Proposals to Increase Retention of Small-scale Landlords in the Residential Rental Market

A joint paper by
Chartered Accountants Ireland
and Focus Ireland

Contents

Chartered Accountants Ireland is Ireland's leading professional accountancy body, representing over 31,000 influential members throughout the globe. The Institute aims to create opportunities for members and students, and ethical, sustainable prosperity for society. An all-island body, Chartered Accountants Ireland was established by Royal Charter in 1888 and now has members in more than 90 countries. It is a founding member of Chartered Accountants Worldwide, the international network of over one million Chartered Accountants. It also plays key roles in the Global Accounting Alliance, Accountancy Europe and the International Federation of Accountants. Chartered Accountants Ireland members provide leadership in business, the public sector and professional practice, bringing experience, expertise and strict standards to their work for, and with, businesses in every sector. Chartered Accountants Ireland engages with governments, policy makers and regulators on key issues affecting the profession and the wider economy.

Founded in 1985 by Sr Stanislaus Kennedy, **Focus Ireland** is a housing and homeless charity that works to prevent people becoming or remaining homeless, or returning to homelessness, through the provision of quality services, supported housing, research and advocacy. Since its foundation, Focus Ireland's services have continued to grow and our research and advocacy work ensures that the rights of people who are homeless remain on the political agenda. In addition to our Dublin projects, we now have services and housing projects across Ireland including in Waterford, Kilkenny, Cork, Sligo and Limerick.

1. Introduction

The residential housing crisis in Ireland is a complex problem. It involves not only supply issues in the social housing sector, but also in the residential retail market and in the residential rental market.

In this paper, we set out the background to the crisis in the housing market, focusing primarily on the residential rental market and the challenge of keeping small-scale private landlords in this market. The paper discusses possible solutions to these challenges by using tax policy as a lever to encourage small-scale landlords to remain in the residential rental market.

Chartered Accountants Ireland and Focus Ireland believe that taxation policy can contribute in a meaningful way to resolving the short- to medium-term challenge of keeping small-scale private landlords in the market. With this objective in mind, it is important to minimise the extent to which any proposed changes to the tax treatment of landlords benefits those who had no intention of leaving the market in the first place. Instead, the focus should be on measures that will be most impactful for landlords who currently plan to sell. This balance can be supported by tax incentives and by linking new incentives to landlords who provide appropriate security of tenure for tenants. Some of the proposed changes discussed in this paper, such as the treatment of property tax, suggest removing issues which create a sense of grievance among landlords which is disproportionate to the amount of revenue they generate.

2. Focus Ireland's insight into the housing crisis

Families being evicted from private rental tenancies, primarily due to landlords leaving the market, is the largest cause of family homelessness, but its root causes lie in a more general shortage of social and cost rental housing. While there may be disagreements about scale and speed of delivery, the Government's view that the long-term solution to homelessness is through increased provision of social and cost rental housing is the correct position. Delivery of this aspect of the plan should be accelerated.

However, the current pattern of large numbers of small landlords leaving the market creates a short- to medium-term problem (approximately four to six years, if Government housing targets can be met and housing need assessments are correct). The fact that restructuring of the private rental market through large scale departure of private landlords is taking place now, rather than in, say, five years, presents very real challenges which must be urgently addressed.

The displacement of renting families through eviction and their replacement by new owner—occupiers is not a 'zero sum game', but rather involves enormous costs to individuals and families and to state services. The tenants who are displaced by this process are more likely to be (but not exclusively) 'vulnerable' and on lower incomes than the households who purchase the properties. The displaced households are more likely to require support from public funds after eviction, while the purchasers are unlikely to be relying on homeless accommodation prior to purchasing.

The experience of relying on emergency homeless accommodation for many families and individuals will have life-long negative consequences on health, education and labour market participation. Any responses to this must focus on addressing and minimising the trauma caused to individuals and families as a result of losing their homes. Urgent policy responses are required in the private rental market which should be targeted at landlords who are considering evicting their tenants to sell over the next six years, convincing them it is in their interest to stay, or not to evict when they are selling.

Although this paper focuses on taxation solutions to the housing crisis, it is not the only policy lever available (**Appendix 1** of this paper contains some non-tax measures for consideration). There is, for instance, considerable scope for simplification in the existing complicated and often contradictory regulations, and speeding up determinations and processes with the Residential Tenancies Board (RTB) through additional State funding and capacity building, without fundamentally shifting the current balance of tenant/landlord rights and obligations. Furthermore, renters are particularly vulnerable to the cost of living and energy challenges, and incentives must be introduced for landlords to undergo retrofitting that supports both tenant and landlord, as well as helping to meet climate targets.

3. The current state of the residential rental market in Ireland with a particular focus on small-scale landlords exiting the market

The residential rental market has grown substantially over the last two decades – not just in total number of units, which have tripled since 2000, but also in terms of percentage of all homes, now accounting for around 20 percent of homes. In recent years, this growth trend has reversed, with a decline in the number of properties for rent and smaller landlords leaving the market in significant numbers. There has been a growth in the number of large-scale landlords and corporate landlords, but the scale of this increase has been less than the decline in small landlords.

Over this period of growth, Ireland has moved from being one of the least regulated private rental markets in Europe to one where there is a high degree of regulation.[1] The most recent phases of this regulation have been driven by Government efforts to provide greater security for tenants in the face of a shortage of rental accommodation. However, some commentators have argued that these additional regulations have increased the likelihood of landlords leaving the market, and so have exacerbated problems they were intended to remedy.

In addition to the increased regulatory pressures, small-scale landlords cite the restrictive taxation obligations which they must pay on any rental profits accruing to them. After settling taxes on any profits, some small landlords often face a current loss on rental income after settling their mortgage repayments and other expenditures which are non-deductible for Irish tax purposes.[2] Further, individual private landlords are required to pay tax at their marginal rates while their corporate counterparts are taxed at 25 percent[3] and, in some cases, are wholly exempt from tax.[4]

The high level of marginal taxation of small landlords, along with the particular capital gains tax (CGT) situation of some landlords, helps to explain the apparent paradox where landlords are deciding that it is no longer profitable to remain in the market even though rent levels have never been higher.

1 Whitehead, C. (2020) '*The Private Rented Sector as part of the Global Housing system in a COVID19 world*', Economic & Social Research Institute.
2 Section 97 Taxes Consolidation Act 1997.
3 Section 21A Taxes Consolidation Act 1997.
4 Section 705G Taxes Consolidation Act 1997.

The small levels of income generated from monthly rental is indicated by data from the Central Statistics Office (CSO), which suggests that more than half (50.5 percent) of landlords in Ireland earned less than €10,000 in 2021 and a little over a quarter (28.6 percent) of landlords earned between €10,000 and €19,999.[5]

Of course, depending on when the property was purchased, landlords normally expect to make a capital gain on the sale of the property. The high marginal taxation of income for small landlords encourages them to see the investment in terms of the benefits of selling. Any strategy to encourage small landlords to remain in the market (and encouraging new small landlords to invest) must increase the monthly return from rent, so shifting the balance away from the attraction of selling. This rebalancing is equally important for those who entered the market as investors and for those who entered it 'accidentally'.

The pressures these landlords are facing because of the foregoing is causing a rapid exodus of these landlords from the market. Landlords are an essential feature of a fully functioning residential property market. Chartered Accountants Ireland and Focus Ireland have each separately made proposals during 2022[6] aimed at encouraging small-scale private landlords to remain in the rental market. Indeed, Chartered Accountants Ireland has been raising the issues in the Irish housing market since 2017.[7]

Research from Sherry Fitzgerald (October 2021) suggests that the exodus of small investors from the residential rental market reduced the number of available tenancies by nearly 22,000 between 2016 and 2020. Furthermore, the RTB estimated that the number of private rental tenancies has reduced by over 43,000 tenancies between 2016 and 2021.

Clearly, renting as an investment is becoming less attractive for small-scale private landlords. As such, Chartered Accountants Ireland, in conjunction with Focus Ireland, is asking for Government and its agencies to carefully consider these proposals for the small-scale private landlord to encourage their continued involvement in the Irish residential rental market to ensure that tenants are protected.

5 The Rental Sector in Ireland 2021, Central Statistics Office (CSO).
6 *The Next Financial Year* (July 2022), Chartered Accountants Ireland.
7 *Consultation on the Tax and Fiscal Treatment of Landlords* (2017), the Consultative Committee of Accountancy Bodies-Ireland.

4. Taxation proposals to encourage retention of small-scale private landlords in the Irish residential rental market

Chartered Accountants Ireland does not recommend a return to tax reliefs in the form of property allowances, but instead proposes the following measures that could be implemented on a short- to medium-term basis to improve retention of small-scale landlords in the rental market.

PROPOSAL — DEDUCTION FOR LPT

Local property tax (LPT) should be allowed as a deduction against rental income.

ESTIMATED COST

€20 million[8]

PROPOSAL — ALIGN ALLOWABLE RENTAL EXPENSES WITH NORMAL TRADING DEDUCTIONS

Expenses available for deduction against rental income are set out in legislation under section 97 TCA 1997 and we believe that they should become less prescriptive and more in line with normal trading deductions. In the context of taxing rental profits earned by an active class of professional landlords, we suggest that the broader based deduction for financing costs under Case I principles should apply. This would mean a deduction for expenses that are revenue in nature and incurred wholly and exclusively for the purposes of the rental business, as well as allowing landlords to offset accrued rental losses against other income.

ESTIMATED COST

The total amount of allowable expenses claimed on residential properties in 2019 was €1,190 million[9] so we would expect a slight uptick on this figure following the introduction of this measure. For example, allowing landlords to offset accrued rental losses against other income would likely cost €43 million as forecast by

8 Revenue estimates provided to Minister for Finance Paschal Donohue in response to parliamentary question, 17 December 2019. Previous estimates suggested a net cost of €28 million as set out in the *Report of The Working Group on the Tax and Fiscal Treatment of Rental Accommodation Providers*, September 2017.

9 *Rental Income Statistics 2019* (July 2022), p. 3, Revenue Commissioners.

Report of The Working Group on the Tax and Fiscal Treatment of Rental Accommodation Providers.[10]

PROPOSAL — INCREASE WEAR AND TEAR RATES

The wear and tear rates for fixtures and fittings should be increased from 12.5 percent to 25 percent per annum to facilitate landlords investing in the maintenance of properties. This will encourage better standards in rental properties where the renovations do not result in the termination of an existing tenancy under section 34 and the property remains in the private rental market for the following five years.

ESTIMATED COST

No cost – introduction would simply reduce the lifespan of capital allowances from eight to four years.

PROPOSAL — 100 PERCENT CAPITAL ALLOWANCES FOR RETROFITTING COSTS

Where landlords retrofit a property to improve its energy rating, 100 percent capital allowances should be offered in the year of work where the renovations do not result in the termination of an existing tenancy under section 34 and the property remains in the private rental market for the following five years.

ESTIMATED COST

Estimates compiled for the Department of the Environment, Climate and Communications indicate that the cost to retrofit the fabric of a house to a Building Energy Rating (BER) B2 and install a heat pump can range between €14,000 and €66,000.[11] Taking the lower end of this range, a spend of €14,000 by each of the 161,000 taxpayers who declared residential rental income in 2019[12] would amount to €2,254 million in additional capital allowances. Gross rental income declared on residential roperties in 2019 amounted to €3,202 million.[13]

10 Tentative costing as provided for in *Report of The Working Group on the Tax and Fiscal Treatment of Rental Accommodation Providers*, September 2017. The report notes, however, that in view of the year-on-year increase in rental prices, it is possible the actual number of landlords who are loss-making has since decreased therefore reducing the likely cost of this measure to the Exchequer.

11 Launch of Government National Retrofitting Scheme, Government Press Release.

12 *Rental Income Statistics 2019* (July 2022), p. 3, Revenue Commissioners.

13 *Rental Income Statistics 2019* (July 2022), p. 2, Revenue Commissioners.

PROPOSAL – BRING PARITY TO TAXATION OF CORPORATE AND INDIVIDUAL LANDLORDS

The Government could introduce a flat rate of 25 percent on Case V income for small landlords who opted to become 'professional landlords' by waiving their rights under section 34 of the Residential Tenancy Act (2014), giving additional security to their tenants.

While corporate and small landlords operate under the same legislation, from the perspective of the tenant, one of the key benefits of renting from a corporate landlord is that they will not exercise section 34 (the rights to move into the property or evict to sell). These limitations were introduced to protect the 'amateur landlord' and eliminating these exemptions to the tenancy agreement should entitle the landlord to the same taxation regime as corporate landlords.

ESTIMATED COST

€117 million[14]

PROPOSAL – SUCCESSION RELIEFS

Professional landlords should be given access to succession reliefs, such as CGT retirement relief available to other business owners, in an effort to improve the long-term investment proposition of the residential rental business.

ESTIMATED COST

Importantly, by allowing the extension of succession reliefs, such as CGT retirement relief to professional landlords, the Government would simply be accommodating a deferral of capital tax receipts rather than facilitating a tax write off.

To illustrate how this deferral would operate, the current proposal can best be set out by way of example:

- The average residential house price in Ireland in Quarter 2 2022 was €311,874.[15]
- A landlord opts to transfer a rental unit at this price to the next generation, with a carrying base cost of €250,000.
- The deemed gain on this disposal would be €61,874, which would be subject to

14 Estimate derived from indicative calculation provided by Department of Finance in its *Property Related Tax Issues – Tax Strategy Group*, July 2022 (Appendix 2) – adjusted for application of 25% flat rate.
15 *The Daft.ie House Price Report, An Analysis of Recent Trends in the Irish Residential Sales Market*, June 2022.

CGT at 33 percent, giving rise to a tax liability of €20,418. If CGT retirement relief applied, this liability would be fully relieved for the disponer, with the latent gain on the property ultimately being inherited by the successor.
- On this basis, should 20 percent of registered landlords[16] (32,200) ultimately opt to transfer a rental property to their next generation using the same values, the net tax temporarily deferred (assuming the conditions for full retirement relief have been met) would be an estimated €657,459,600.

PROPOSAL – CGT RELIEF FOR RENTAL PROPERTIES ACQUIRED WITH TENANTS-IN-SITU

Where a property is purchased with a tenant-in-situ and is retained as a rental property for a minimum of five years, a CGT relief of four percent per annum would accrue on an annual basis for the length of time the asset remains as a rental property. Under the terms of this relief, any taxable gain arising on the ultimate disposal of the property would be reduced by four percent for each year that it was held as a rental property, provided the minimum rental term is met. This proposal was specifically examined in the *Report of the Working Group on the Tax and Fiscal Treatment of Rental Accommodation Providers* in 2017 which, in its analysis of this policy option, noted how a measure of this type would:

- reduce incentives for landlords planning to exit the market to seek vacant possession in order to sell their rental properties;
- encourage prospective investors to purchase properties with tenants-in-situ, thereby resulting in a "reduction in tenancy churn in rental markets" and encouraging a "greater continuity of tenancies";
- facilitate a "reduced call on social housing services" by households evicted as a result of disposals of rental properties; and
- encourage the retention of properties as rental stock in the longer term overall.[17]

As part of any such measure, anti-avoidance provisions to prevent abuse of the relief would need to be provided for, as well as a review of regulations to ensure tenant rights are maintained through a change of landlord. In addition, the relief should be extended to current landlords who continue to operate rental properties for the minimum five-year period following the enactment of this incentive.

16 *Rental Income Statistics 2019* (July 2022), p. 2, Revenue Commissioners.
17 *Report of The Working Group on the Tax and Fiscal Treatment of Rental Accommodation Providers*, September 2017.

ESTIMATED COST

The economic cost of this relief is best set out by way of illustrative example:

- Assume an investor acquires a residential property in 2023 with a tenant-in-situ for an amount equal to the average residential house price in Ireland of €311,874.
- The investor continues to operate the property as a rental unit until 2028 at which point they dispose of the property for €400,000.
- As the property has operated as a rental unit for a minimum of five years, the gain of €88,126 is reduced by €17,625 (five years × four percent) resulting in a net taxable gain of €70,501.

According to the RTB's 2022 Rental Survey, approximately 25 percent of private landlords have signalled that they are likely or very likely to sell their rental properties in the next five years.[18] Taking this figure to broadly represent approximately 40,250[19] taxpayers, and applying the illustrative figures above, if half of these taxpayers sold a property with tenants-in-situ to new landlords who then continued to operate the properties as rental units for five years, the net cost to the Exchequer would be approximately €117 million.[20]

5. Conclusion

Chartered Accountants Ireland, in association with Focus Ireland, would welcome the opportunity to discuss our concerns about the Irish residential rental market and we would be pleased to explain our proposals in more detail.

We look forward to hearing from you.

18 Opening Statement of Tom Dunne, Chair of the RTB, to a hearing of the Joint Committee on Housing, Local Government and Heritage, 29 November 2022.

19 *Rental Income Statistics 2019* (July 2022), p. 2, Revenue Commissioners.

20 CGT payable without relief = €29,082 (€88,126 × 33 percent). CGT payable after five years = €23,265 (€70,501 × 33 percent). Net reduction in CGT payable per property after five years = €5,817. Half of landlords who intend to sell = 20,125 (50 percent of 40,250). Overall tax cost: 20,125 × €5,817 = €117,067,125.

APPENDIX 1

Non-tax measures to improve to encourage the small-scale landlord to remain in the rental residential market

(i) RTP capacity and funding

In addition to the costed measures set out in this paper, issues with the processes associated with renting out a property needs to be urgently addressed. Over recent years, the Government have introduced a large number of well-intentioned amendments to tenancy legislation but has not responded to repeated calls by the RTB for a simplified consolidation of legislation. Many of the regulatory unfairness which many landlords complain about – and which fuels their decision to sell-up – arises from needless complexity and provides no additional protection to the tenant. This cannot be resolved immediately, but the Government should send a clear message that will prioritise simplifying tenancy legislation, without reducing the rights of tenants, but removing unnecessary hassle and regulation.

Focus Ireland acknowledges that increased funding has been allocated to the RTB along with new responsibilities, but the range of functions has increased at an even faster rate. Long delays and other problems arising from capacity issues often contribute to the decision of landlords to evict-and-sell as the fastest mechanism to resolve disputes.

At this point, new functions should only be added to the RTB role where they directly relate to tackling the homeless crisis, and the RTB should be allocated sufficient funding to tackle capacity constraints. The RTB has had to double the number of contract staff this year to contend with the volume of landlords making contact with the agency. The RTB also took the decision to suspend its webchat function in August 2022 because it could not deal with the volume or complexity of the queries it was receiving. There has also been many issues with the new registration system introduced in April 2022. All of these capacity issues causes headaches and bad will amongst landlords.

Additional funding should be accompanied alongside a clear commitment to short-timelines for hearing and resolving disputes. Cases where tenants experience mental health issues which make it difficult for them to sustain their tenancy frequently manifest themselves as ‘anti-social behaviour’ complaints. After prolonged regulatory, legal and enforcement processes, these cases usually end with the tenant entering homeless services. After several years in emergency accommodation the individual may become eligible for Housing First support which will enable them to then sustain a tenancy. This is an expensive and wasteful process.

A better approach in cases where an eviction is occurring due to ASB caused mental health and related issues, would be for the landlord or RTB to be able to refer tenants to appropriate AHBs with Housing First supports. The provision of alternative housing with appropriate supports would remove the distress and cost involved in such evictions and reduce the sense of risk that many landlords report.

(ii) Link climate crisis targets goals to maintaining tenancies through conditional funding for BER upgrades

The homes of lower income households, and those most at risk of energy poverty, should be prioritised for retrofitting and many of these are homes owned by smaller landlords. Households that rent their homes are more likely to experience poverty and deprivation than owner occupiers, and this needs to be reflected in all policies and schemes that seek to address fuel poverty, housing insecurity and our climate targets. The National Retrofit plan recognises that improving the energy efficiently of private rented accommodation will pose more challenges than retrofitting owner occupied homes.

The National Retrofit Scheme plans to address this issue through the introduction of a minimum BER rating requirement for private rental properties where feasible from 2025, in line with the commitment in Housing for All. In its Climate Action Plan 2023, the Government have set out its ambition to retrofit 120,000 dwellings to BER B2 by 2025 with this increasing to 500,000 dwellings by 2030.

While SEAI grant support will continue to be made available to help landlords to retrofit their properties as well as the planned low-cost loan scheme for retrofit, these proposals do not reflect the realities of the current rental market. The number of current evict-to-sell NoTs confirms recent research from the RTB that found that 1 in 4 small landlords say they plan on selling their property in the next five years. None of this indicates a sector ready to respond to ‘low-cost loans’.

The prospect of a minimum BER rating applied to private rented accommodation without an appropriate level of support to small landlords, would likely result in more landlord departures and homelessness, rather than warmer homes or secure housing. The low-cost residential retrofit loans proposed for landlords should be replaced with a grant system that covers the majority of costs in exchange for increased tenure security for tenants from eviction.

This would improve the value of the property for landlords, provide more secure and more affordable homes for tenants and help support the achievement of the Government's climate change targets set out in the Climate Action Plan 2023. Such retrofitting schemes targeting private rental accommodation would also need to ensure that work could be carried out on a property without a tenant needing to vacate and potentially become at risk of homelessness.