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‘Rent-to-Buy’ (and similar) Schemes

This article provides guidance on the likely tax treatment (income tax, corporation tax, capital gains tax and stamp duty) of ‘Rent-to-Buy’ and similar schemes that have become a feature of the Irish property market. These are essentially schemes, devised by builders/developers, to provide an incentive for individuals to purchase a property by giving them the opportunity to live in the property for a trial period before deciding whether to purchase that property and by discounting the purchase price of the property in certain situations.

It appears that the most common type of arrangement is for the potential purchaser to occupy the property under a letting agreement. Where the person decides at some stage within a pre-agreed period to purchase the property, the purchase price is reduced by some, or all, of the rent that has already been paid. The purchase price may be further discounted to reward early purchase. Usually, any rent that has already been paid is forfeited where the person decides not to purchase. There is an increased likelihood of the person proceeding with the purchase, as walking away from the arrangement involves a cost in the form of the non-refundable rents.

There are many variations on this type of ‘rent-to-buy’ scheme. For example, the prospective purchaser may occupy the property under a caretaker’s agreement and, instead of paying rent, he or she pays a deposit towards the purchase price of the property. Another variation is for the prospective purchaser to make a payment for an option to purchase the property at a pre-agreed price within a pre-agreed timeframe. Such deposits and option payments may be paid up front or by instalments over the pre-agreed period.

Because of the variations in the types of arrangements used, each case is ultimately to be decided on its particular facts and circumstances. The guidance provided by this article is, therefore, of a general nature only. How a particular scheme is structured and the legal form of its transactions will usually determine how the parties to the transactions will be treated for tax purposes. Thus, similar type arrangements may have different tax consequences. However, the legal form of a transaction is not necessarily the determining factor and Revenue may need to look to the substance of the transaction in deciding on the appropriate tax treatment. For example, in certain cases where a licence was purported to exist, case law has established that the label put by parties on their relationship is not conclusive and it may be necessary to look behind that label to discern the intention of the parties and the substantive nature of their relationship.

Outlined below are some of the tax consequences that are likely to result from three different types of arrangements from the perspective of both vendor and purchaser. As mentioned earlier, these are intended as general guidance and are not to be taken as being definitive or exhaustive.

1. Rent-to-Buy

This part deals with the type of arrangement where a potential purchaser of a property occupies the property under a letting agreement.

(a) Vendor

Where property is rented out by a builder/developer, section 641(2) TCA 1997 is relevant. Paragraph (b) of that section states that land (or an interest in land) that is held as trading stock can only cease to be trading stock if the particular trade is discontinued. This means that the option to appropriate trading stock to fixed assets is not available to builders/developers.^[1] Paragraph (a) of the section precludes the receipt of rent from being treated as a trading receipt. Thus, where such property is rented out, the rental payments are Case V rental receipts but the eventual disposal proceeds will be a Case 1 trading receipt and not a capital receipt from the disposal of a fixed asset.

Interest payments on a loan that was used to finance the development of the property becomes a Case V expense deduction under section 97(2)(e) instead of a Case 1 trading deduction during the period when the property is occupied by the tenant. The amount of the trading receipt will be the net amount received by the vendor from the purchaser for the purchase of the property, i.e. after any discount given to the purchaser, for example, for rent previously paid or for early purchase.

In the case of companies, Case V profits are taxed at the 25% non-trading rate while Case 1 profits are taxed at the 12½% trading rate. In the case of close companies, any Case V income is taken into account in determining whether a surcharge on undistributed estate income applies.

[1] In the sense that such persons construct, or cause to be constructed, buildings in the course of a trade with a view to their sale.

(b) Purchaser

As the prospective purchaser is paying rent, he or she is entitled to claim **rent relief** under section 473 TCA 1997 in relation to the rental payments made.

Any rent paid by the purchaser or any discount received by the purchaser for rent paid (or for early purchase) is not regarded as part of the cost of the property and will not be taken into account in determining the cost of the property for **Capital Gains Tax** purposes.

Where a prospective purchaser occupies a new property that is subsequently purchased by that person under a 'rent-to-buy' scheme, the property will be regarded as new for the purposes of **Stamp Duty** reliefs that apply on the purchase of a new house. Where the prospective purchaser does not ultimately purchase the property, the property is regarded as a second-hand property in relation to any subsequent purchase of the property by another person. A lease of a residential property for a term not exceeding 35 years, or for any indefinite term, is exempt from Stamp Duty where the rent does not exceed €30,000 per annum.

Where the property is in a tax incentive area and can qualify for **owner-occupier relief**, the strict position is that the first use of the property after the qualifying expenditure has been incurred (i.e. as a result of the purchase of the property) must be as the person's only or main residence (section 372AQ(2) TCA 1997). However, Revenue will not deny owner-occupier relief where occupation of the property occurred prior to incurring the qualifying expenditure provided that the original occupier actually purchases the property under the rent-to-buy arrangement. The 10-year period for claiming relief will commence from the time that the full amount of the qualifying expenditure is incurred. As any rent paid or any discount received by the purchaser (e.g. for rent paid) is not regarded as part of the cost of the

property, it will not be taken into account in determining the qualifying expenditure for relief purposes. If the first occupier does not purchase the property, that property can no longer qualify for owner-occupier relief as it will not meet the 'first used' condition required for such relief in relation to any subsequent purchaser.

2. Payment of deposit on purchase price

This part deals with the type of arrangement where a potential purchaser of a property occupies the property otherwise than under a letting agreement and, instead of rent, pays a deposit towards the purchase price of the property.

(a) *Vendor*

Where the prospective purchaser pays a non-refundable deposit towards the purchase price of the property that deposit will be a Case 1 trading receipt when it is received. This is the position whether the deposit is paid as a lump sum or by instalments or whether or not the person goes ahead with the purchase of the property. The balance of the purchase price will also be a trading receipt if, and when, it is received.

(b) *Purchaser*

Where the prospective purchaser does not pay rent (i.e. separate from any deposit payment(s)) he or she is **not** entitled to claim **rent relief** under section 473 TCA 1997.

Where the person occupies the property under a caretaker's agreement instead of a letting agreement, that person is potentially assessable to '**benefit in kind**' (BIK) on the benefit of rent-free occupation of the property as the creation of a caretaker agreement establishes a 'master/servant' or 'employer/employee' relationship between the vendor and the prospective purchaser. The BIK charge arises under section 118(1) TCA 1997 as a body corporate or, by virtue of section 120 TCA 1997, any other employer, is providing living accommodation for a person employed by it in an employment. The BIK assessable on the caretaker/employee is the open market rent of the property together with any expenses connected with the property borne by the employer, less any rent payable by the employee. In practice, Revenue accepts 8% of the current market value of the property as representing the annual value of the accommodation provided.

The deposit is regarded as part of the cost of the property and is taken into account in determining the cost of the property for **Capital Gains Tax** purposes.

Where a prospective purchaser occupies a new property for which he or she has paid a deposit and the property is subsequently purchased by that person, the property will be regarded as new for the purposes of **Stamp Duty** reliefs that apply on the purchase of a new house. Where the prospective purchaser does not ultimately purchase the property, the property is regarded as a second-hand property in relation to any subsequent purchase of the property by another person.

In relation to **owner-occupier relief**, the position as outlined in the "rent to buy" scenario in part 1 above applies except that the deposit is regarded as part of the cost of the property in determining the qualifying expenditure for relief purposes.

3. Payment for option to purchase property

This part deals with the type of arrangement where a potential purchaser of a property pays for an option to purchase the property at some stage in the future.

(a) Vendor

Where the prospective purchaser pays for an option to purchase the property, for example, at a pre-agreed price and/or within a pre-agreed timeframe, that payment is treated as a Case 1 trading receipt when it is received. Section 641(2)(a) TCA 1997 treats any consideration (other than rent or an amount treated as rent) for the disposal of an interest in land as a consideration for the disposal of trading stock and thus a trading receipt. Section 639(2) TCA 1997 states that an option, or other right to acquire or dispose of any interest in any land, is deemed to be an interest in the land. Thus, the grant of an option is treated as the disposal of an interest in land and as a trading transaction. This is the position whether the payment is paid as a lump sum or by instalments or whether or not the person goes ahead with the purchase of the property. Where the payment for the option reduces the purchase price, that discounted purchase price will be a Case 1 trading receipt if, and when, it is received.

(b) Purchaser

Where the prospective purchaser does not pay rent (i.e. separate from any option payment(s)) he or she is **not** entitled to claim **rent relief** under section 473 TCA 1997.

Where the person occupies the property under a caretaker's agreement instead of a letting agreement, that person is potentially assessable to **'benefit in kind'** as outlined in part 2 above.

For **Capital Gains Tax** purposes the exercise of an option to purchase a property and the associated purchase of the property are treated as a single transaction (section 540(4) TCA 1997). Therefore, the payment for the (exercised) option forms part of the cost of the property.

Where a prospective purchaser occupies a new property in respect of which he or she has paid for a purchase option and the property is subsequently purchased by that person, the property will be regarded as new for the purposes of **Stamp Duty** reliefs that apply on the purchase of a new house. Where the prospective purchaser does not ultimately purchase the property, the property is regarded as a second-hand property in relation to any subsequent purchase of the property by another person. A liability to Stamp Duty can arise on the grant of an option to purchase property. The option is property in its own right and the duty is chargeable on the amount of the consideration paid for the option at the rates of duty applicable to non-residential property.

In relation to **owner-occupier relief**, the position as outlined in the 'rent to buy' scenario in part 1 above applies. The payment for the option is not regarded as part of the cost of the property and will not be taken into account in determining the qualifying expenditure for relief purposes.