 2007.

	2010	2009	2008	2007
Profit per room before tax	€4239	€4650	€7056	€9284
Percentage change (YoY)	-9%	-34%	-24%	
Change in 2010 relative to 2008	-54%			
Change in 2010 relative to 2008	-40%			

Table 11: Hotel profitability analysis

Source: Horwath Bastow Charleton
(See footnote 13 herein)

Role of Capital Allowances

8.21 The discussion above related to excess supply, falling prices and reduced profitability are linked to the overall macroeconomic environment affecting Ireland and countries that 'purchase' Ireland's tourism exports. However the absolute levels of excess appears to be driven by the significant capacity added to the system in the years preceeding the 2008-2009 global recession. In a report for the Irish Hotel Federation in 2009 Peter Bacon & Associates argued that even in the years prior to the downturn in demand, entry into the sector was not driven by the fundamentals of the hotel industry or by the available returns from operations.[14]

8.22 In well functioning markets prices and gross margins are signals of the possibilities of successful entry for potential entrants. The standard model for entry decisions is based on a discounted cash-flow analysis where the present value of all costs and revenues are taken into account and only those opportunities that offer positive net present value outcomes are selected.[15] Bacon and Associates suggest that even from 2001 all new investments in hotels were effectively uneconomic given the estimated debt associated with construction and the valuations that could be placed on rooms at the time (based on discounted cash flow analysis). Bacon and Associates argue that investment in the sector post 2001 was driven entirely by factors other than the usual entry decisions and attributed this to the capital allowances schemes.

8.23 It is a settled principle of economics and corporate finance that the use of debt finance can lower the overall weighted average cost of capital (WACC)

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[12] European Cities Hotel Forecast 2011 & 2012, PWC, October 2011
[13] Ireland and Northern Ireland Hotel Industry Survey 2011, Horwath Bastow Charleton
[14] Over-capacity in the Irish hotel Industry and Required Elements of a Recovery Programme, Peter Bacon & Associates, November 2009
[15] See Chapter 6, "Making Investment Decisions with the Net present Value rule", Principles of Corporate Finance (Sixth Edition), Brealey & Meyers

compared with an all equity financed investment due to the tax preferential treatment of debt.[16] The capital allowances scheme facilitated the use of leveraged finance to make the overall cost of capital cheaper. It appears however that the scheme over-incentivised the use of debt and resulted in excessive entry relative to the expected rate of return.

8.24 An extract from the Bacon and Associates report is set out below which describes a stylised example of the strength of the different incentives in play.

"*In this example, a developer in 2004 is looking for planning permission for a mixed use development involving shops and some residential development. It was common that the planning authority would request that a hotel would also be developed on the site. Faced with this, the developer would allocate some land at zero cost and perceive this as a cost associated with obtaining the required planning consent. Assume the hotel has 50 to 60 rooms with a construction cost of €10 million. Indeed, the developer has an incentive to maximise the cost incurred in the hotel, for example by including all access infrastructure, so as to maximise the value of allowances.*

The developer contacts high net worth individuals who expect that they will have big tax liabilities over the next seven years. These fund the €10 million in return for sharing in the tax allowances. In effect, given that the allowances will be worth €4.2 million, the investors provide funds directly to the developer to the value of €2.1 million. The remaining €7.9 million is then borrowed from a bank on an interest only basis, in the investors' names but with non-recourse to other assets, to fund the hotel. Once built, the hotel is leased to a hotel operator, often an international chain, and the lease income is used to pay the interest on the bank loan. At the end of the seven years the hotel and the loans are transferred back to the developer or sold. Unless property prices fall sharply, the sale will raise sufficient funds to pay the loan and provide a profit to the developer.

There are quite a range of incentives involved from the point of view of many actors in this process:

- *The developer gets planning permission and the prospect of a good profit in seven years;*
- *The investors get the difference in the net present value of the tax allowances over seven years instead of 25 years, less the payment to the developer;*
- *The planning authority ensures that what it has determined to be good integrated development occurs, local employment is provided, tourism is promoted, it gets revenues from levies associated with the development, and a rates base is created;*
- *The tourism development agencies see the accommodation base being strengthened;*
- *The Exchequer can look forward to new taxes and since the social discount rate is lower than the private discount rate that the investors will attach to the allowances, the cost to the Exchequer of providing the allowances, in present values, is less than the value perceived by the investors;*
- *The banks get to provide a loan to high net worth individuals secured on a property with a loan to value ratio of 79%;*
- *Hotel operators who usually do not want the trouble of developing or owning hotels get an opportunity to enter a booming economy as a result of the new hotel for lease;*

[16] See Principles of Corporate Finance, Chapter 18, Sixth Edition, Brealey, Richard A. & Meyers, Stewert C., Irwin McGraw Hill

- *Residents in the local area get a new facility that can be used by residents as well as visitors.*"

Box 17: Model for tax incentivised hotel development

Source: Bacon & Associates

8.25 It is clear, as noted in the report, that a result of a combination of drivers the decision to invest was no longer solely based on an objective analysis of the likely profit levels in the industry ex-post. The capital allowances schemes were certainly a driver of the over-supply but the scenario described by Bacon and Associates also identifies the planning system as a contributor.

8.26 That factors other than underlying economic fundamentals drove the expansion of hotel supply appears to support the analysis presented elsewhere in the Bacon report of debt per room exceeding value per room for all new rooms added after 2001. The altered incentives created by the capital allowances may also explain why approximately 17,000 rooms were added to the industry during the period 2005-2009.

8.27 Bacon and Associates attempt to estimate the total amount of unused capital allowances at end-2009. The methodology is based on the estimated average cost per hotel room by classification of hotel per annum over the period 2000-2008 according to HBC, and the estimated amount of new room capacity according to Fáilte Ireland Hotel register. The same methodology is applied to assess the Bacon analysis and to update it to end 2011.

8.28 The table below presents the estimated number of new rooms per annum from the Fáilte Ireland register and the estimated cost per room as cited in the Bacon Report originally estimated by HBC.

	One Star	Two Star	Three Star	Four Star	Five Star	Total
Estimated number of new Rooms per annum						
2000	15	194	874	975	0	2058
2001	10	173	475	742	359	1759
2002	0	22	30	422	145	619
2003	0	35	277	396	0	708
2004	0	119	1524	1285	137	3065
2005	10	12	1191	2211	168	3592
2006	50	273	2148	5161	585	8217
2007	10	10	449	1232	309	2010
2008	0	36	132	643	134	945
Estimated Cost per Room (€)						
2000	80,000	90,000	120,000	170,000	226100	80,000
2001	90,000	100,000	130,000	180,000	239400	90,000
2002	100,000	110,000	140,000	190,000	252700	100,000
2003	110,000	120,000	150,000	200,000	266000	110,000
2004	120,000	130,000	160,000	210,000	279300	120,000
2005	130,000	140,000	170,000	220,000	292600	130,000
2006	140,000	150,000	180,000	230,000	305900	140,000
2007	150,000	160,000	190,000	240,000	319200	150,000
2008	160,000	170,000	200,000	250,000	332500	160,000

Table 12: Estimated number of hotel rooms and cost per room

Source: Department of Finance from Fáilte Ireland and HBC Data

8.29 The data in the Table above can be used to estimate the annual expenditure in the industry on new rooms. It should be noted that 100% of expenditure qualified up to 2006 with 75% and 50% allowable for years 2007 and 2008 respectively. It would appear unusual if a hotel owner or operator didn't avail of the tax incentive given the generous tax benefit associated with the incentive. The allowances are assumed to be fully utilised over seven years starting with the year of expenditure. The impact of the high earners restriction is ignored. The Department estimates that there may be as much as €318m in unclaimed allowances, with an associated tax cost of €130m, at the end of 2011. All allowances are assumed to be fully utilised by 2014. The analysis is presented graphically below.

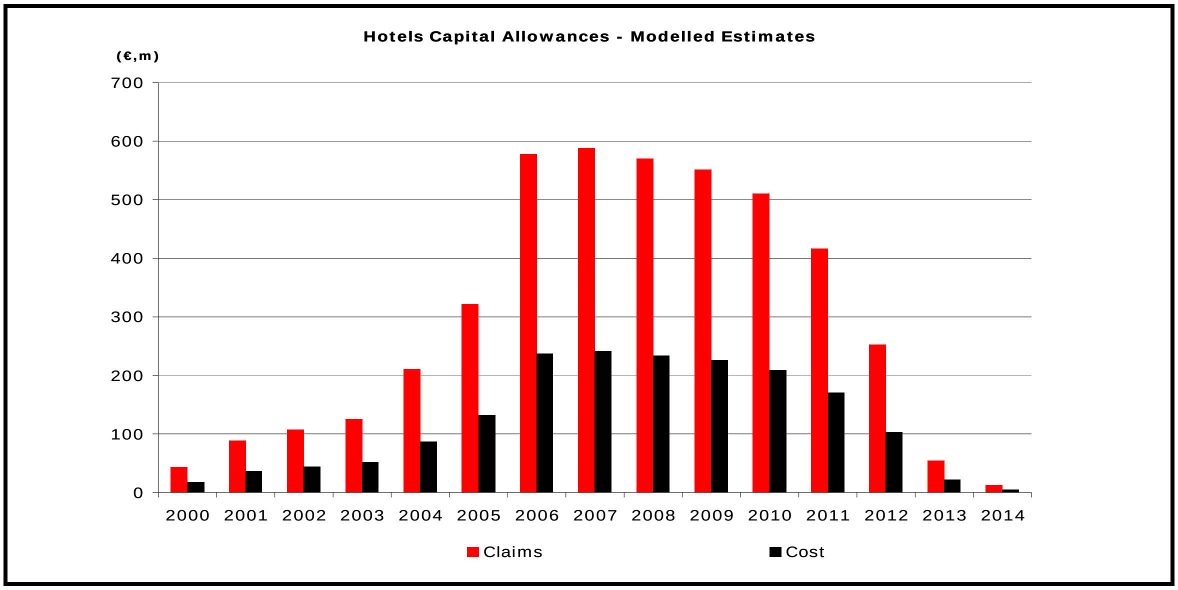

Figure 16: Modelled estimates of cost of hotels capital allowances

Source: Department of Finance analysis of Fáilte Ireland data using Bacon & Co Methodolgy

8.30 Surprisingly the 'modelled' results presented above from the Bacon methodology do not correspond to actual claims made according to Revenue data for the period 2004-2009. For comparability owner occupiers are included in the Revenue data which is presented below.

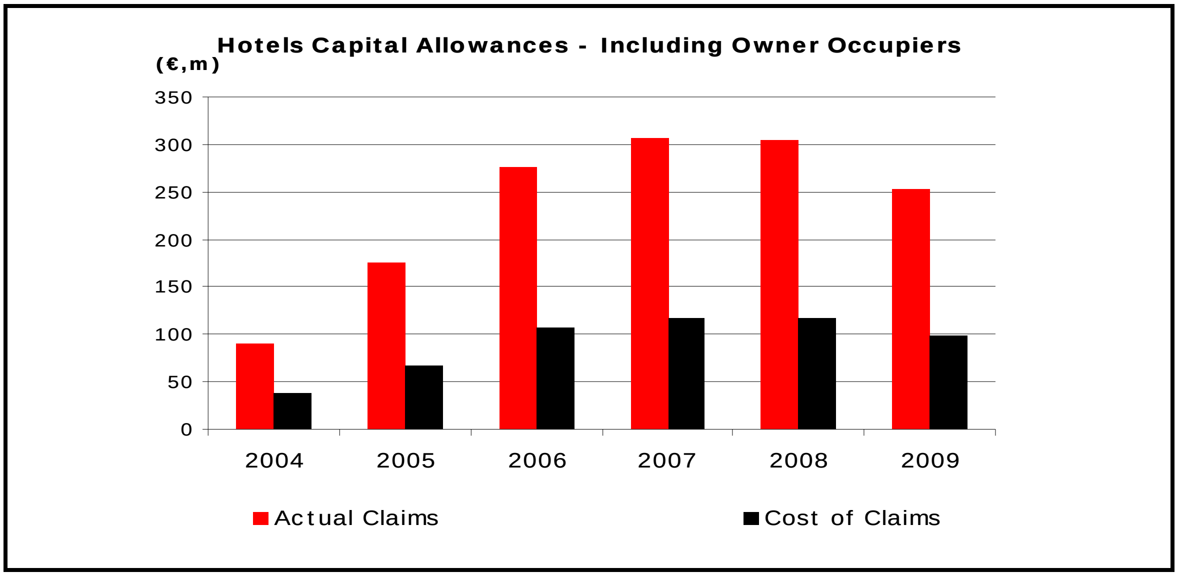

Figure 17: Actual outturn cost of hotels capital allowances

Source: Department of Finance analysis Revenue data

8.31 The modelled outcomes are nearly double the size of claims received in the years 2004-2009 according to the Revenue data. It is possible to use this relationship to extrapolate the Revenue claims forward. Using such an extrapolation the outstanding amount of unclaimed allowances from non-owner occupiers may be €122m with an associated tax cost of €50m.

8.32 A factor that should be considered is why has exit from the industry been limited so far. A possible explanation is that credit institutions have kept the businesses operating in order to generate cash flow. Another explanation, which is highlighted in Bacon's 2009 report for the IHF is the threat of Revenue claw-backs of allowances for investors where the hotel they invested in did not trade for a full seven years. As stated in Chapter 3 as much as €1.95bn in allowances were claimed for during 2004-2009. The potential clawback cost to an individual investor of a hotel exiting the sector would be substantial. This is likely to have acted as a credible barrier to exit from the market.

8.33 As the number of hotels still within the seven year 'clawback period' declines one would naturally expect to see some of these hotels – if operating unsustainably – to exit the sector. All hotels for which claims were initially submitted in 2005 will have completed this holding period at the end of 2011 and may be closed or sold on in 2012 without the relevant investors incurring a Revenue clawback of allowances. However the demand for cash flow from credit institutions may dampen this effect.

Possible effect of withdrawing allowances

8.34 Any proposal to terminate outstanding allowances would not affect hotels where the investor is an owner occupier but rather those where the investor is a passive investor. Tax indemnities similar in style to those described in the discussion on the healthcare sector are also widespread in the sector. In the absence of the capital allowances the investors may have a claim against the hotel operator. The key issue is what would happen to the hotel business, and the jobs supported by the hotel, if this came to pass.

8.35 Were investors to seek compensation from hotel operators due to the termination of all outstanding reliefs the probable scenarios are that operators with sufficient cash flows or liquid assets would compensate investors from their own resources, or the investors would seek to have the courts enforce the terms of the contract and potentially place the hotel into receivership with the likely outcome being that the investors assume control of the hotel from the operator. The latter is assumed to be the more likely scenario.

8.36 If investors sought to enforce the terms of their contracts through the courts this would likely impact on all of the assets controlled by the other party to the contract. There does not appear to be any benefits to investors if the hotels were to cease trading as no cash flows or assets would accrue to the investors. The best outcome is therefore for a resolution to be sought whereby cash flows are paid to the investors over a period of time or the investors assume control of the running of the business. Neither outcome would appear to jeopardise the continued operation of the business, though may result in a change to the business model and lower maintenance if the hotel is operated solely to reimburse losses by the investor.

8.37 Another possibility is that the investors may seek to sell the hotel in order to recoup some of their investment and recover some of the capital owed to credit institutions in respect of loans taken out for the original financing of the hotel. It should be noted that only where the investor chooses to shut the hotel down would there be a loss of employment and this outcome is only economically rational where the hotel is unsustainable due its underlying fundamentals, such that a buyer cannot be found, or the investor has some alternative use for the assets. Two examples from the Fáilte Ireland report help to illustrate the likely outcomes. These examples are included in the box below.

Example 1
Consider the case of a heavily indebted hotel that would be commercially viable at a lower level of debt as there is a reasonable level of demand for its services. There are a number of options open to restructure the debt and continue operating the hotel as a going concern, these include: • *Selling the hotel at a loss, with the next owner successfully operating the hotel at a lower debt level, thereby enabling it to operate into the longer term at rooms rates previously considered unviable* • *Taking the examinership route, if the courts allow, to write-down the debt to more sustainable levels and facilitate lower room rates* • *Going into receivership with a new owner buying the hotel at a price that makes commercial sense relative to the underlying demand and income projections.* *In such cases, the hotel continues to operate regardless of the option chosen.*
Example 2
Example 2 concerns a hotel that is simply in the wrong place in that there is insufficient demand to generate enough revenue flows to meeting the operating cost, let alone cover debt repayments. This type of hotel cannot be made commercially viable through debt restructuring and, therefore, is unlikely to find a buyer. The most likely outcome is that the current owner limits their losses by shutting down the hotel.

Box 18: Hotel restructurings

Source: Fáilte Ireland

8.38 The Department supports the Fáilte Ireland analysis. If the level of debt is such that the investor continues to operate the hotel or sell the hotel as a going concern and pay down the loans the hotel would remain trading. If as in Example 1 the level of debt is unsustainable, unless the investor can find an alternative use for the assets which can generate cash flow to service the loans, the Example 1 situation would arise, resulting in the hotel continuing to operate, albeit under different ownership. If the hotel does not have any underlying fundamental rationale, as in Example 2, it would close. The existence of a clawback may however prevent the investor from voluntarily selling. Overall the outcome in Example 2 may benefit the sector as a whole considering the need to address excess-supply.

8.39 One aspect that hasn't been discussed herein is the effect on investors. The text above relates to the hotel businesses they financed but not their own finances. The introductory paragraphs in this section illustrated the types of investors who participated in hotels schemes. They were in the main professionally advised investors of high net worth with over 83% of claims received in 2003 coming from investors with income in excess of €100,000 and 45% of claims coming from those with income in excess of €275,000.

8.40 The Department's view is that the effect on these investors will be as described in the discussion on 'professionally advised investors' in this report. Depending on the level of unused allowances it would be expected that a significant tax liability could be placed on these investors. This may result in the insolvency of some investors if their cash flows can no longer sustain debt repayments and tax obligations.

8.41 It is clear also that ring fencing reliefs to rent from the hotels would be of no benefit to investors who typically receive no net rent from the hotel. Rents from the operator are structured to offset interest payments in respect of the loans taken out to finance the investment.

8.42 In its submission in response to the consultation the Irish Hotel Federation present a number of examples of individual investors. The examples describe situations where (non owner occupying) investors are faced with unforeseen tax liabilities. The consequent outcomes are actions taken against the hotel operator or loan default. Whilst there is a risk that some investors may become insolvent it is not accepted that viable hotels will exit the market though it is accepted that the operator or ownership structure may change.

8.43 It is important to note that the net gain to the State, from a curtailing of the reliefs, beyond that achieved with the high earners restriction is likely to be limited. The change in the restriction in 2010 increased the effective income tax rate for the highest earners to 30% by restricting their use of reliefs. Given that for all hotels constructed in years 2006 or earlier, the seven year tax life of the allowances will expire in 2012 it is possible to envisage a situation whereby the yield could be increased by a change to the high earners restriction or by disallowing unused allowances after the initial seven year life without resulting in investor bankruptcy. This issue is returned to later under policy proposals.

Conclusions

8.44 The capital allowances schemes were extended beyond their useful lives and played a part in creating the levels of excess supply currently seen in the sector, although they were not the only influencing factor. Other factors such as the planning system also contributed to excess supply.

8.45 The current levels of price discounting in the hotel sector may be beyond normal recessionary pricing and could be unsustainable. Even allowing for a recovery of demand significant excess supply will remain in the system unless unviable hotels exit the market. The clawback provisions may act as a market distortion preventing exit.

8.46 The hotel schemes were primarily used by wealthy investors and their use of reliefs is already significantly reduced due to the high earners restriction.

8.47 The threat to viable hotels is believed to be limited though it would be expected that non viable hotels would exit the market.

8.48 Whilst our analysis in respect of hotels may appear to differ somewhat from our analysis in respect of private hospitals the Department believes the fundamental economics of the sectors differ. The State is not a provider of hotels services whereas the State's provision of public healthcare is capacity constrained and would be impacted by supply reductions in private healthcare.

8.49 There are specific examples of hospitals that were 'late arrivals' in terms of uptake of the scheme and would be forced to close if investors sought to enforce their rights. The level of capital expenditure is also significantly higher for hospitals.

8.50 The existence of a clawback may be acting as a barrier to exit from the market and preventing a return to equilibrium however the clawback provision is likely to disappear as hotels outlive the seven year holding period for the application of a clawback. Whilst the sector favours a rapid removal of the clawback provision from legislation this could only be achieved following a State Aid notification and clearance by the European Commission's competition directorate.

9. Section 50 – Student Accommodation

9.1 Many of the issues facing investors in the Section 50 student accommodation schemes are similar to those faced by individual investors in the Urban, Town and Rural Renewal residential buy to let schemes described within the Chapter on investors above. Investors who have used the tax shield to make mortgage payments on the tax incentive property will face cash flow constraints that may in some cases lead to insolvency. There are also some unique issues faced by investors in Section 50 schemes that merit separate consideration.

9.2 Section 50 properties differ from other buy to let properties due to requirements relating to the standards and location of the properties and restrictions on who the property may be let to. While a Section 23 property may be developed by reference to general planning regulations as to its overall architecture and design, Section 50 developments were required to conform to specific guidelines issued by the Minister for Education and Science. These guidelines dealt with various features of the scheme, including the institutions which qualify, conditions relating to the standards and location of accommodation and the categories of students whose accommodation will be covered.

9.3 Perhaps the most crucial distinction between Section 50 schemes and Section 23 from an investor's point of view is the category of tenant that the property may be let to. During the academic year the property must be let to students. This therefore narrows the pool of potential tenants vis-à-vis other buy to let properties. This places downward pressure on expected yields. Students however are not constrained in where they choose to live. In terms of cash flows the investors are therefore competing for rent from a narrow category of potential tenants who themselves are unconstrained as to where they live. The cashflow prospects for student accommodation schemes are seen as being weaker than standard buy to let schemes.

9.4 In its review of the property incentive schemes Indecon stated that "*the scheme ha[d] undoubtedly expanded the supply of high quality student accommodation*" but expressed concerns at the potential oversupply of student accommodation and that the oversupply "*would be significantly affected if pipeline projects proceed*". Based on recent Revenue data from the years after the Indecon study it is clear that the pipeline projects have proceeded. There is no doubt therefore that students have benefited through greater supply of accommodation options however the level of competition for student tenants amongst landlords and the wide choice available to students has constrained the cash flow benefits to landlords.

9.5 In terms of investor profiles a similar proportion of each investor group participated in 2007 in student accommodation, with the share of overall claims for each income group between five and eight percent. In the non-professional investor group the share is 7% and overall 45% of claims came from this group. As all other groups are already restricted in their ability to use reliefs due to the high earners restriction the focus of this analysis is on the non-professional investor group.

9.6 As stated above the effects on investors would be largely identical to that of the other buy-to-let schemes, though given the constraints on rental income, the effects may be more pronounced. To illustrate the point in example is set out below from the "Development A" student accommodation development. Data was provided as part of the consultation. A similar pattern emerges for other schemes.

Case Study: Development A Student Accommodation

The development consists of [150-200] apartments. Thirteen investors own more than one property while there are 134 single unit owners. Properties were sold for €226,000 in the first phase and €350,000 in the final phase. These properties have recently been valued at €175,000. Data from the management company of Development A also indicated that annual occupancy has fallen from 98% in academic year 2007/2008 to 74% in academic year 2010/2011.

Data from the company also indicated that average net (i.e. after service charges and sinking fund) income per apartment was €5,146 in the 2010/2011 academic year.

We estimate that annual mortgage payments for an investor who borrowed 100% of the purchase price of a phase 1 property at €226,000 would be €15,040 and €23,293 for Phase 2 purchaser of a €350,000 property assuming 3% interest and a 20 year term (assuming an annuity profile)

Box 19: Case study of student accommodation scheme

Source: Response to Consultation and Department of Finance analysis

9.7 It is clear therefore in the Case Study that the rental income does not cover mortgage payments for individual investors. Thus the rent from the non-Tax designated property which is contributing towards mortgage repayments is therefore crucial to both the mortgage and an individual's overall solvency. Loss of the 'tax shield' would reduce (or eliminate) the cash that services mortgage payments.

9.8 A number of responses to the consultation, in particular from property management companies, expressed concerns relating to non-payment of management fees and the risks of building decay. Arrears and management fees have grown since the economic downturn and further risks to the downside are likely if cashflows are further constrained though loss of tax reliefs. Parties see this as an issue affecting all residential buy to let schemes.

10. Financial Institutions

10.1 The discussion of the effects on individual investors above identified the potential risks to personal solvency if individuals were unable to utilise unused tax reliefs. This Chapter discusses possible risks to the institutions that lent to buy to let investors.

10.2 Data presented in Chapter 6 showed that individuals who purchased during the peak property period are likely to have high levels of negative equity with loan-to-value ratios as high as 150% nationally, and 192% for Dublin apartments, for individuals who purchased a €300,000 property.

10.3 Investors in residential buy-to-let tax schemes would be expected to have higher LTV ratios given the expected higher decline in values for tax incentive schemes – due to their relatively lower quality locations, supply overhang and market uncertainty regarding the treatment of tax incentives. In addition it is understood from consultation responses that buy-to-let investors typically borrowed on an interest only basis for an initial two to five year period such that the outstanding principal on a loan would not have declined as per our analysis in the table. Thus the LTV values for buy-to-let investors are assumed to be minimum values for investors in tax designated properties.

10.4 While negative equity is a necessary condition for default – as investors who have positive equity can always sell their property if unable to service their loans – it not a sufficient condition as actual insolvency depends also on cash flows. A number of forces have put downward pressure on cash flows in recent years including:

- Falling rental yields from tax designated and non tax designated properties;
- Rising interest rates and requirements to repay capital due to the expiry of interest-only periods;
- Reduction of tax deductibility of interest payments from 100% to 75%;
- The introduction of a non principal private residence tax; and,
- The expected introduction of a residential property tax

10.5 Our understanding from the consultation responses is that individual investors are overwhelmingly reliant on the use of the Section 23/50 relief in order to compensate for the downward pressure on cash flows. In a number of instances it is the 'tax shield' that is covering the mortgage on the tax designated property – rather than offering an overall rental gain. A genuine and material risk to individual investors if their tax relief were to be terminated is that cash flow will be diverted away from servicing mortgages and towards a new tax liability. At an aggregate level this is likely to put further pressure on the credit quality of the loan books of financial institutions. The possible impact of increased insolvencies on the loan books of the financial institutions is set out below.

10.6 The outstanding amount of on-balance sheet loans for buy-to-let residential properties was €24.5 billion at end-June, accounting for 25 per cent of loans for house purchase.[17] Floating rate mortgages accounted for 92 per cent of the outstanding amount of loans for buy-to-let residential properties at end-June of which 68.8 per cent were low margin tracker mortgages and 31 per cent standard variable rate mortgages.

10.7 The residential buy to let sector has been recognised as a weak lending sector in terms of credit quality. This is reflected in the Central Bank of Ireland's March 2011 Financial Measures Programme Report, which included the results of stress tests conducted by BlackRock Solutions, and recent outturns by Ireland's two pillar banks Bank of Ireland and AIB.

10.8 As part of the March 2011 stress tests BlackRock performed an analysis of lifetime losses under a baseline and stressed scenario for four credit institutions; AIB, Bank of Ireland, Irish Life and Permanent and EBS. The Central Bank relied on Blackrock's results in determining its own three year projections for loan losses under a baseline and stressed scenario. The capital requirements were determined based on the Central Bank's three year stressed scenario for loan losses.

10.9 Its analysis covered the loan portfolios of these institutions in Ireland and the UK across a number of sectors. Within the residential sector in Ireland a separate analysis covered owner occupier and residential buy to let mortgages. Our analysis relates to the implications of Blackrock and the Central Bank's stress testing as it related to the residential buy to let sector. While tax incentive properties formed a sub-set of the buy to let sector the credit risk associated with loans in respect of tax designated properties was not separately considered. Neither were the possible credit risk implications of changes in the treatment of legacy tax reliefs.

10.10 The following table presents the buy-to-let loan portfolios at December 2010 of the four banks covered by the March 2011 stress test. EBS has the lowest portfolio share in the buy to let sector while the share of lending in the other credit institutions in that sector is broadly similar at just over a quarter of all loans with a similar amount for the four banks combined.

	AIB	BOI	ILP	EBS	Total
Residential Mortgages	27,535	27,948	26,329	15,891	97,704
Owner-occupier	20,179	20,869	19,428	13,961	74,437
Buy-to-let	7,356 (27%)	7,080 (27%)	6,900 (26%)	1,930 (12%)	23,267 (24%)

Table 13: Notional ROI loan balances as at 31 December 2010 (€m)

Source: The Central Bank of Ireland

10.11 The Table below presents the baseline and stressed projects for the buy-to-let loan books of the four institutions by BlackRock (lifetime loan loss projections) and the Central Bank (three year loan loss projections). The capital requirements set by the Central Bank were based on its three year stressed scenario.

[17] Trends in Business Credit and Deposits, Central bank of Ireland June 2011

	AIB		BOI		ILP		EBS		Total	
	Base	Stress	Base	Stress	Base	Stress	Base	Stress	Base	Stress
Blackrock Lifetime losses	1308 (17.8%)	1879 (25.5%)	1145 (16.2%)	1761 (24.9%)	1323 (19.2%)	2128 (30.8%)	224 (11.6%)	331 (17.1%)	4000 (17.2%)	6099 (26.2%)
Central Bank three year losses	844 (11.5%)	1216 (16.5%)	599 (8.5%)	901 (12.7%)	629 (9.1%)	996 (14.4%)	148 (7.6%)	216 (11.2%)	2219 (9.5%)	3330 (14.3%)

Table 14: Potential loan losses in of domestic covered institutions

Source: Central Bank of Ireland Financial Measures Report

10.12 The riskiness of this sector is evident by BlackRock's forecast of 26% impairment ratio and the Central Bank's three year projection of 14% in a stressed scenario. This contrasts with 13.7% and 7.6% respectively for the owner occupier sector.

10.13 Recent data has supported the conservatism in these projections. In its 2011H1 interim results Bank of Ireland reported arrears in excess of 90 days of 7.8% in the buy to let sector. In its H1 interim results AIB report arrears in excess of 90 days of 16.5% in the buy to let sector with almost 14% of its book impaired. The level of AIB's total arrears (>90 days) in its BTL portfolio increased significantly from €747 million or 9.60% at 31 December 2010 to €1,353 million or 16.55% at 30 June 2011. AIB attributed this to "increased financial pressure on borrowers".[18] Over the same period BOI experienced growth in arrears from 5.9% of the BTL book in December 2010 to 7.8% in June 2011.

10.14 A key input that did not factor into the Central Bank (or BlackRock's) projections is probability of increased credit risk that would arise if investors could no longer subsidise mortgages on tax designated property with rent from a non-tax designated property that benefits from a tax-shield. Whilst neither impairments nor arrears at AIB and BOI have reached their stressed levels in the buy to let sector for which they were capitalised, both banks have experienced disimprovements in the quality of their BTL books.

10.15 Given the reductions in property prices in the State it is unlikely that defaulted loans could be fully recovered by selling the properties onto the open market. It is likely therefore that the costs of the loss on loans would have to be borne by the credit institutions themselves. This would not necessarily fall only on the domestic lenders as foreign-owned banks also lent in this sector.

[18] AIB Half yearly Financial report 2011, Section 5 Asset Quality

11. Impacts on the State

Summary

11.1 This Chapter assesses the potential gains to the Exchequer in terms of additional tax revenue and outlines potential costs that may arise for the State in respect of a policy change designed to restrict the legacy property reliefs.

11.2 A new modelling approach is undertaken in this Chapter to estimate the maximum lifetime cost of unused reliefs. The total modelled lifetime costs of unused reliefs may be close to €500m though the period in which they would be claimed would extend into the middle of the next decade. The assumptions are somewhat aggressive so as to reach a maximum cost and thus the actual figure would be lower. The ability of investors to use the maximum relief available is of course contingent on their income streams.

11.3 The National Recovery Plan 2011-2014 estimated that €400 million could be saved over the life of the Plan by restricting/terminating the legacy property reliefs from all individuals with unused reliefs. The Plan therefore did not estimate the possible post-2014 savings. The balance between this figure and the modelled figure represents a tail that would be gradually used over an extended period by non professional investors.

11.4 It is possible that the yield from restricting / terminating the legacy property tax reliefs may be significantly lower than either of the above estimates. This is because:

- If owner-occupiers are excluded the base would be narrowed;
- The impact of the 2010 changes to the high earners restriction potentially absorb some of the yield (the extent of this impact will not be known until mid 2012); and,
- Overall income levels in the economy have continued to fall reducing the potential tax cost of a no policy change approach.

11.5 The measures actually introduced in Budget 2011 were intended to restrict the use of property reliefs in a narrower manner to the National Recovery Plan and targeted only passive investors rather than owner occupiers. It forecast a yield of €60 million in 2011 from these narrower measures. The estimate took account of the fact that the policy measures were restricted to passive investors (i.e. non owner occupiers) only and the interaction of the proposed measures with the "high earners restriction". No estimate was included in the budgetary arithmetic for a proposed "guillotine" on relief at the end of 2014 because the consideration of this measure was to be preceded by an economic assessment.

11.6 It has been consistently argued in the consultation process that very many of the tax subsidised properties did not yield an income themselves that the tax relief could be used to shelter from taxation. Instead they were used to generate relief that could be used to shelter rental income from other properties. The net effect of the restriction of the relief, as proposed in Budget 2011, to those specific properties would therefore likely have been to effectively bring the relief to an immediate end for many investors. In other words the measures in Budget 2011 could have had a more severe impact than originally intended. While this could have resulted in a greater initial tax saving for the Exchequer, it could also have resulted in more significant negative impacts on particular sectors in the economy, which could in turn have resulted in additional downstream exchequer costs.

11.7 It is worth considering therefore whether less harmful measures could achieve a similar yield to that targeted in Budget 2011, adjusting for the downward trend in claims costs reflected in data on 2009.

Impact of the Schemes on the State

11.8 As Chapter Three illustrated the various tax incentive schemes cost the Exchequer some €5bn in foregone tax revenues. However this did not take account of the tax gain to the State from economic activity.

11.9 In its submission in response to the consultation document the Construction Industry Federation estimated that as much as 40% of the initial sales price of all new developments constructed with the benefit of Section 23 relief constituted direct and indirect tax revenue in the form of VAT, Stamp Duty, payroll taxes and social insurance, Corporation Tax and Development Contributions. The Department has received evidence from a number of private hospitals that ongoing annual tax payments from tax investor funded hospitals exceed annual costs from capital allowances claims (see private hospital case studies in Chapter 7 of this Report).

11.10 While a full cost benefit analysis would exclude the tax revenue generated from activity that would have taken place without the incentive, it is worth acknowledging the existence of both an up-front and an ongoing stream of tax revenues accruing to the State as a result of the economic activity generated by the property tax relief schemes. A very important element of this increased economic activity would have been additional employment creation.

11.11 The gains to the State also included the fulfilment of public policy. The tax incentive schemes facilitated the economic regeneration of certain geographic areas and the investment of private capital into certain underfunded sectors that had experienced supply shortages such has healthcare.

11.12 The reviews of the various schemes by Indecon and Goodbody consultants in 2005 demonstrated that while some schemes may not have been successful due to poor uptake or poorly targeted incentives, others served their purposes well and contributed to the fulfilment of Government policy in the area of regeneration and the attraction of private capital. Extracts from their consultancy reports in the Box below demonstrate some of the benefits of successful schemes.

The Urban Renewal Scheme, from Goodbody (2005)
"The Scheme has had very positive impacts on dereliction and has been reasonably successful in improving urban designs. With regard to economic impacts, the scheme has enhanced housing outputs in the target areas. This housing has been taken up and there is no evidence of excess supply. Moreover, the scheme had a strong emphasis on commercial development and has delivered significant benefits in this area."

Capital Allowances for Private Hospitals, from Indecon (2005)
"While there has not yet been a high level of investment in private hospitals under the tax incentive scheme for this sector, there are plans for a large number of these facilities coming online. Existing investment would not have occurred in the absence of the tax incentive"

Box 20: Extracts from Indecon and Goodbody reports 2006

Source: Budget 2006: Review of Tax Incentive Scheme

Potential Gains to the State of Restricting or Terminating Reliefs

11.13 Budget 2011 sought to restrict rather than eliminate the use of property based tax reliefs and targeted €60m from a narrower range of restrictions to the reliefs in 2011.

11.14 The forecast in the National Recovery Plan was based on historical claims made by all investors in property schemes including owner occupiers of residential and industrial/commercial buildings. The Government took the view in Budget 2011 that no change should be made to reliefs used by owner occupiers of residential and commercial properties and instead targeted 'passive' investors in tax incentives schemes. These were individuals who purchased properties for the purposes of benefiting from a tax incentive but leased the property to residential or commercial tenants. This was a prudent policy approach which sought to minimise the impacts on individuals living in or operating a business from their own tax incentive property and instead targeted 'tax investors'. However this meant that the estimate in the National Recovery Plan ("NRP") related to a wider population of individuals than the measure in the Budget and Finance Act.

11.15 The estimate in the National Recovery Plan ("NRP") was based on the average annual cost in the years 2007 and 2008, the most recent years for which data was available. Taking account of the impact of owner occupiers and netting out the additional yield that would already be derived from the high earners restriction it was estimated that €60m could be generated from the measures proposed in Budget 2011.

11.16 However arising from this impact assessment it is believed that the 2011 forecast yield understates the potential yield from the measures as it is clear from the analysis and the consultation process that for many investors the restriction would have had a very severe and immediate impact and would have amounted to an effective termination of reliefs in some cases.

11.17 It is worth exploring why it is now believed that the estimate in the NRP would overstate the true savings and why the Budget and Finance Act measures may have understated the savings.

11.18 Claims data from 2009 is now available. It is therefore possible to make an updated estimate of the Exchequer gain using the total cost for years 2008 and 2009. This amounts to approximately €350m, which is €50m less than the 2007/2008 average.

11.19 The NRP forecast was based on a restriction of the reliefs used by all investors including owner occupiers. It was not the objective of the Finance Act (No. 1) 2011 or the recent Programme for Government to impact on owner occupiers. Claims from these investors must therefore be factored out from total claims in 2008 and 2009. On average over the period 2005-2009 the annual cost of claims in terms of tax foregone was €392m (assuming all claims at the higher tax band of 41%). Owner occupiers accounted for on average €46m per annum, or approximately 12% of total cost. The Graph below illustrates the maximum possible costs of all claims received between 2004 and 2009 and the costs if owner-occupiers are excluded.

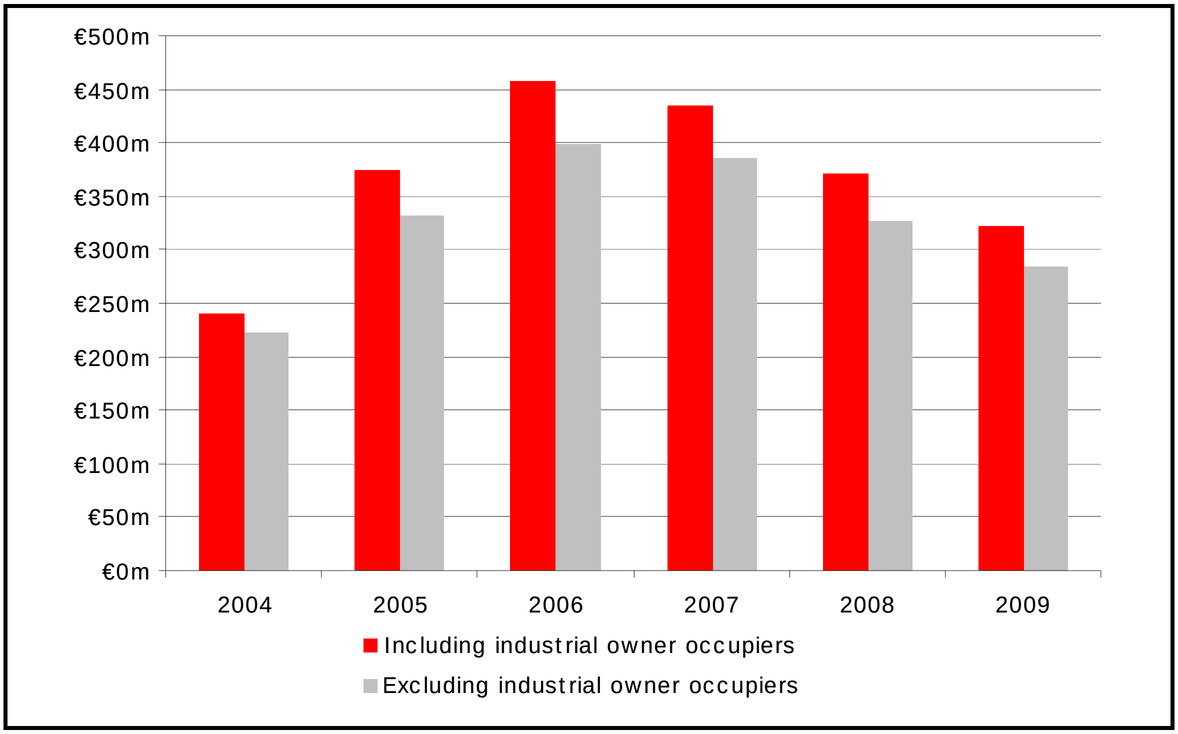

Figure 18: Maximum possible ‘lifetime’ costs of claims received during 2004-2009

Source: Department of Finance analysis of Revenue data

11.20 By factoring out the owner occupiers from the 2008/2009 average it results in an average cost over the two years of €306m from passive investors only. There are a number of reasons why even this lower figure is likely to be an overstatement of potential yield:

- The change to the high earners restriction in 2010, which is discussed in more detail below, will significantly affect the ability of high earners to utilise available tax reliefs. Restricting or abolishing the legacy property reliefs will have a limited benefit to the State on top of what would be achieved by the high earners restriction;

- High earners invested heavily in schemes offering accelerated capital allowances, the majority of which could be used in seven or ten years. In the absence of the high earners restriction nearly all seven year schemes will naturally end by 2014 at the latest with those that commenced by 2006 expiring on or before 2012. The high earners restriction has deferred the ability of affected investors to utilise allowances as planned;

- Section 23 reliefs were most heavily invested in by middle income earners. These reliefs are used against other rental income and are therefore dependent on rental levels. The rental market has declined in recent years thereby also reducing the potential tax foregone from these investors. This point is returned to later in this Chapter.

11.21 As a result of this economic impact assessment and the information provided during the consultation process it now seems clear that the target in 2011 may have understated the true yield for the State due to the likely impact of the proposed restrictions which appear to go further than intended.

11.22 The Budget and Finance Act proposed to ring fence the use of reliefs to rent accruing from the property that gave rise to the relief. In other words rent from other properties could not be shielded from tax. As set out in Chapter 5 the purpose of the investment for many investors was to shelter rental income from other sources.

11.23 Section 23 properties are low yielding properties and combined with high levels of leverage do not normally generate rental profits. Many capital allowances schemes were structured such that rent from the tax designated property exactly offset interest payments. Thus no net rent would arise in either case from the tax designated properties. Thus by disallowing rent from other properties to be shielded by an investor's reliefs, the investors would cease to have income to shelter, thus further increasing the potential savings to the Exchequer. This is discussed in detail in the in Chapter 5.

11.24 It is possible that the measures in Finance Act (No. 1) 2011 may have achieved a yield closer to that which would be generated from an outright termination of reliefs. However against this many harmful economic impacts would also have arisen. These are discussed in throughout the report. It is worth considering therefore whether less harmful measures could achieve a similar yield to that targeted in the Budget, adjusting for the downward trend in claims costs reflected in data on 2009. In doing this it is necessary to analyse the impacts of the high earners restriction.

Impact of the Higher Earners Restriction

11.25 The 2006 and 2007 Finance Acts introduced, with effect from 1 January 2007, measures to limit the use of certain tax reliefs and exemptions by high-income individuals. Such individuals, by means of the cumulative use of various tax incentive reliefs, had in previous years substantially reduced their tax liabilities.

11.26 Budget 2006 introduced a measure to ensure a minimum effective income tax rate of 20% for high income individuals that availed of specified reliefs who had adjusted income levels above €500,000. Individuals with adjusted income levels between €250,000 and €500,000 would pay an effective income tax rate that gradually increases towards 20% as their adjusted income level increases towards €500,000. Individuals' use of specified tax exemptions were restricted to the higher of €250,000 or 50% of their adjusted income.

11.27 The Revenue data for the 2009 tax year, the most recent year for which figures are available, indicate that the overall number of individuals who were subject to the restriction was 452 and that the additional tax yield was €38.86m. The figure for additional tax is slightly down on that arising in 2008 when the amount was €39.68m.

11.28 183 high-income individuals with an adjusted income of €500,000 or more (i.e. where the full restriction applies) paid an average effective tax rate of 20.05%. This met the objective set out for the measure. The additional tax involved from these individuals was €32.21m, representing a 149% increase on the tax that would otherwise have been paid if the restriction had not applied. 10 individuals with adjusted income of €500,000 or more, who would not otherwise have paid tax in 2009, were brought into the tax net for that year.

11.29 Outstanding reliefs which cannot be claimed in a year, as a result of the high earners restriction can be rolled forward and, where possible, claimed in subsequent tax years. The table below shows the number of individuals affected by the restriction and the additional tax yield to the State in years 2007-2009. The Table subdivides individuals into those with incomes greater than €500,000 and those with incomes between €250,000 and €500,000.

	Number of individuals			**Additional Tax (€,m)**		
	Over 500K	Up to €500k	Total	Over 500K	Up to €500k	Total
2009	183	269	452	32.21	6.65	38.86
2008	189	234	423	33.12	6.56	39.68
2007	214	225	439	34.15	5.84	39.99

Table 15: Outturn yield from high earners restriction 2007-2009

Source: Report of the Office of the Revenue Commissioners: Analysis of High Income Individuals' Restriction 2009

11.30 Budget 2010 introduced changes to the restriction on the use of specified tax reliefs. It reduced the upper adjusted income threshold for the payment of a minimum effective tax rate to €400,000 and applied a minimum effective income tax rate of 30% for those affected. The adjusted income threshold at which individuals became subject to the restriction was reduced to €125,000 from €250,000. In addition, the changes reduced the amount of specified reliefs that could be claimed in any one tax year to the higher of €80,000 or 20% of adjusted income.

11.31 Revenue data for 2010 for the tax yield from the modified High Earners' Restriction is not yet available. However at the time of the change in Budget 2010 it was forecast to bring in an additional €55m above the yield achieved by the restriction that operated from 2007-2009. This would suggest that the measure would generate a total of €95m per annum in revenues to the State. Not all of the additional taxes generated will derive from property reliefs. If unclaimed relief that was rolled over from previous years is excluded, in 2009 approximately 50% of reliefs used by individuals affected by the high earners restriction came from property related schemes with the majority of the balance coming from exemptions for mining operations, exemptions for writers, artists and composers, exempt patent royalty income and relief for interest in respect of payments to companies. It's not clear how this proportion will change into 2010 due to the reduction in the threshold. In addition, due to the abolition, phasing out and curtailment of a number of specified reliefs, it is possible that property based reliefs will make up a significant proportion of those reliefs affected by the restriction going forward.

11.32 Data on the 2010 restriction will be available in mid-2012. Anecdotal evidence from tax practitioners and evidence received in responses to the consultation paper indicates that the Budget 2010 forecast may be a underestimate of the true increase in yield. In the absence of outturn data anonymised case data provided by the Irish Tax Institute and a tax advisory firm as part of the public consultation process is presented below. Both sources indicated a significant increase in tax payments by individuals.

	Total Liability 2009 (€)	Total Liability 2010 (€)	Percentage change	Total unused allowances in 2010 (€)
Taxpayer A	207,971	359,182	72%	644,202
Taxpayer B	43,319	51,160	18%	7,852
Taxpayer C	50,928	74,610	47%	45,109
Taxpayer D	40,126	96,049	139%	136,396
Taxpayer E	11,109	83,347	650%	18,4919

Table 16: Anonymised examples of impact of 2010 High Earners Restriction

Source: Irish Tax Institute

	Allowances Available 2009	Allowances Claimed 2009	Allowances Available 20010	Allowances Claimed 2010	Exchequer Saving 2010
Taxpayer A Married Couple	669,271	641,023	578,931	206,154	239,178
Taxpayer B Single Person	253,852	25,000	198,291	80,000	93500
Taxpayer C Married Couple	548,942	216,283	453,001	80,000	74,955

Table 17: Anonymised examples of impact of 2010 High Earners Restriction

Source: Anonymised case files from Respondent 14, a professional services and tax advisory firm

Respondent 14 calculate the Exchequer saving as 55% of the differential in allowances claimed in 2010 compared with 2009

11.33 The evidence presented above would appear to suggest that there might be a non-linear relationship between the change in thresholds and the additional yield to the State. It is therefore possible that a significant proportion of the €100m targeted in the National Recovery Plan could be generated in any event from the high earner restriction.

Amount of reliefs remaining in the system

11.34 This section attempts to model the maximum possible savings to the exchequer from an immediate termination of reliefs. The objective is to set an upper bound estimate which in reality may be unrealistic for reasons discussed below. In order to set out the methodology it is necessary to describe the data.

11.35 Total claims across all tax schemes during the period 2004-2009 totalled approximately €5bn with €2.3bn claims received in respect of residential property schemes in urban, town and rural renewal schemes (i.e. Section 23) and €2.6bn received in respect of industrial buildings schemes (Accelerated Capital Allowances).

11.36 Section 23 relief is claimed for in its entirety in the first year the property is let. Thereafter any unused relief is carried forward as a rental loss along with all other rental losses. Therefore after the first year Section 23 relief carried forward is no longer separately identified as Section 23 relief.

11.37 There are two types of Section 23 investors, professionally advised investors and non-professional investors. The distinctions between these investor types are described in detail in the next Chapter.

11.38 Professionally advised investors are investors with income in excess of €100,000 and are mostly subject to the high earners restriction. These investors are assumed to have sufficiently large income to, on average, use their Section 23 reliefs within five years. Given these investors have the choice of entering a Section 23 investment or an industrial building (accelerated capital allowance) investment, it appears logical that an investor would only enter a Section 23 investment if the relief could be used at least as quickly as the accelerated capital allowance in respect of industrial buildings. With Section 23 there is the added benefit that the investor can use the relief as quickly as his allowable income allows. With industrial buildings the period is fixed. It is therefore assumed that the relief is used at a quicker rate than the shortest industrial buildings scheme – i.e. shorter than seven years.

11.39 For non-professional investors it is assumed that they use their relief in 15 years. This reflects investors who bought earlier but may have had a quicker rate of usage due to higher rents in the early 2000s and lower purchase prices – and thus lower overall relief.

11.40 To account for data only being available from 2004, assumptions are made regarding the level of claims that may have been made prior to that year. The rate of growth in national house prices is used as a benchmark for the possible level of claims in the years for which data is unavailable.

11.41 Claims for industrial buildings are received annually during the life of the scheme. The majority of these schemes last for seven, ten or fourteen years. Thus investors claim a capital allowance to offset against taxable income annually for seven or ten years. The tax incentive schemes were closed to new investment after 2008. Thus the final claim from the seven years schemes will be received in 2014. Claims in respect of any seven year schemes which commenced up to 2005 should be fully utilised within 2011. The 'legacy' cost for seven year capital allowances schemes after 2011 should relate only to investments in years 2006-2008. For one of the major schemes – hotels – only a 75% and 50% of expenditure qualified for 2007 and 2008 respectively.

11.42 A claim in a given year of say €100m could either be the first €100m 'slice' of claims for a new investment in 2004 or it could be the last €100m 'slice' relating to claims that originated seven years previously or a combination of a number of years leading up to and including 2004. To overcome this problem assumptions need to be made regarding the level of capital allowances claimed in a given year that related to investments made prior to 2004.

11.43 Provided that income levels were sufficient to absorb the capital allowances, all industrial buildings claims during the period 2004-2009 should have been fully used up with no outstanding tax cost, in other words without a roll forward of unused relief into the following year. This is not an unreasonable assumption given that these schemes were availed of by professionally advised investors with higher incomes.[19] The high earners restriction however in the years 2007-2009 would have restricted the use of some reliefs. This point is dealt with below.

11.44 The modelling results provide an estimate of unused Section 23 reliefs at end-2011 of approximately €941m with an associated tax cost of just over €385m. It is estimated that these reliefs will continue to be used until approximately 2024 but with professionally advised investors making their final claim by approximately 2014. There is also estimated to be €285m in unused capital allowances with an associated tax cost of €117m. This leads to an overall level of unused reliefs of just over €1.2bn with an associated tax cost of €502m.

	Reliefs	**Tax Cost**
Section 23 High Earners	€69m	**€28m**
Section 23 Non High Earners	€872	**€357m**
Accelerated Capital Allowances	€285m	**€117m**
Total Unused	€1226m	**€502m**

Table 18: Maximum cost of unused reliefs at January 2012

Source: Department of Finance Modelling

11.45 The results of the modelling are presented graphically below. The amount of potential tax cost associated with unused relief is represented by the area to the right of 2012. It should be noted that the impact of the high earners restriction has not been accounted for. Thus since the introduction of the restriction in 2007, it is possible that a large proportion of the cost associated with capital allowances and Section 23 investments by professionally advised investors has not materialised.

11.46 For the avoidance of confusion this estimate is a total lifetime cost until all reliefs are fully used whereas the estimate in the National Recovery Plan was only in respect of savings during the 2011-2014 period. The higher figure in this estimate is accounted for by post 2014 usage. It is also possible that the post 2014 claims would be less than modelled given that they are

[19] In 2007 50% of all industrial buildings claims (by claim size) came from tax units with income in excess of €275,000 with approximately 90% of total claims by claim size coming from tax units with income in excess of €100,000.

dependent on the continued solvency of investors, their ability to use the reliefs, and claims are assumed to always be made at the higher rate of income tax.

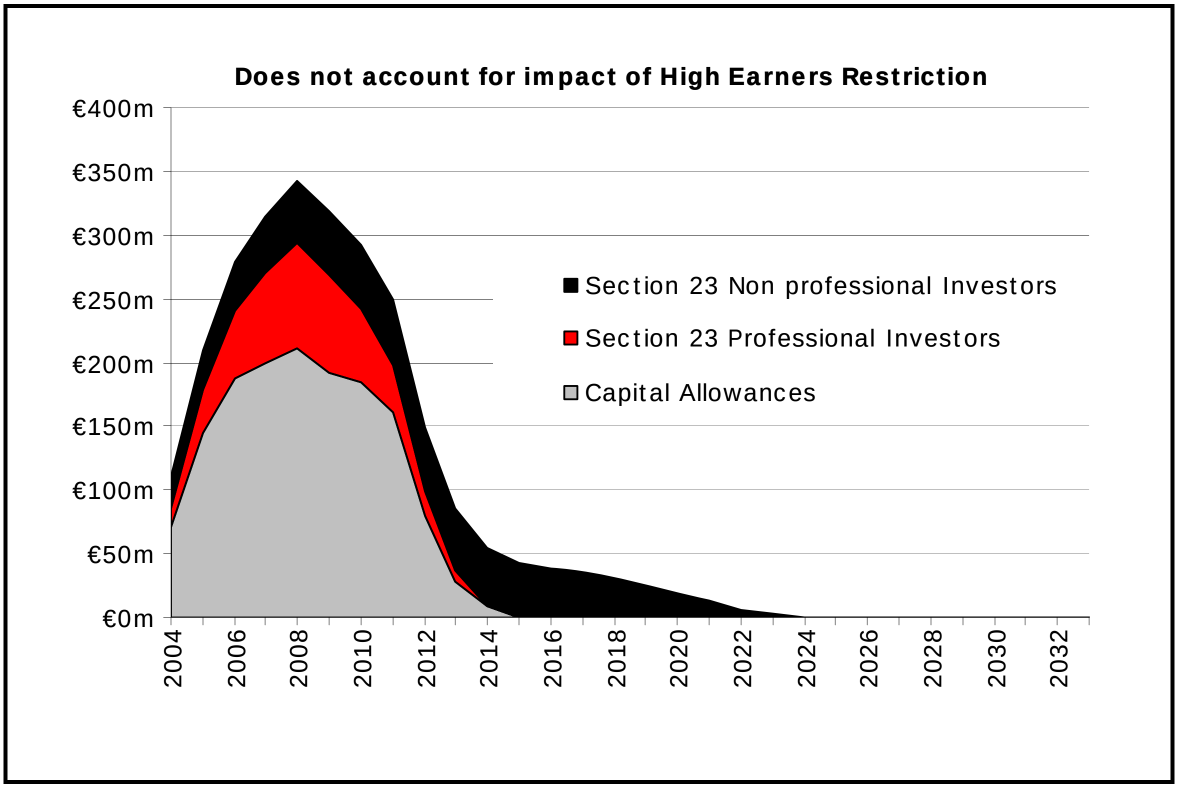

Figure 19: Modelled timeline of maximum possible exchequer costs 2004-2024

Source: Department of Finance Modelling

Note: Does not include the impact of the High Earners Restriction

**For Section 23 reliefs Assumes 5 year usage for professionally advised investors and 15 year usage for non professional investors*

*** Assumes no roll forward by capital allowances investors after 2015*

Levels of Income

11.47 It is important to note that investors must have rental profits to shelter before any relief can be utilised. Rents have fallen and costs have risen during the period 2008-2011 thus in the case of residential property there is not a linear relationship between the presence of reliefs and their use. An immediate change in law eliminating the use of any outstanding reliefs would generate tax revenue only insofar as investors earn rental profits. For instance if no rental profit is earned in 2012 from schemes such as Section 23 and Hotels which only allow rental income to be sheltered, the associated tax cost in 2012 from these schemes would be zero.

11.48 The property website daft.ie publishes a national index of residential rents which it constructs based on asking prices of properties advertised for rent. The peak month for rental asking prices was February 2008. Since February

2008 rental asking prices have fallen by 27% with most of this fall occurring by 2010 and flat-lining thereafter (see Figure 19 below). The forecast made by the Department of Finance in the National Recovery Plan did not have access to claims data on 2009 or 2010, years in which claims should have fallen in line with rental levels.

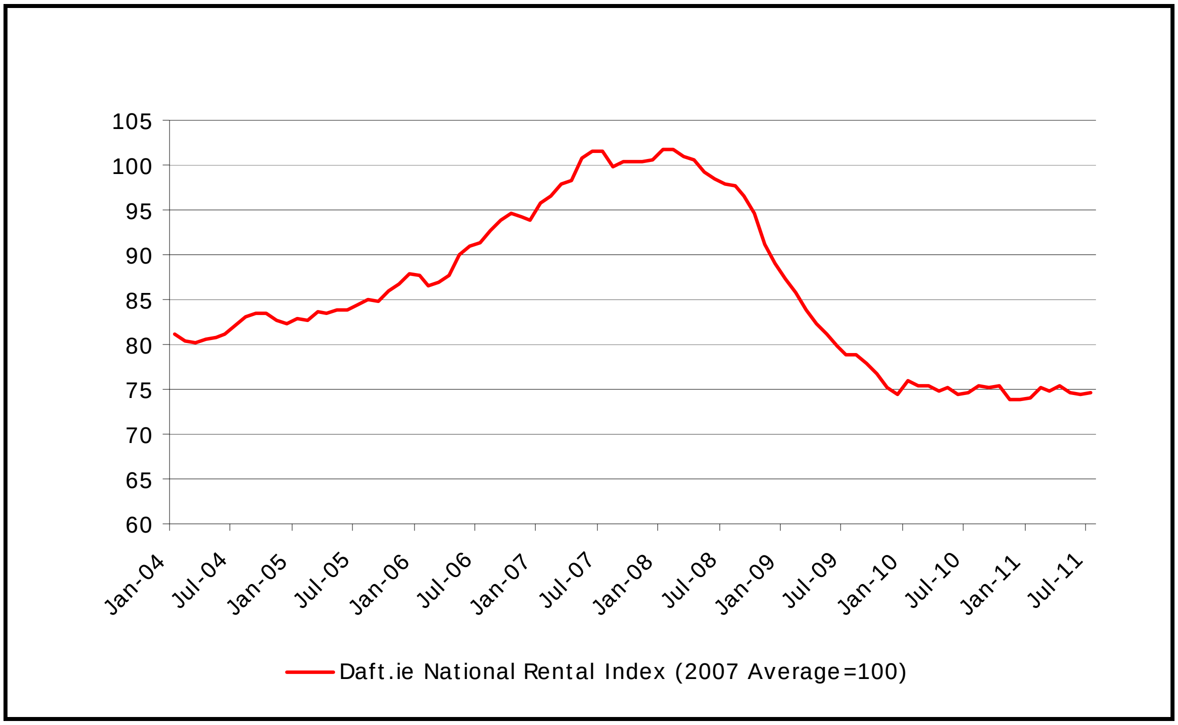

Figure 20: Rental income index

Source: Daft.ie National Rental Index

11.49 The likelihood of the State generating additional tax revenue depends on the effects on two groups of investors, those that are captured by the high earners restriction (i.e. have income greater than €125,000) and those that are not.

11.50 As demonstrated above those individuals that were impacted by the high earners restriction in 2010 are – by definition - already restricted in their ability to use property reliefs to shelter income. This group accounted for approximately 70% of the total cost of claims in 2007. However the incremental gain above the level of tax revenue already derived from these individuals by the high earners restriction is likely to be limited.

11.51 Individuals not impacted by the high earners restriction by definition have less income to shelter and are therefore less costly to the State in terms of foregone tax. These individuals only accounted for 30% of the cost to the State based on 2007 claims. Additionally, rising costs - in particular mortgage interest - and falling rent levels will inevitably lead to lower use of Section 23 relief than in previous years. Thus the potential annual cost from these investors is likely to decline in the short term.

11.52 Clearly some tax benefit would accrue to the State from restricting tax relief used by these individuals. However the ability to claim relief is likely to be of benefit to this investor group in assisting with the payment of mortgages on properties that are likely to be in negative equity. Approximately 67% of claims by these individuals in 2007 were in respect of buy to let properties in urban, town, rural, seaside and student accommodations schemes. These properties tended not to be located in areas with high demand and have disproportionately suffered during the property collapse. This point in covered in Chapter 5 of this report.

11.53 Overall the Department's view is that the gains to the State on top of what would in any event be derived through the high earners restriction are likely to be limited. The situation for some individuals already restricted in their use of reliefs may not greatly change. The biggest impact at the individual investor level will be on those individuals who are not currently restricted in their use of reliefs – namely middle and lower income individuals. These individuals currently have full use of reliefs and stand to lose 100% of their reliefs. A termination or restriction of reliefs may therefore have a disproportionate effect on middle and lower income investors.

Costs to the State

11.54 Against this limited additional gain it is worth considering the effect on the State in terms of current and future fiscal policy. A key message from the responses to the consultation is the possible reputational effects that an outright abolition or premature guillotining of reliefs could have on current and future tax policy by the State. The consultation paper referred to this as another possible deadweight loss, as lower take-up of current or future tax incentive schemes designed to remedy market failures and stimulate desirable economic activity would reduce overall economic welfare.

11.55 Attention was drawn by consultation responses to the consequences on uptake on the National Solidarity Bond and the new Employment and Investment Incentive Scheme "EIIS" (the replacement to the Business Expansion Scheme ("BES")). If investors were to suffer a loss of tax reliefs in respect of property investments it is difficult to conclude that investors would not question the likelihood of receiving expected tax relief in respect of the National Solidarity Bond and the EIIS.

11.56 A number of submissions cited an example in Canada where the Provincial Government of Newfoundland and Labrador retrospectively changed its approach to a property based tax relief. Lower uptake was encountered in respect of future schemes.

11.57 Given the widespread nature of participation in property incentive schemes across all income groupings in the State these risks are regarded as credible but limited. Other submissions referred to risks to Ireland's international reputation if the State were seen to renege on a commitment.

Conclusions

11.58 As part of the Economic Impact assessment, the Department has modelled the potential maximum lifetime costs of unused tax reliefs without taking account of the impact of the high earners restriction. There may be a maximum upper bound of approximately €500m in tax cost associated with unused reliefs though it is likely that the actual level of claims would be significantly less than this amount.

11.59 The majority of cost would occur during the envisaged life of the National Recovery Plan and would be close to €400m. The balance represents a maximum possible tail that could extend into the middle of the next decade and would be associated with smaller residential buy to let investors of modest income.

11.60 The high earners restriction may restrict between €50m-€100m in reliefs by high earners annually during this period. The ability of investors to be able to use the maximum relief available is of course contingent on their income streams.

11.61 Income levels of those individuals who are not high income earners have declined since 2008. Accordingly the additional yield that could be generated from these individuals may be significantly lower than modelled.

11.62 There are possible risks to the reputation of the State and its future fiscal policies if it is seen to renege on past commitments.

11.63 The actual impact of the measures in Budget 2011, if implemented immediately would be greater than their anticipated impact. This is because rather than restricting the use of reliefs the measures would have effectively terminated the reliefs with immediate effect in some cases. Whilst the total saving over the life of the plan would probably have been achieved there would have been an extreme front-loading of savings that would have had severe consequences on investors.

11.64 While this could have resulted in a greater initial tax saving for the Exchequer, it could also have resulted in more significant negative impacts on particular sectors in the economy, which could in turn have resulted in additional downstream exchequer costs.

11.65 It is worth considering therefore whether less harmful measures could achieve a similar yield to that targeted in the Budget, adjusting for the downward trend in claims costs reflected in data on 2009.

Annex 1: List of Schemes

A1.1 The table below lists the various tax-based property schemes and respective termination dates

Scheme	Closing Date
Urban Renewal	31/07/2008
Town Renewal	31/07/2008
Seaside Resort	31/12/1999
Rural Renewal	31/07/2008
Multi-storey Car Parks	31/07/2008
Living over the Shop	31/07/2008
Enterprise Areas	31/12/2000
Park and Ride	31/07/2008
Student Accommodation	31/07/2008
Hotels	31/07/2008[20]
Holiday Cottages	31/07/2008
Holiday Hostels	-
Guest Houses	-
Nursing Homes	30/06/2010 or 30/06/2011[21]
Housing for elderly/infirm	30/04/2010
Convalescent Homes	30/06/2010 or 30/06/2011[22]
Qualifying Hospitals	30/06/2010 or 31/12/2013[23]
Qualifying Mental Health Centres	30/06/2010 or 30/06/2011[24]
Qualifying Sports Injury Clinics	31/07/2008
Childcare Buildings	31/03/2011 or 31/03/2012[25]
Specialist Palliative Care Units	Scheme not commenced
Registered caravan & camping sites	-
Mid-Shannon Corridor Tourism Infrastructure	31/05/2015 (subject to EU State Aid approval)

Table 19: List of property incentive schemes and closing dates

Source: Department of Finance

[20] This is the termination date for incurring construction/refurbishment expenditure in order to avail of the accelerated rate of capital allowances of 15% per annum for the first 6 years and 10% in year 7. Capital allowances are still available for hotel projects at a rate of 4% per annum.

[21] The termination date for these schemes is 31 December 2009 except for pipeline projects. The latter dates in the table relate to these pipeline projects. The earlier termination date relates to projects where no planning permission is required and certain proportion of expenditure has been incurred by 31 December 2009. The later termination date relates to projects where planning permission is required.

[22] Same as footnote 10.

[23] Same as footnote 10.

[24] Same as footnote 10.

[25] The termination date for this scheme is 30 September 2010 except for pipeline projects. The latter dates in the table relate to these pipeline projects. The earlier termination date relates to projects where no planning permission is required and certain proportion of expenditure has been incurred by 30 September 2010. The later termination date relates to projects where planning permission is required

Annex 2: Summary Information on Property-Based Tax Relief Schemes

A2.1 The various property related relief schemes can be divided into three broad categories:

- Seven year schemes,
- Ten year schemes and
- Schemes greater than 10 years.

Seven year Schemes

A2.2 The tax code provides for tax-based property incentives on a sectoral basis in the form of capital allowances for capital expenditure incurred on the construction or refurbishment of certain types of buildings which are designated as industrial buildings under tax law.

- Among the buildings which qualify are certain health care related facilities e.g. nursing homes, nursing home residential units, private hospitals, convalescent homes and mental health centres.
- The schemes of accelerated allowances for the above developments were generally terminated with effect from 31 December 2009 - the date by which qualifying construction/refurbishment expenditure had to be incurred except for pipeline projects for which transitional arrangements were put in place. If certain conditions are met, the termination date is extended for these pipeline projects. See table at Appendix 1 which sets out the termination dates for the various schemes.
- Hotels and registered holiday cottages, sports injury clinics, childcare facilities and buildings in use for third level educational purposes could also qualify and these schemes have also been terminated.
- In general the qualifying expenditure is written off at a rate of 15% per annum for the first 6 years with 10% in year 7 (with the exception of registered holiday cottages where the rate was 10% p.a.).
- Claims in respect of capital allowances may only commence to be made after the development to which the qualifying expenditure relates comes into operation.
- The schemes have various conditions regarding clawback of the allowances where the building ceases to be used for the purpose for which the allowances were given within a specified period.
- An annual limit of €31,750 may also apply in certain schemes in relation to any excess capital allowances over rental or trading income which an individual passive investor can set off against other non-rental or non-trading income.
- In the case of childcare facilities there was an option to avail of a 100% initial allowance or free depreciation of up to 100% (for owner-occupiers).
- A scheme of capital allowances for palliative care units was not commenced.
- While the Mid-Shannon Corridor Tourism Investment Scheme is similar in certain respects to previous "area" based incentive schemes capital

allowances were only made available for certain approved tourism infrastructure projects. This scheme has a final termination date for incurring construction expenditure of 31/5/2015.

Ten Year Schemes

A2.3 Section 23 relief is a commonly used term for rented residential relief and was first introduced by Section 23 Finance Act 1981. The relevant legislation is contained in Chapter 11 of Part 10 of the Taxes Consolidated Act, 1997.

- Section 23 is a tax relief that applies to rented residential property in a tax designated area.
- It is available on expenditure incurred on the construction, refurbishment or conversion of a qualifying property and who lets that property having complied with certain conditions
- Following construction it is the first use of the property that determines the type of relief that will apply e.g. owner occupier or lessor relief.

Schemes Under Section 23

A2.4 The following is the list of Schemes under Section 23 currently with legacy relief:

- Integrated Area Urban Renewal Scheme
- Living over the Shop
- Park and Ride
- Rural Renewal Scheme
- Town Renewal Scheme
- Student Accommodation Scheme

Rented Residential Relief

A2.5 In the case of Rented Residential relief the following applies:

- The full amount of the relief is deducted from the rental income of the particular property in the first year of letting, together with other allowable deductions such as management expenses and interest relief etc.
- If, as is most likely, the deductions exceed the rental income from the property, the excess can be deducted from other Irish rental income for that year.
- Any remaining excess deductions are treated as a rental loss for that first year and can be carried forward against any Irish rental income arising in later years until the loss is used up.
- If an individual does not have sufficient rental income to absorb a rental loss, the carry forward of the rental loss can continue beyond the 10-year period following the first letting of the property under a qualifying lease.
- If a section 23 property is sold within 10 years from first being let under a qualifying lease then the section 23 relief is clawed back.

- If a second-hand property is purchased within the 10 year period, and is still a qualifying property at the time of purchase, section 23 relief will be available to the new purchaser provided he or she fulfils all of the relevant conditions.
- If a section 23 property is sold more than 10 years after the date on which the property was first let under a qualifying lease, there is no withdrawal of the relief granted and the new purchaser is **not** entitled to relief, even if relief was not claimed by the original owner.

Residential Owner-Occupier Relief

A2.6 In the case of a newly constructed property, 50% of the qualifying expenditure is allowed. Relief is granted at the rate of 5% per annum over a period of 10 years as a deduction from total income.

- In the case of a refurbished or converted property, 100% of the qualifying refurbishment or conversion expenditure is allowed.
- Relief is granted at the rate of 10% per annum over a period of 10 years as a deduction from total income.
- The first claim can be made for the year in which the individual first uses the property as his or her sole or main residence.
- Where an individual's income for a year of assessment is not sufficient to absorb the relief for that year, the excess relief cannot be carried forward and is lost.
- Owner-occupier relief is terminated if there is a disposal of the property or if it otherwise ceases to be a qualifying property by, for example, ceasing to be used as the sole or main residence of the individual claiming the relief, within the period of 10 years beginning when the property was first occupied by the owner.
- Unlike section 23 relief, there is no withdrawal of the relief already granted to the first owner.
- Owner-occupier relief is only available to the first owner and occupier of the property after it has been constructed, converted or refurbished.
- Unlike section 23 relief, there is no provision for any relief to be passed on to any subsequent owner of the property.

Property Developers

A2.7 A property developer is not precluded from section 23 relief or indeed owner-occupier relief provided, obviously, that it is not a company as owner-occupier relief can only be claimed by the person who is using the property as their sole or main residence.

A2.8 This group of commercial schemes is generally where the writing down period is 14 years.

- An initial allowance of 50% can be claimed in the first year
- An annual allowance of 4% for the next 12 years
- Commercial Schemes include : Seaside Resort Scheme, Enterprise Areas, Multi Storey Car Parks, Town renewal, Rural Scheme, Living Over the Shop, Park and Ride Scheme

Clawback of capital allowances

A2.9 Where certain events (known as balancing events) occur within **13 years** of a qualifying building being first used this can potentially lead to a clawback of part or all of the allowances claimed.

- Among the events, which could lead to a clawback of the allowances granted, is the sale of the building.
- The clawback of the allowances is known as a balancing charge and occurs when the tax written down value of the building (qualifying expenditure less allowances claimed to date) is less than the sales proceeds.
- Alternatively where the tax written down value of the building is greater than the sales proceeds this will give rise to a balancing allowance (basically an additional allowance).
- No balancing charge will be imposed if the sale (or other balancing event) occurs more than 13 years after the building is first used however a balancing allowance may still arise.
- Other events which could potentially give rise to a balancing charge, where they occur within 13 years of the building being first used, are the building being demolished or destroyed or ceasing altogether to be used.
- This is not a full list of possible balancing events.

Annex 3 – Summary Matrix of Submissions

Submission	1. Merit in limiting scope to small number of schemes	2. Schemes for study	3. Other issues re schemes for study	4. Economic arguments for restricting or terminating	5. Economic arguments against restricting or terminating	6. Separate treatment of S23 and ACA's	7. Alternative policy proposals to minimise State costs
Respondent 1	Study income of affected taxpayers and their current tax burden rather than nature of scheme or allowance.	Focus on overall income of individual and impact of high earners restriction.	X	Over reliance on one sector e.g. property, should not be permitted again. No significant revenue from restriction of reliefs as high earners restriction already achieving this aim. Await 2010 returns to see impact of stricter rules.	Questions over reliability & stability of Ireland's taxation framework; FDI implications; Further damage to property values; Reliefs needed to fund tax-based investments - changes may determine who gets paid first - Revenue or lending institution.	Taxpayer rather than relief focus.	Analyse 2010 returns to assess Horizontal measure impact while curtailing property reliefs on a year to year basis. Once that analysis is complete replace existing proposals with modifications to the high earners restriction to ensure yield from property tax incentives is sustainable.
Respondent 2	Yes	Urban renewal, hotels, Section 50, rural, town - 80% proxy for studying all schemes	Funding of public buildings may require specific analysis due to nature of implied contract between the State and investor.	Reliefs represent a cost to the Exchequer. Analysis is required of the sunk costs versus future costs. Case for eliminating all future projects and investments from these reliefs in current economic conditions.	Reliefs promised, withdrawal is a breach of contract. International reputation damaged. Financial impact on affected parties. Costings do not reflect revenue generated. Accuracy of underlying data.	No	Horizontal measure is dealing with tax cost. Reduce stamp duty on commercial property. Terminate reliefs after tax life (7 or 10 years) of the property. Link claims to NPPR payment and timely filing of returns. Yield from an annual property in place of perceived benefits from abolition of property reliefs.

Submission	1. Merit in limiting scope to small number of schemes	2. Schemes for study	3. Other issues re schemes for study	4. Economic arguments for restricting or terminating	5. Economic arguments against restricting or terminating	6. Separate treatment of S23 and ACA's	7. Alternative policy proposals to minimise State costs
Respondent 3	No - schemes differ. Study as many as possible.	Study all	Different schemes have different characteristics and profiles of investors. Policies derived from analysis of a small number of schemes may not suit across the board.	None - on evidence presented in the submission.	Savings of €400m not realistic. Proposed measures will ultimately increase the cost to the State and negatively impact economic output. Unnecessary as horizontal measure already reducing benefits available annually. Fairness, certainty and reputation of tax policy.	No.	None. Comments on options considered by TSG: Suspend for 4 years - some survive, others don't. Extend tax life to 25 years - horizontal measure already extends & thus reduces annual cost. Phasing out over 4 years - funding difficulties & loan default, also likely to trigger investors to opt out & impact negatively on promoter.
Respondent 4							Horizontal measure mitigates impact of CAs
Respondent 5							Exclude S.843 schemes (CA's for third level educational buildings) from any changes as State will incur cost due to indemnities.

Submission	1. Merit in limiting scope to small number of schemes	2. Schemes for study	3. Other issues re schemes for study	4. Economic arguments for restricting or terminating	5. Economic arguments against restricting or terminating	6. Separate treatment of S23 and ACA's	7. Alternative policy proposals to minimise State costs
Respondent 6							
Respondent 7	X	X	X	Regressive - favour better-off. Taxpayers should not remain exposed to such expenditures, which enable investors to build up value in long term investments.	No - Implement original proposals	X	No - Implement original proposals
Respondent 8	Yes	Hotels. Given high proportion of overall allowances accounted for.	In overall response…	None	Anticipate the yield to the Exchequer will be much lower than forecasted. Will impose costs on the Exchequer. (Parties, including many small hoteliers may become insolvent/bankrupt/default. Closure of hotels resulting in loss of tax receipts and unemployment. Will result in lowering activity levels in the wider economy inc.	Yes (Trading v passive activity)	No

Submission	1. Merit in limiting scope to small number of schemes	2. Schemes for study	3. Other issues re schemes for study	4. Economic arguments for restricting or terminating	5. Economic arguments against restricting or terminating	6. Separate treatment of S23 and ACA's	7. Alternative policy proposals to minimise State costs
					tourism.) Hoteliers and hotel businesses primarily impacted by any further restrictions to hotel capital allowances schemes as not possible to isolate them from high net worth sector. Effects of the changes in the High Earner's Restriction not visible until 2010 returns are compiled. Many allowances unlikely ever to be used as in NAMA. Legitimate expectation and may damage business view of future government incentives.		

Submission	1. Merit in limiting scope to small number of schemes	2. Schemes for study	3. Other issues re schemes for study	4. Economic arguments for restricting or terminating	5. Economic arguments against restricting or terminating	6. Separate treatment of S23 and ACA's	7. Alternative policy proposals to minimise State costs
Respondent 9	Yes - Split between commercial and residential (CA & S23/50).	Hotels. Urban renewal. Rural renewal. Subject to analysis on quantity, amount of relief used and carried forward.	Profile of investors in S23/50 - one third self employed - could force them out of business thus cause unemployment, lack of repayment capacity, high level of bank debt, up-front Exchequer take, contract with State, penailising those with insufficient (lower) income to absorb the reliefs before now.	None - Outweighed by those against.	Bank losses; tax take will not improve due to lack of funds; HNI and USC mean high earners no longer have meaningful tax shelters; USC payable on all net rents for 2011; undermines trust in State incentive schemes; further damage to confidence in property market; no further sales of tax relieved property; private sector housing contributes to State housing needs; current rents not covering bank repayments.	Yes.	Reintroduce tax relief for refurbishment of property. This would stimulate job creation in construction and help counteract growth in black economy. Tax relief conditional on proper invoicing.

Submission	1. Merit in limiting scope to small number of schemes	2. Schemes for study	3. Other issues re schemes for study	4. Economic arguments for restricting or terminating	5. Economic arguments against restricting or terminating	6. Separate treatment of S23 and ACA's	7. Alternative policy proposals to minimise State costs
Respondent 10	X	X	X	X	Unsustainable increase in bank defaults, leading to increased burden for the taxpayer. Rents have fallen dramatically making many loans challenging to repay before adding a massive unforeseen tax burden. Investors' financial planning will be severely impacted on day to day finances. Increase in receiverships, liquidations and bankruptcies with associated consequences. More downward pressure on property prices, leading to increased losses for banks, NAMA and ultimately the taxpayer. Risk of increase in black economy leading to reducing income for the Exchequer. Loss of trust in current and future fiscal stimuli promoted by Government.	X	If curtailment a necessity adopt a more realistic date e.g. 2018 or a phased reduction in the amount which can be claimed with retention of offset against other rental income over a number of years.

Submission	1. Merit in limiting scope to small number of schemes	2. Schemes for study	3. Other issues re schemes for study	4. Economic arguments for restricting or terminating	5. Economic arguments against restricting or terminating	6. Separate treatment of S23 and ACA's	7. Alternative policy proposals to minimise State costs
					Substantial decrease in confidence both home and abroad.		
Respondent 11	Schemes differ widely (e.g. legal structure and indemnity agreements) so true representative sample would be difficult to generate without looking at each one	Broad as possible - S.23, Urban and Rural Renewal, Hol. Cottages, Hotels, Nursing homes, Private hospitals, Childcare and Student Accom.	Doesn't take account of 2010 changes to HER or the dramatic fall in average incomes. Table 3 on Pg 19 of the consultation document out of date - many in the €100k - €150k bracket would now be in the <€100k bracket - (60% of all owners)	None	Resultant increase in personal debt will damage the banks. Damage investor confidence (e.g. BES and Pensions). Loss of activity and growth in the economy as investors would shun BES, EII, Seed Capital Scheme etc.	Yes UnderS23, investors own asset at the end. Under Acc. Cap All, they typically don't	None

Submission	1. Merit in limiting scope to small number of schemes	2. Schemes for study	3. Other issues re schemes for study	4. Economic arguments for restricting or terminating	5. Economic arguments against restricting or terminating	6. Separate treatment of S23 and ACA's	7. Alternative policy proposals to minimise State costs
Respondent 12	No	All	X	None	Damage the Economy and Banking System and restrict future BES investment. Discourage future investment due to fears Govt would renege on other tax incentive schemes (BES) or ultimately 12.5% rate	Yes	Hire a panel of Tax and Banking Experts to advise on possible cost savings from NAMA banks. Cut public service pay.
Respondent 13	Yes	Urban Renewal, Hotels, Student Accom, Nursing Homes and Creches	Nursing homes and Creches should get more in-depth analysis (stats may not accurately reflect the level of investors affected)	Increase tax take in economic downturn	Limits future investment in BES. Loss of employment in nursing homes etc. HER restricition already acheives a reduction in the reliefs. Nursing home patients would fall back on State care.	Yes	None. 2010 HER goes far enough and 2010 tax returns should be studied to ascertain truth of this
Respondent 14	No	All		None	Bank Default and Job losses (creches, nursing homes etc. will close and small business owners who invested in s23s will go bust). Decrease in disposable income will have knock-on effect on economy. Decrease in future investment (inc. FDI) due to loss of confidence in tax incentive schemes	No	Suspend Relief for 4 years (quote of Min. Noonan's statement at time of FB 2011)

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					and 12.5% rate and R&D tax credit scheme		
Respondent 15	X	Interested in childcare only	X	X	Where the people availing of the relief are engaged in a trade (for which the relevant properties are used) - the withdrawal of reliefs will force businesses to close with resulting loss of staff	X	X
Respondent 16	X	X	X	X	Loan Defaults	X	Restriction to be linked to overall taxable income OR Higher marginal rate of tax for residential landlords (+5% for incomes < 100k and 7.5% for >100k) and reduce HER to €75k
Respondent 17	No	X	X	None	Debt default, business closure, unemployment	No	None
Respondent 18	X	X	X	X	Resultant fire sales would depress prices in already disadvantaged areas.	X	None

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					Private hospital closures would put strain on HSE and increase costs for the State		
Respondent 19	No	All	X	None	Further deterioration in property market as investors try to exit	Yes	None
Respondent 20	No	All	X	X	Employment loss following business closures. Closure of private hospitals, holtels and nursing homes as operators have indemnified investors. Fall in investor confidence will have negative impact	X	High Earner Restriction should yield more than is budgeted for.
Respondent 21	X	X	X	X	X	X	X
Respondent 22	Yes	Sectors which contribute to the public good and lessen the burden on	Wider public good of certain investments: difficulty in evaluating reliefs: displaced	Wider economic impact would outweigh economic benefit: Impact on future investment decisions	Displaced demand would become a direct Exchequer liability: Negative signals for future private healthcare investment: Spill over	No opinion	Targeted write-off of tax liabilities: Other adjustments to the tax system

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		public sector	demand: wider funding/group structures		effects on confidence in other tax commitments.		
Respondent 23	X	X	X	None - on evidence presented in consultation paper.	Overall net cost to Exchequer because of taxes forgone elsewhere: Curtail future developments: Closure of private healthcare facilities	No opinion	None offered
Respondent 24	X	X	X	X	X	X	None offered
Respondent 25	No - schemes differ. Study as many as possible.	Hospital Scheme	Risk of default on Loans	None - on evidence presented in consultation paper.	Loss of investor confidence: bank write-offs	X	Limit to existing investors
Respondent 26	Yes	Hospitals	Potential to undermine Irish tax law: Difficulty in raising finance for healthcare: long term capacity requirements:	None - on evidence presented in consultation paper.	Lead to Bankruptcy: Loss of employment	Yes	Re-introduce certain targeted initiatives for healthcare infrastructure: phase out over a 3/4 year period at end of tax life;

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Respondent 27	No - schemes differ. Study as many as possible.	Childcare	Restrictions on ECCE	None - on evidence presented in consultation paper.	Threat of Insolvency: Disruption to supply and quality of childcare:	Yes	None
Respondent 28	Yes	Nursing Homes; Urban Renewal; Hotels and Student Accommodation	Societal implications	None - on evidence presented in consultation paper.	Knock-on effects on Investor confidence: May cause businesses to fold: Significant impact on small investors: Loss of employment: Displacement to Public care	Yes	Already in place with High Earners restriction
Respondent 29	X	X	Legitimate expectations of investors	X	Loan defaults:	X	X
Respondent 30	Yes	Focus on demand areas	X	X		Yes	None
Respondent 31	No - schemes differ. Study as many as possible.	Nursing homes and sheltered accommodation	Contribution to Social fabric of society	None - on evidence presented in consultation paper.	Targeted accommodation would be made available to open market: Burden for alternatives would fall on State	Yes	Need to be assessed differently than Section 23

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Respondent 32	Yes	Urban Renewal, hotels, Section 50, rural, town	Prospect for defaults and instability in property market. Also extent of reliefs used and unused to date	None.	Any restriction would have significant negative impact on economic activity. Large scale defaults likely. Insolvencies will escalate. Investors in Catch 22 situation because of clawback provisions. Increase in distressed property for sale will further strain the market. Will also impact financial institutions and NAMA.		Do not believe that legacy property relief schemes should be retrospectively altered in any form
Respondent 33	Yes	Urban, town and rural renewal, hotel and student accommodation	Issue of investor default and resultant effects on banks, NAMA, the economy and the property market	None	Significant potential negative impact on economic activity. Greatest consequence would be investor insolvency. No win situation for investors due to negative equity, limited saleability and clawbacks.	Irrelevant	Restrictions to these schemes could end up costing the State
Respondent 34	Yes	Urban Renewal and Hospitals	Removal of Property Reliefs will make the collection of service charges more difficult	None	Subcontractors, such as property maintenance companies will lose their jobs if reliefs are restricted and complexes will become run down.	NA	NA

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Respondent 35	Yes	Urban Renewal, Hotels and Student Accommodation	Defaults, insolvencies, bankrupcies, additional tax and bank repayment, bad debts and further sustained instability in the market.	None	Impact on NAMA and the banks. Negative impact on economic activity. Negative equity and clawbacks will increase. Increase in the number of distressed sales likely. Distressed sales will lead to a write-down in financial institutions loan books.	Yes. Should honour schemes aimed at regeneration and economic development	Ability to sideways set out relief should be maintained as mainly small investors
Respondent 36	Yes	Urban Renewal, Hotels, Student Accommodation and Holiday Cottages	More up to date data needed	Perceived monetary benefit to the state may actually have the opposite effect due to potential for increased default.	Any future incentives may not garner significant interest if these reliefs are curtailed. Need to take into account interest only mortgages.	Termination of either or both should be considered.	Any attempt to limit or extinguish these reliefs cannot be considered equitable.
Respondent 37	Yes but need to understand interactions between schemes		Various impacts: Property market; Fiscal, Planning and social. Removal of Section 23 will jeopardise long term viability of modest investors. Removal of ACAs will				Remove incentives over a phased basis. To be done on a tiered basis along lines of mortgage interest relief. Complete abolition by 2018. Provide investors with incentives to sell.

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			impact severely on hospitals, nursing homes, creches and NAMA. Significant mortgage default likely. Will particularly effect regeneration areas				
Respondent 38	Yes	Focus should be on finding solutions for Section 23	Helathcare provision for the future; bank security - many units are used as bank security for loans; NAMA has a major role to play.	Preventing oversupply	Small scale property construction sector is essential in Ireland.	Yes.	Measures needed to aid sale of unsold stock. Section 23 relief could be brought into self administered pensions schemes.
Respondent 39	No		Impact on foreign investment into Ireland. Impact on other schemes such as BES. Impact on the property market.				Lengthen the years that reliefs can be claimed over

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Respondent 40	No	Urban / Town and Rural Renewal	Those above a certain income threshold could perhaps be treated differently	Need to examine different investor profiles	Overall impact on economy would be counterproductive. Impact on individuals below a certain income threshold will be most severe. Urban and town renewal investors will be particularly hit due to NPPR, PRTB and otrehr charges also impacting. Reduced rental income also increases importance of section 23 relief.	Yes as impact from section 23 restrictions will be greatest.	Restriction or termination of section 23 relief should not happen below a certain income threshold.
Respondent 41			Proposed restrictions represent a threat to investment in Ireland. Many business owners use S23 to give themselves an income outside of their businesses which may only be operating at break even.				Best proposal would be to do nothing. Put relief on par with mortgage interest. Alternatively a cap on relief could be introduced of 50,000 euro

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Respondent 42	Yes	Urban/Rural Renewal, Private Hospitals, Hotels and Student Accommodation	Financing arrangements; commercial reality of transactions (change of law clause); effect on local employment; statistical analysis; response to social need and investment incentive; legitimate expectation; equal taxation; insufficent tax saving; international perception;			No	High earners restriction is already curtailing these reliefs. Need more analysis of the actual cost of the reliefs before introducing legislation. Additional information should be collected by Revenue in the Form 11 tax return to aid this.
Respondent 43	Pitfalls with so many different scenarios among different investors due to events outside their control eg receivership or liquidation	Don't agree that focused study will give an accurate picture due to different situations applicable to each investor	Geographical spread, length of time left to run on scheme - greater impact on newer schemes, how many unsold properties in country that may be sold to generate tax revenue.	Urgency of addressing national deficit	There are already restrictions in place. Rental incomes have been decimated. Self employed people are not paying themselves anything. Legal issues - threat of litigation. Local loss of business.	X	Restrict tax life of allowances to eg 5 years.

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Respondent 44	X	X	X	X	negative impact on local economy	X	X
Respondent 45	X	X	X	X	local employment	X	X
Respondent 46	X	X	X	X	Depletion of supply of holiday homes. Negative impact on economic activity in local communities. Loss of jobs in local areas. Negative impact on investors.	X	X
Respondent 47	X	X	X	X	local employment	X	X