## Topics to be covered

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| 5. Common issues encountered |
Depreciation is not allowed as a deduction for tax purposes, and must be added back to the profit before tax for tax purposes – instead capital allowances are given for the depreciation of certain assets.

Capital allowances allow a taxpayers to write off qualifying capital expenditure on the provision of certain assets.

Legislation: CA regime is governed by over 600 sections in TCA 1997.

Case law precedent: over 100 well known cases and many more less known deal with capital allowances.

Revenue practice can be persuasive in tax treatment therefore a detailed knowledge is required.
Capital allowances overview
Main property tax incentives

► Revenue deduction for 'repair' expenditure - 100% in Y1
► Accelerated capital allowances (ACAs) – 100% in Y1
► Wear and tear allowances (WTAs) – 12.5% per annum
► Industrial building allowances – 4% per annum
Capital allowances overview

Relevant Projects

Who can claim?

- Landlords/investors
- Owner occupiers
- Tenants

Relevant Projects:

- Development
- Extension
- Fit-out
- Refurbishment
- Property purchase
Capital allowances overview
The value of allowances

► The nature and quantum of allowances potentially available varies dramatically based on circumstances and the property specification.

► Below are general qualifying percentages we could expect to find on capital projects and property projects.

► The range of potential savings provided are indicative only and based on our experience and industry norms.
Capital allowances overview
The value of allowances

WTAs – Potential Qualifying Amounts (up to)

<table>
<thead>
<tr>
<th></th>
<th>Purchase</th>
<th>Development</th>
<th>Fit-out/Refurbishment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Data Centres</td>
<td></td>
<td>40%</td>
<td>100%</td>
</tr>
<tr>
<td>Industrial</td>
<td></td>
<td>20%</td>
<td>100%</td>
</tr>
<tr>
<td>Residential</td>
<td>10%</td>
<td>30%</td>
<td>100%</td>
</tr>
<tr>
<td>Medical</td>
<td></td>
<td>30%</td>
<td>100%</td>
</tr>
<tr>
<td>Office</td>
<td></td>
<td>40%</td>
<td>100%</td>
</tr>
<tr>
<td>Hotel</td>
<td>40%</td>
<td>30%</td>
<td>100%</td>
</tr>
</tbody>
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## Capital allowances overview

The value of allowances

### Example showing tax/cash savings:

<table>
<thead>
<tr>
<th></th>
<th>No capital allowances</th>
<th>With capital allowances</th>
<th>Cash/Tax saving achieved</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company profit</td>
<td>€1,000,000</td>
<td>€1,000,000</td>
<td></td>
</tr>
<tr>
<td>Deduct capital allowances</td>
<td>Nil</td>
<td>(€500,000)</td>
<td></td>
</tr>
<tr>
<td>Taxable profit</td>
<td>€1,000,000</td>
<td>€500,000</td>
<td></td>
</tr>
<tr>
<td>Tax paid at 12.5% (e.g. trading company)</td>
<td>€125,000</td>
<td>€62,500</td>
<td>€62,500</td>
</tr>
<tr>
<td>Tax paid at 25% (e.g. property investor company)</td>
<td>€250,000</td>
<td>€125,000</td>
<td>€125,000</td>
</tr>
<tr>
<td>Tax paid at 40% (individual)</td>
<td>€400,000</td>
<td>€200,000</td>
<td>€200,000</td>
</tr>
</tbody>
</table>
Capital allowances overview
How to claim

**Property expenditure**
- Establish entitlement
- Collate backup information for claim

**Prepare claim**
- Analyse relevant information
- Calculate capital allowances claim

**Submit claim**
- Submit claim in tax return
- Deal with Revenue queries
- Obtain tax relief
Capital allowances overview
Wear and tear allowances

What qualifies? – Plant and Machinery

**Machinery** – dictionary definition could be used

**Plant** – Derived from over 130 years of case law precedent

Key tests:

► Function test: Relates to the function of the item (Jarrold (HMIOT) v John Good & Sons Ltd [1963])

► Business use test: Whether the item is employed in carrying on the business

► Premises test: Whether the item is part of the premises

► Setting test: Whether the item plays a part in conducting the trade or is simply part of the decoration

► Completeness test: Whether the building would be complete without the item
Capital allowances overview
Wear and tear allowances

Key tests:
► Function test: Relates to the function of the item (Jarrold (HMIOT) v John Good & Sons Ltd [1963])
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► Setting test: Whether the item itself plays a part in conducting the trade or is simply part of the decoration
► Completeness test: Whether the building would be complete without the item
Capital allowances overview
Wear and tear allowances

- Furniture
- Computers
- Security Equipment
- Signage
- HVAC Equipment
- Sanitary ware
- P&M
Industrial building allowances (IBAs) available at 4% per annum on the net cost of the building

- A definition is included in TCA 97 s268
- Broadly, an industrial building or structure must be in use for the purpose of any of the following trades:
  - A trade carried on in a mill;
  - A factory or;
  - Other similar premises
- IBAs are available to whoever holds the 'relevant interest' in relation to the construction expenditure – both owner-occupiers and lessors of industrial buildings can be entitled to claim.
Capital allowances overview
Revenue expenditure

- Capital expenditure can relate to replacement/repair of existing assets
- If the expenditure qualifies as straight repairs expense the good news is that 100% of the expenditure can be claimed in year one
- Must be nearest modern equivalent
- No betterment
- Like for like replacement
Reasons to maximising capital allowances claims:

- Realise opportunities to claim capital allowances yields many benefits- unlocking significant cash tax savings and increasing cash flow efficiency
- Many businesses miss out on significant tax relief due to expenditure being allocated to land and buildings and thus, don’t identify opportunities to claim
- To maximise capital allowances claims, it is critical to understand what qualifies and to allocate this expenditure to the correct category
Capital allowances overview
Maximising claims

► Many businesses do not realise that capital allowances can be claimed on second-hand buildings

► For property purchases, the cost of the land and building can be separated from the fixed plant and machinery, which qualifies for capital allowances.

► Some qualifying examples include:
  ► Certain electrical installations
  ► Heating, ventilation and air-conditioning
  ► Sanitaryware
  ► Built-in equipment
  ► Security installations
Capital allowances overview
Maximising claims

Key considerations for maximising claims:
- Identify buildings qualifying for IBAs
- Maximise P&M for wear and tear allowances
- Claim allowances over 8 years rather than 25 years
- Consider treatment of professional fees
- Consider costs incidental to the installation of P&M
- Tax efficient design of the property at design stage
- Claim accelerated capital allowances
- Consider other tax incentives – tax deductible expenses provide 100% relief in year 1
- Detailed knowledge of legislation and case law is essential
Relevance to Chartered Surveyors
Relevance to chartered surveyors
Overview

► Chartered surveyor skills are relevant in maximising claims
► Clients expect professional advisers to be able to recognise when claims can be made
► Valuable rebate for property expenditure
► Savings are often drastically underestimated
► Rebates should be factored into investment appraisals
► Rebate could be added to project/investment budget or used to fund other investments
Relevance to chartered surveyors
Quantity surveyor relevant skills

► Knowledge of construction procurement
► Ability to interpret construction contracts, drawings and specifications
► Understanding construction costs and terminology
► Ability to break down construction cost information
► Qualified to prepare reconstruction cost estimates for purchase claims
Relevance to chartered surveyors
Agency surveyor relevant skills

► Expertise in the acquisition process
► Ability to interpret purchase contracts
► Understanding of lease agreements and lease incentives
► Knowledge of investment appraisals
► Ability to undertake land valuations
Property Transactions
Property transactions
Purchase claim methodology

► Property purchase price includes qualifying plant and machinery (“P&M”) fixtures

► Where no value is attributed to P&M: S.311 TCA 1997 states - A “just apportionment” of qualifying plant and machinery can be undertaken

► Irish Revenue precedent states – “A professional valuation is required”

► Apportion the independent values of constituents of the purchase
Contrasting apportionment examples for a €10m acquisition:

<table>
<thead>
<tr>
<th>1. Office – Regional Location</th>
<th>2. Office – City Centre</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Apportionment components</strong></td>
<td><strong>Apportionment components</strong></td>
</tr>
<tr>
<td>Land Value</td>
<td>Land Value</td>
</tr>
<tr>
<td>Independent valuation</td>
<td>Independent valuation</td>
</tr>
<tr>
<td>€2m</td>
<td>€4m</td>
</tr>
<tr>
<td>Apportioned valuation</td>
<td>Apportioned valuation</td>
</tr>
<tr>
<td>€2.5m</td>
<td>€3.6m</td>
</tr>
<tr>
<td>Building cost</td>
<td>Building cost</td>
</tr>
<tr>
<td>€4m</td>
<td>€5m</td>
</tr>
<tr>
<td>Apportioned valuation</td>
<td>Apportioned valuation</td>
</tr>
<tr>
<td>€2.5m</td>
<td>€4.6m</td>
</tr>
<tr>
<td>Plant and machinery</td>
<td>Plant and machinery</td>
</tr>
<tr>
<td>€2m</td>
<td>€2m</td>
</tr>
<tr>
<td>Total</td>
<td>Total</td>
</tr>
<tr>
<td>€8m</td>
<td>€11m</td>
</tr>
<tr>
<td>Apportioned valuation</td>
<td>Apportioned valuation</td>
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<tr>
<td>€10m</td>
<td>€10m</td>
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</tbody>
</table>
Property transactions
When to consider capital allowances

Purchaser considerations for investment property transaction:

Pre-Contract:
- Review contract clauses
- Investigate entitlement
- Estimate potential claim
- Factor potential savings into investment appraisal

Contract Stage:
- Ensure contract wording favourable
- Request any information required

Post Completion:
- Prepare capital allowances claim
- Obtain tax relief from rental income
- Deal with Revenue enquiries
Property transactions
When to consider capital allowances

Vendor considerations for a transaction:

► Consider whether the value of capital allowances can be retained?
► Ensure correct actions undertaken to retain the savings
► Where vendor cannot/does not wish to retain the benefit:
  ► Highlight potential savings to prospective purchasers
  ► Input potential savings into property marketing material
  ► Availability of a valuable claim makes the investment more attractive
Property transactions
Case study 1

- Dublin city centre office
- €18.6m acquisition
- Due diligence undertaken to establish entitlement
- Purchase apportionment undertaken
- €3.3m WTAs equated to 18% of purchase price
- €825,000 tax/cash savings (WTAs of €3.3m x 25% tax rate)
Property transactions
Case study 1

WTAS AND CASH/TAX SAVINGS OVER TIME

Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8
--- | --- | --- | --- | --- | --- | --- | ---
€500,000 | €500,000 | €500,000 | €500,000 | €500,000 | €500,000 | €500,000 | €500,000
€1,000,000 | €1,000,000 | €1,000,000 | €1,000,000 | €1,000,000 | €1,000,000 | €1,000,000 | €1,000,000
€1,500,000 | €1,500,000 | €1,500,000 | €1,500,000 | €1,500,000 | €1,500,000 | €1,500,000 | €1,500,000
€2,000,000 | €2,000,000 | €2,000,000 | €2,000,000 | €2,000,000 | €2,000,000 | €2,000,000 | €2,000,000
€2,500,000 | €2,500,000 | €2,500,000 | €2,500,000 | €2,500,000 | €2,500,000 | €2,500,000 | €2,500,000
€3,000,000 | €3,000,000 | €3,000,000 | €3,000,000 | €3,000,000 | €3,000,000 | €3,000,000 | €3,000,000
€3,500,000 | €3,500,000 | €3,500,000 | €3,500,000 | €3,500,000 | €3,500,000 | €3,500,000 | €3,500,000

Wear and Tear Allowances | Cash/Tax Saving
€45m regional shopping centre acquisition
► Constructed in mid-90’s
► Basic specification

Results from “just apportionment” claim:
► €5.1m WTAs identified
► €1.275m tax/cash savings (WTAs of €5.1m x 25% tax rate)
Capital Projects
Capital projects
Claim overview

1. Design/tender stage
- Initial planning and due diligence
- Collate tender documentation
- Tax efficient design planning

2. Construction stage
- Collate construction information
- Collate initial accounting information
- Property inspection
- Initial analysis

3. Post Completion - information analysis
- Collate final accounting information
- Collate final construction information
- Analyse information
- Identify and justifiably maximise qualifying expenditure

4. Post completion - submission and agreement
- Taxpayer submits capital allowances claim
- Deal with Revenue enquiries/negotiations

Connected Tax
Capital projects
Tax input at design stage

Early planning can maximise the level and cash flow of relief:

► Design building to maximise qualifying installations
► Build a case for “grey items” during design and construction
► Tenant incentives – consider tax efficient alternatives
► Drafting leases – consider burden of wear and tear
► Accelerated capital allowances (ACAs) planning at design stage
Capital projects
Tax input at design stage

Accelerated capital allowances:

► Available for either specified energy efficient equipment or expenditure on childcare and fitness facilities

► Childcare and fitness facilities
  ► Facilities must be for the provision of employees
  ► Not available to commercial childcare or fitness businesses
  ► Available for all construction expenditure and not just plant and machinery

► Energy efficient equipment:
  ► Must be used in a trade, cannot be leased, let or hired
  ► Triple E Products Register: http://triplee.seai.ie/AcaProducts/Search.aspx
  ► Minimum expenditure thresholds apply
Capital projects
Tax input at design stage

Main energy efficient equipment categories:

- Building energy management systems
- Lighting
- Motors and drives
- Information and communications technology
- Heating and electricity provision
- Process and heating, ventilation and air-conditioning
- Electric and alternative fuel vehicles
- Catering and hospitality
- Electromechanical systems
- Refrigeration and cooling
Capital projects
Tax input at design stage

Maximising ACAs:
► Design stage - consider ACA qualifying equipment
► Add value - don’t compromise design and budget
► Consider the benefits of providing childcare and fitness facilities for employees use
► Consider lighting – over 5,000 lighting units on Triple E list
Case study 3
Development - Pharma manufacturing facility

€380m greenfield development in Dublin

► Advised on procurement of ACA qualifying equipment at design stage
► Due diligence review revealed:
  ► IBAs available as qualifying building under legislation
  ► Implications of grants received towards development were considered
► Tax deductible expenses identified
► Detailed analysis undertaken of entire development expenditure to identify qualifying expenditure

Results:
- Revenue deductions: €500k
- ACAs: €650k
- WTAs: €279m
- IBAs: €95m
- Non-qualifying: €4.85m
Case study 3
Development - Pharma manufacturing facility

Capital allowances claimed over 9 years

<table>
<thead>
<tr>
<th>Year</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Year 6</th>
<th>Year 7</th>
<th>Year 8</th>
<th>Year 9</th>
<th>Year 10</th>
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<tbody>
<tr>
<td>ACAs</td>
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<td>WTAs</td>
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Revenue Deductions

Connected Tax
Case study 4
Refurbishment – city centre office

€3.4m Cork city centre office refurbishment

- Due diligence revealed entitlement to claim:
  - Wear and tear allowances
  - Revenue deductions for certain “repair” works

- Outcome of detailed analysis:
  - €2.2m of tax allowances
  - €275k tax/cash saving (12.5% tax rate x €2.2m)
Common issues encountered
Common issues encountered

**Issues with assets ‘in use’**

- Incorrect identification of the chargeable period in which the qualifying asset has been brought into use.
  - If the item asset is not in ‘use’ at the end of the accounting period.
  - Testing/Commissioning activities

**Non-qualifying costs claimed**

- Land acquisition
- Entire M&E costs included
- Accruals
- Legal fees associated with purchase of site
- General lighting
- Internal doors
Common issues encountered

Not all capital expenditure qualifies for capital allowances. For example concerning fit-out projects the following are not P&M:

- New doors
- Stud partitions
- Leased items of energy efficient equipment

Under claiming on items such as:

- Ironmongery
- HVAC

Demountable partitions are P&M

Incorrect apportionment

- Allocating internal labour costs to industrial buildings
- Claiming legal fees in relation to acquisitions of properties
Common issues encountered

- Tender documents and Main Contractor Reports are typically required.
- Invoices tend to offer insufficient evidence as they do not typically provide any description of the work undertaken.
- Lack of M&E specifications.

Capital allowances cannot be claimed in respect of grants or certain lease incentives. These need to be properly identified and treated appropriately.
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