

Section 97(2) Taxes Consolidation Act 1997

Deductibility of loan interest in computing rental income

Part 04-08-06

This manual should be read in conjunction with section 97 of the Taxes Consolidation Act 1997

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Table of Contents

1.	Introduction.....	3
2.	Restriction of interest relief for rented residential premises.....	3
3.	Security for loan	4
4.	Timing of deductions	4
5.	Direct purchase etc. of premises	5
6.	Transfer of properties between spouses or civil partners.....	5
7.	Registration with the Residential Tenancies Board	6
8.	Stamp duty and legal fees	6
9.	Interest rate caps and cancellation fines	6
10.	Replacement Loans.....	7
11.	Interest relief for residential premises let to tenants in receipt of housing supports.....	8

1. Introduction

The deductions which can be made in computing taxable Case V rental income are set out in section 97(2) Taxes Consolidation Act 1997 (TCA). Paragraph (e) provides for a deduction in respect of 'interest on borrowed money employed in the purchase, improvement or repair of the premises'. The loan obtained must be used for one or more of these purposes. The borrowed money can be used for both residential and commercial premises. Money incurred on the construction of a premises and the purchase of the site for that premises is regarded as being incurred on the purchase of the premises.

Where borrowed money is used to purchase, improve or repair an entire premises, but only part of the premises is let, the interest must be apportioned between qualifying and non-qualifying interest on a just and reasonable basis; for example, on the basis of the floor area that is let/not let.

The provisions of section 97(2)(e) TCA also apply to the purchase of foreign premises. Although rental income from foreign property is assessed under Case III rather than Case V, section 71(4) TCA applies section 97(2)(e) to foreign rental income and provides for the same deduction for interest on borrowed money as that allowed in computing Irish rental income.

2. Restriction of interest relief for rented residential premises

Where a loan has been used to purchase, improve or repair a rented residential premises and interest on the loan accrues on or after 7 April 2009 and up to 31 December 2018, section 97(2J) provides that the deduction for interest on the loan under section 97(2)(e) is restricted to a percentage of the interest as follows:

- interest accrued on or after 7 April 2009 to 31 December 2016 – 75%;
- interest accrued from 1 January 2017 to 31 December 2017 – 80%;
- interest accrued from 1 January 2018 to 31 December 2018 – 85%.

For the purposes of the restriction, interest is treated as accruing on a daily basis and the date the loan is taken out is not relevant.

Finance Act 2018 restored full deductibility of interest accruing on such loans from 1 January 2019.¹

¹Section 97(2J)(c).

The interest restriction does not apply to loans taken out in respect of non-residential property, in which cases the full amount of interest continues to be deductible. In the case of mixed residential and non-residential premises interest should be apportioned on a just and reasonable basis before the restriction, where appropriate, is applied to the residential part of the interest.

Paragraph 9 below sets out the effect of the restriction on fees for interest rate caps and cancellation fines.

Paragraph 11 below sets out the circumstances in which the restriction did not apply where residential premises are let to tenants in receipt of certain social housing supports.

3. Security for loan

For interest to be deductible under section 97 TCA, it is not necessary for the loan to be secured on the premises in question. For example, in the case of interest on a loan that is secured on an individual's principal private residence and used for the purchase, improvement or repair of a rented premises, the interest is deductible under section 97 in the normal manner. However, interest is not deductible where the loan is obtained on the security of a rented premises but is used for purposes other than its purchase, improvement or repair.

4. Timing of deductions

Interest can only be deducted under section 97 TCA during the period in which the premises are let.² This means that interest is not deductible for the period following the purchase of the premises up to the time a tenant enters into a lease, nor after the period of the last letting. In the case of the first letting of a premises, section 105 requires actual occupation by the lessee before interest can be deducted. (However, section 97A TCA provides for relief for certain pre-letting expenditure incurred in respect of vacant residential premises. See Tax and Duty Manual (TDM) [Part 04-08-11](#) for further details.) Interest incurred in the period between lettings is deductible provided that the landlord does not occupy the premises during that period and a new lease is granted.

² Described in section 97(3) as "during the currency of the lease" or "the period during which the person chargeable was entitled to the rent."

5. Direct purchase etc. of premises

Interest is deductible under section 97(2)(e) where the money borrowed is used, inter alia, to purchase a rental premises. However, the borrowed money must be used or employed directly in the purchase of that premises. Where a premises is acquired indirectly through a company using borrowed money, the money borrowed will have been used to purchase an interest in the company and will not have been employed in the purchase of the premises. The position is not altered by the fact that –

- the investor's borrowed money is subsequently used by the company to purchase the premises, or
- the investor may be able to receive rental income directly from the tenants of the premises, or
- the investor may be able to sell the premises by selling his or her underlying shares in the company.

The position outlined above applies equally where the borrowed money is used to purchase an interest in any other type of entity such as a property-owning trust.

The same treatment also applies for money borrowed for use in the improvement or repair of a premises. Relief is only available where such money is employed directly in the improvement or repair of the premises.

Interest on a loan to acquire an option to purchase a premises is not deductible even if that option is subsequently exercised.

6. Transfer of properties between spouses or civil partners

There is no deduction for interest accruing on or after 6 February 2003 where an individual purchases a let residential premises from her/his spouse, or, on or after 27 July 2011, from her/his civil partner. This restriction does not apply to purchases between

- spouses who are legally separated or divorced, or
- civil partners who are separated under a deed of separation or other agreement, arrangement etc. which gives rise to a legally enforceable obligation and which has been entered into as a result of the partners living apart in circumstances where the separation is likely to be permanent, or where the civil partnership has been dissolved.

7. Registration with the Residential Tenancies Board

With effect from 1 January 2006, interest on loans used to purchase, improve or repair a residential premises is not deductible where the landlord has not complied with the registration requirements of Part 7 of the Residential Tenancies Act 2004 in respect of all tenancies relating to the particular premises for the tax year or accounting period in question.³ See TDM [Part 04-08-10](#) for details.

8. Stamp duty and legal fees

Interest on any loan, or part of a loan, that is used to pay stamp duty, legal fees and other expenses incurred in relation to the purchase, improvement or repair of a premises is not deductible. Only interest relating to the purchase, improvement or repair costs is deductible.

9. Interest rate caps and cancellation fines

Interest rate caps (IRCs) set an upper limit to the interest rate on variable rate loans for a specified period, which may be for the duration of the loan but is generally for a shorter period. They may be effected as part of a loan agreement or by a separate agreement with the lender or with another institution. The IRC provider agrees, in return for a fee (which may be paid up-front), to compensate the borrower if interest rates rise above the agreed upper limit.

Revenue will treat a payment for an IRC as part of the interest expense relating to a loan. Where the interest on the related loan is an allowable deduction in calculating profit rent under Case V, the payment for the IRC is also allowable. Where, however, the interest restriction applies (see paragraph 2), only the appropriate percentage of the IRC payment can be deducted instead of the usual 100%.

In certain circumstances, a financial institution may impose a fine of an additional amount of interest on the cancellation of a loan. The amount of the fine is treated in the same manner as any other interest paid on the loan which gives rise to the fine and is, where applicable, also subject to the appropriate percentage restriction on the amount that is deductible.

As the period to which the IRC refers is generally shorter than the loan period, a once-off payment for an IRC should be spread over the IRC period, in accordance with normal accounting practice, so that the payment is matched to the periods to which it relates.

In Revenue's view, a payment received from an IRC provider is not a payment of rent or a payment in the nature of rent and accordingly does not fall to be charged under

³ Section 97(21).

Case V. However, where the cost of the IRC is allowable in accordance with Revenue practice, the related IRC income may in practice be taken into account in computing profits under Case V for the relevant year or accounting period.

10. Replacement Loans

Where a loan used for the purchase, improvement or repair of a rented premises is replaced by another loan, interest paid on the replacement loan is not strictly deductible under section 97(2)(e). This is because the replacement loan is used to replace the original loan and not directly for the specified purposes. However, Revenue practice has been to treat the interest on a replacement loan as being deductible, subject to certain conditions.

Given that the amalgamation of loans is often required by lending institutions, Revenue accepts that interest on amalgamated borrowings that accrued on or after 1 January 2002 qualifies for relief where:

- the capital and interest in respect of each rented residential premises could be readily identified and traced back to the original borrowings, and
- borrowings were amalgamated for genuine commercial reasons on an arm's length basis and not for the avoidance of tax.

In all cases, the onus is on the taxpayer to make a just and reasonable apportionment of qualifying interest and non-qualifying interest, especially where loans were amalgamated and there was a subsequent sale of a premises. Where the taxpayer financed the purchase of premises with amalgamated loans, s/he could not claim any further interest as a deduction in respect of the part of the amalgamated loan that referred to a premises that had been sold. The remaining qualifying interest after apportionment was deductible.

Example

Jenny has three properties, a principal private residence and two other houses, which are let. Originally her principal private residence and one of the rental properties were secured by two separate loans secured on each property. She purchased the third property by refinancing and releasing equity in her principal private residence. Jenny subsequently amalgamated the two loans into one single loan to obtain a lower mortgage interest rate. She then sold the first rental property.

What interest qualifies as a rental deduction? The amalgamated loan will be treated as if it were three separate loans:

- the original loan used to purchase the principal private residence
- the original loan used to purchase the first rental property

- the equity release in the principal private residence used to purchase the other rental property.

Jenny must apportion the borrowings on a pro-rata basis between the rental property she sold, the rental property she retained and her principal private residence. She may make a deduction in computing rental income for the interest relating to the remaining rental property only. Mortgage interest relief may be claimed in the normal way, if applicable, for the part of the borrowings relating to the principal private residence only.

The capital and interest in respect of each rented residential property must be readily identified and traced back to the original borrowings and the borrowings must have been amalgamated for genuine commercial reasons on an arm's length basis and not for the avoidance of tax.

It is not necessary that replacement loans in the case of borrowings for commercial premises obtain pre-clearance from Revenue. However, in the event of a Revenue audit, taxpayers must be able to demonstrate that a just and reasonable apportionment of qualifying and non-qualifying interest has been made.

11. Interest relief for residential premises let to tenants in receipt of housing supports

Where a loan has been used to purchase, improve or repair a rented residential premises and interest on the loan accrues on or after 7 April 2009 and up to 31 December 2018, the interest on the loan is restricted as a rental expense deduction.⁴ From 1 January 2019 interest accruing on such loans is fully deductible as a rental expense. For the purposes of the percentage restriction, the interest is treated as accruing on a daily basis. The date the loan is taken out is not relevant.

From 1 January 2016 a landlord who rents residential premises for a period of three years to tenants in receipt of certain social housing supports may, notwithstanding the general percentage interest restriction on such premises, deduct all of the interest accrued in each year of the three-year period as an expense in computing the taxable rents from the premises in question. The rolled-up interest balance is treated as accruing on the day after the three-year period ends and relief is obtained by way of a claim to Revenue after the end of the period.

For example, an individual lets residential accommodation to a housing support tenant for a three-year period ending on 31 December 2018. The additional interest (that is, 25% for the tax year 2016; 20% for the tax year 2017 and 15% for the tax year 2018 inclusive) is deemed to accrue on 1 January 2019 and is taken into account, along with interest actually accruing in 2019, in computing the taxable rents

⁴ section 97 (2J) see para 2 above

from the property in question for 2019. Please refer to [Notes for Guidance - Part 4](#) for further information.

Landlords must submit a [Declaration of Undertaking Form](#) to the Residential Tenancies Board (RTB – previously called the Private Residential Tenancies Board) to avail of this relief.

For tenancies commencing on or after 1 January 2016, the undertaking was required to be submitted at the same time as the tenancy is required to be registered in accordance with section 134 of the Residential Tenancies Act 2004 (that is, within one month of the start of the tenancy).

For tenancies which commenced prior to 1 January 2016 (where the tenancy would be a “qualifying lease”, within the meaning of section 97(2K)(a) TCA 1997, if it commenced on that date) the undertaking was required to be submitted by 31 March 2016.