Revenue Explanatory Note on the operation of the provisions of the Taxes Consolidation Act, 1997 in relation to the Student Accommodation Scheme.

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Student Accommodation

1. Introduction

Section 50 Finance Act, 1999 introduced tax relief in respect of expenditure incurred on the construction, refurbishment or conversion of residential property for use as student accommodation. The legislation governing this relief is contained in Chapter 11 of Part 10, Taxes Consolidation Act, 1997. Changes introduced by Section 32 Finance Act, 2003 are contained in section 372AM.

Relief is available in respect of developments that comply with the requirements of guidelines issued by the Minister for Education and Science. These guidelines are available on the Department of Education and Science website at www.education.ie/ and should be consulted in conjunction with this document.

The purpose of this Explanatory Note is to clarify the Revenue practice in relation to a number of issues that have arisen following the changes made by the Finance Act, 2003. These issues are-

- the receipt of rent by persons other than investors
- investors' obligations in relation to monies borrowed by them
- what constitutes management and letting fees

In addition, the issue of rent pooling, while not specifically provided for in the legislation, is addressed.

This Explanatory Note applies where section 372AM(9A), Taxes Consolidation Act, 1997 applies and where eligible expenditure was incurred after 18 July 2002.

2. Who can receive rent

Section 372AM(9A)(a)(i) provides that all rent payable in respect of the letting of student accommodation during the 10 year holding period for the relief must be paid to investors. The section was introduced to close off tax avoidance schemes whereby rental income from student accommodation was not taxable in the hands of investors.

It has been brought to Revenue's attention that there are circumstances where it is necessary for a college or a management company appointed by investors to enter into tenancy agreements with students giving it an entitlement to rent and obliging it to incur expenditure in relation to the rental and upkeep of the accommodation. Typically these arrangements are covered by formal written agreements between a college and an investor and oblige a college or management company to pay an investor the net rent after deduction of expenses. Revenue is prepared to accept these arrangements provided that rent (after deduction of expenses) secured and taxable in the hands of investors under Schedule D Case V is the same as if investors contracted individually with students. The written agreement between a college or management company and an investor may

provide for the retention of expenses incurred. However, only so much of those expenses that relate to management or letting fees of not more than 15% of gross rent received or receivable and other expenses that are properly allowable as Schedule D Case V deductions will be taken into account in the calculation of an investor's Case V liability (see section 4 below). A college or management company, and not an investor, must be responsible for any pro rata allocation and direct payment of rent to investors in a situation where a property is jointly owned. Should rents fall below a certain level it is acceptable for a college or management company to guarantee investors a minimum level of rent provided that this is not less than the rent actually received from students less allowable deductions.

Investors may incur expenditure themselves outside of any arrangement with a college or management company. For example, an investor may pay mortgage interest in connection with the purchase of a property. The arrangements set out in this Explanatory Note will not preclude an investor from claiming his or her entitlement to a Schedule D Case V deduction in respect of this type of expenditure.

3. Investors' obligations in relation to monies borrowed by them

Section 372AM(9A)(b), Taxes Consolidation Act, 1997, requires that an investor must be personally responsible for the repayment of a loan, the payment of interest on a loan and the provision of any security required in relation to a loan. In addition, there must be no arrangement or agreement, whether or not known to the lender, whereby some other person agrees to be responsible for the obligations of an investor in relation to a loan.

It is not uncommon for a college to put a sinking fund arrangement in place to provide comfort to investors that a college will be in a position to pay the option price to investors if called upon to do so under a put and call option. Investors may seek to take a charge on the sinking fund and in turn a financial institution may seek to obtain an assignment of an investor's interest in the sinking fund. Such an assignment may create a situation whereby a financial institution may have access to monies in a college account or receive payments directly from a college. Revenue takes the view that any assignment of an investor's interest in a college account would breach the requirements of the legislation. It is, however, acceptable for a financial institution to take an assignment of an investor's interest in a put and call option.

All borrowing must be from a financial institution and expenditure by an investor that is funded partly by an interest free loan and partly by borrowing from a financial institution will disqualify all of that expenditure from tax relief.

4.Management and letting fees

An annual deduction is allowed for management and letting fees incurred in relation to the letting of student accommodation where those fees are shown to be bona fide fees that reflect the level and extent of services provided. Even where the fees are bona fide and reflect the level and extent of services provided the maximum deduction by law cannot exceed an amount equal to 15% of gross rent from the letting. Management and letting fees cannot be structured to reach the 15% threshold but must genuinely reflect the level

and extent of services provided. If the fees exceed 15% this will not invalidate the entire claim but any amount exceeding 15% is not tax deductible and should not be claimed by an investor. In this context it should be noted that management and letting fees mean the VAT **inclusive** amount of such fees.

Listed below are the items that Revenue would normally regard as management and letting fees -

Management fees

- maintenance of accommodation, e.g. carrying out inspections and ensuring that repairs are carried out (the actual cost of any repairs will not be included in management fees)
- transferring names on utility bills when lettings change
- collection of rent

Letting fees

- advertising for and finding suitable tenants
- obtaining and verifying references
- drawing up letting agreements including legal fees
- taking deposits from tenants
- setting up names of tenants on utility bills
- setting up direct debits between tenants and landlords

An investor, college or management company must be able to show that management and letting fees incurred were bona fide and that they reflect the level and extent of services provided.

5. Other deductible expenses

Certain service charges and out of pocket expenses of a revenue nature allowable as deductions under Schedule D Case V will be allowed. Examples of such expenses are -

- accountancy fees incurred for the purpose of preparing a rent account
- repairs of a revenue nature, e.g. repair of a broken window
- landscaping costs of a revenue nature, e.g. grass cutting, hedge trimming etc.
- lift maintenance
- security costs (including cost of hiring security personnel, fitting and monitoring of alarms but not the alarm itself)
- heating, electricity and cleaning of common areas
- insurance costs
- charges for other services such as refuse collection.

A detailed schedule of expenses incurred must be made available if required by the Inspector of Taxes dealing with an investor's affairs. The Inspector must have access to

receipts to vouch the cost of out of pocket expenses and to records relating to salary costs. Where an investor is preparing a Case V computation and where, for example, a college or management company pays for the cost of repairs and pays over the rent net of such costs to an investor, an investor should gross up the amount of rent received to include the repair costs where a tax deduction is being claimed. It should be noted that, should any expense be found not to be deductible at a subsequent date, Revenue will increase the level of income chargeable under Schedule D Case V on an investor.

6. Rent pooling

Rent pooling is a feature of many student accommodation schemes. Revenue recognise that it is a practical way for a college or management company to allocate rent appropriate to each investor without having to do a separate calculation in each case. Revenue is prepared to allow rent pooling in the particular circumstances and context of the student accommodation scheme and **only** in respect of rent received from students during the academic year. Revenue understands that rent pooling schemes have been devised using an allocation of rent based on bed space and accepts that this is a reasonable method.

It will not be appropriate to pool all deductible expenses. Revenue will accept a pooling of management and letting fees and other deductible expenses appropriate to all houses or apartments, e.g. expenses in relation to common areas. Expenses listed in section 5 above that are specific to an individual house or apartment should not be pooled. As indicated earlier, deductible pooled management and letting fees cannot by law exceed 15% of gross rent.

Rent pooling arrangements will determine the amount of net rent applicable to an apartment or a house. Where two or more investors have incurred expenditure in relation to a qualifying premises the rent determined by the pooling arrangement in respect of that premises should be divided by a college or management company and paid to each investor in proportion to the level of expenditure incurred by them. This is necessary to satisfy the requirements of Section 372AM (9A)(a)(ii) of the Taxes Consolidation Act, 1997, introduced by the Finance Act, 2003.

In some schemes investors have an interest in the entire development rather than in a particular house(s) and they have the same proportionate interest in all of the houses in the development. In such cases rent and expenses should be allocated among investors in proportion to the expenditure incurred by them.

Houses or apartments that have not yet been sold to investors should not be included in a rent pooling arrangement. In order to qualify for tax relief it is imperative that **all** of the accommodation is let at some stage. In order to be a 'qualifying premises' the accommodation must be let to and occupied **solely** by students during the academic year. Outside of the academic year the accommodation may be let to non-students. Temporary periods of disuse are allowed. Rent pooling will be allowed **only** in respect of rentals during the academic year. Rent and expenses for periods outside of the academic year

must be allocated in accordance with the provisions of the Taxes Acts. Section 97(1)(c), Taxes Consolidation Act, 1997 provides that the amount of the rental surplus or deficiency must be calculated separately for each house or apartment. This prohibition on rent pooling outside of the academic year applies equally to co-ownership structures where investors have an interest in the entire development rather than in a particular house(s).

A rent pooling arrangement must be entered into for genuine commercial reasons and must not be part of a scheme or arrangement intended to secure a tax advantage or tax avoidance for a particular taxpayer or group of taxpayers, as, for example, the diversion of a higher proportion of rent to investors with losses. Any such scheme or arrangement will lead to the withdrawal of the rent pooling facility and to a recalculation of the tax liability of investors based on the rent that would have been receivable in the absence of rent pooling.

Many schemes have been operating rent pooling arrangements in advance of the publication of this Explanatory Note and the procedures may not fully comply with its requirements. The new rent pooling arrangements will apply, going forward, from 1 January 2004.

7. Powers of inspection

Under the Self Assessment system the Revenue Commissioners are authorised to inspect investors' records to verify both rental income and deductible expenses. It should be noted that none of these arrangements (i.e. management companies, rent pooling etc.) will be acceptable unless investors, colleges and management companies have satisfactory arrangements for the maintenance of written records to ensure compliance with this Explanatory Note and the relevant legislation. In this regard investors in a scheme and colleges or management companies should understand that an Inspector of Taxes dealing with the tax affairs of a particular investor may need to examine third party records relating to other investors. All such third party records must be made available for inspection if required.