Joint Committee of Inquiry into the Banking Crisis

Clarification Statement of

Bertie Ahern

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>
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Serious sanctions apply for breach of this section. In particular, your attention is drawn to section 41(4) of the Act, which makes breach of section 37(1) a criminal offence.

[1] *See s.37 of the Houses of the Oireachtas (Inquiries, Privileges and Procedures) Act 2013*

Oireachtas

Mr Ciaran Lynch TD,
Joint Committee of Inquiry into the Banking Crisis,
Leinster House,
Dublin 2.

23rd October 2015.

Dear Deputy Lynch,

Thank you for your letter date 2nd October 2015 which sought clarification on the "the analyses, considerations and rationales used surrounding the decision to extend the property tax incentives in the Finance Bill of 2002 Finance Bill 2004, and Finance Bill 2006." You also specifically asked what role did I or the Government have in the decision to extend property tax incentives.

In order to answer your queries, it might be helpful for me to point out the general context in which property tax incentives are framed. My understanding is that from the introduction of Property Tax incentive scheme, these incentives were continually reviewed by both the Department of Finance and the Department of Environment. These reviews were based on how well individual incentives were working, the take up for particular incentives, the views of local authorities, as well as taking account the input of the social partnerships process, sectoral groups, such as the Construction Industry Federation and Irish House Builders Association, and others interested bodies, especially Dail/Senate contributions.

This wide-range of opinions and views were analysed within the Department of Environment and where significant changes or new departures were being considered brought to Department of Finance for approval. Arising from this process, a memo would be brought to Government to modify or improve on existing property tax incentives if

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this was considered necessary. This would usually happen in conjunction with the annual Finance Bill. If extensions or limitations were approved by cabinet, these would be incorporated in the Finance Bill and debated in the Dail/Senate and committees and approved through the usual parliamentary process.

From my experience and knowledge, the range of issues that arose over the years of my tenure as a Minster and subsequently as Leader of the Opposition and then Taoiseach were numerous. But from 1999, the biggest focus was on extending the numbers of towns and areas that were designated or refining the areas that were designated. There was also a significant focus on taking on board the views of and working with the local authorities on the integrated area plans. Other significant issues were dealing with new concepts of designation such as Park and Ride, Hotels, and Nursing Homes among others. In addition to these reviews, there were a number of others.

In his Budget 2005 statement on 1 December 2004, the then Minister for Finance, Brian Cowen, announced that the Department of Finance and the Revenue Commissioners would undertake a detailed review of certain tax incentives schemes and tax expenditures in 2005. Indecon Economic Consultants and Goodbody Economic Consultants were commissioned to undertake detailed reviews of the various property-based reliefs to review the cost to the Exchequer and the benefits of property-based tax relief with the aim of improving the equity of the tax system, taking into account the social and economic benefit of reliefs in delivering investment in housing enterprise, urban and rural renewal, tourism, films and health facilities.

As part of the review process, three separate studies were undertaken. These studies were all published in 2006 and are available on the Department's website.

Goodbody Economic Consultant reviewed the Rural Renewal Scheme, the Urban Renewal Scheme, the Town Renewal Scheme and the Living Over the Shop Scheme. Indecon Economic Consultants reviewed capital allowances for hotels, holiday cottages and private hospitals, third level buildings, student accommodation and car parks. The Department of Finance and Revenue reviewed tax reliefs for pension's provision, tonnage tax, greyhound stud fees, artists, and significant buildings and gardens.

In summary, the reports recommended discontinuation of many of the tax reliefs. Most of these were 'expiring' schemes, i.e. they were already closed to new projects (since planning applications had to be submitted before end December 2004) and qualifying construction expenditure had to be incurred by July 2006 at the latest. Indecon recommended, in most cases, a five-year extension of the July 2006 construction deadline (subject however to a reduced level of capital allowances), as well as continuation of capital allowances for private hospitals, private nursing homes and childcare facilities, subject to some modifications.

In addition, the following export reports were also undertaken and were influential.

1. KPMG was commissioned to review the URS in 1996. It was found that the predominant effect of the original scheme was on location rather than scale of economic activity. The key recommendation was the future schemes should be linked to area based integrated strategic planning. This recommendation was taken into account in designing an amended URS which came into effect in 1999.

2. The 1998 Bacon Report on the housing market recommended that the deductibility of interest on borrowings undertaken for investment in residential property be removed. Accordingly, the Finance No. 2 Act 1998 terminated the deductibility for interest on borrowed money used on or after 23rd April 1998 in the purchase, improvement or repair of rented residential premises in the State, and on or after 7th May 1998 in relation to foreign residential premises.

3. A second Bacon Report in 1999 found that reducing investor demand for residential properties through the removal of deductibility of interest on borrowings undertaken for investment in residential property against rental income had contributed to the easing of house price inflation. However, it was noted in the second Bacon Report that considerable concern was being expressed that the measure of removing interest deductibility against rental income for personal taxation purposes had already led to rapid escalation in rents. Due to rising rents and a lack of confidence in the market, the Finance Act 2002 restored interest relief for residential premises where the interest accrued on or after 1 January 2002. There was significant discussion of this amendment at the Tax Strategy Group prior to its reintroduction.

4. A third Bacon Report on housing was produced in 2000 proposing the introduction of a tax of 2-3% of property-value on homes which were not

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the principal primary residences, with an exemption for compliant landlords. A tax on second homes was finally introduced in 2009, albeit at a flat-rate.

In regard to the years you have asked me to focus on, I have attached as an appendix a list of the key property incentives that were approved by cabinet and implemented in the Finance Bill. This list may not be fully comprehensive, but it may be helpful to you in your deliberations and in providing context.

I am conscious of your advice that this correspondence “will be treated as evidence and may be relied upon in making findings in the final report.” As the rest of my evidence has been given in public hearings or made publicly available by way of your website in regard to my opening statement, I think as a matter of transparency that it is important that this series of correspondence is also made fully publicly available at a time and means of your discretion.

Yours sincerely

Bertie Ahern

(Appendix 1)

2002

The Finance Act 2001 provides for capital allowances for expenditure incurred on the construction or refurbishment of buildings used as private hospitals. The Bill removed the condition that the hospital has to be operated by a body with charitable status for tax purposes and reduced the minimum requirement of 100 in-patient beds is being reduced to 70. As announced in the Budget the Bill will provide for a broadly similar scheme for expenditure incurred on the construction or refurbishment of Sports Injury Clinics. These schemes were subject to clearance by the European Commission from an EU State Aids perspective. In order to comply with EU State Aid rules, the Bill excluded corporate investors, property developers and individual investors who have an involvement with the management or running of the hospital from entitlement to the capital allowances.

Park & Ride

The Finance Act 1998 provided for a scheme of capital allowances for the construction of approved ‘park and ride’ facilities in certain urban areas i.e. parking and ancillary commercial and residential premises for commuters located at public transport connections. The relief was available for expenditure incurred in the three period form 1 July 1999 to 30 June 2002. This qualifying period was extended for a further 2 years to 30 June 2004.

Urban renewal relief

The bill provided for an extension to the deadline for the Urban Renewal Scheme for tax relief for expenditure on commercial, industrial and residential projects from 31 December 2002 to 31 December 2004. As the business elements of this scheme are subject to EU State Aids rules, the extension of the deadline for these reliefs were subject to European Commission approval. No such approval was required for the residential elements of the scheme.

Rural renewal relief

The bill will provide for an extension to the deadline for the Rural Renewal Scheme for tax relief for expenditure on commercial, industrial and residential projects from 31 December 2002 to 31 December 2004. The 2 year extension of the current 31 December 2002 deadline of the business elements of the scheme will be subject to European Commission

approval in the context of the EU State Aids rules while no such approval is required for the residential elements of the scheme.

Multi-storey car parks
The Bill provided for an extension of the deadline for the relief for expenditure on the construction of multi-storey car parks for a further 2 years from 31 December 2002 until 31 December 2004 where 15 per cent of total project costs were incurred by 30 September 2003 of by 30 September 2001 as at present.

Capital Allowances and Incentive Schemes

Capital allowances for buildings used for third level educational purposes
Section 843 of the Taxes Consolidation Act 1997 provided capital allowances are available at 15% per annum (10% in year 7) in respect of expenditure incurred on certain buildings used for the purposes of third level education. This scheme was due
to expire on 31 December 2002 and the bill extended the qualifying period for a further two years to 31 December 2004.

Appendix (2)

2004.

Certain Capital Allowances & Tax incentive Schemes.

Capital Allowances for Hotels and Holiday Camps.
The transitional period for incurring expenditure for the special regime of capital allowances of 15% per annum over 7 years in respect of hotels and holiday camps is being extended from 31 December 2004 to 31 July 2006.

Capital Allowances for Holiday Cottages
The transitional period for incurring expenditure for the special regime of capital allowances of 10% per annum over 10 years in respect of holiday cottages was extended from 31 December 2004 to 31 July 2006.

Student Accommodation Scheme
The final qualifying dater for incurring expenditure under the Student Accommodation Scheme was extended from 31 December 2004 to 31 July 2006.

Buildings used for Third Level Education Purposes
The final qualifying date for incurring expenditure under the scheme of capital allowances for third level education purposes extended from 31 December to 31 July 2006. The end-date by which a Ministerial certificate of application must be issued was 31 December 2004.

Urban Renewal Scheme
The final qualifying dater for incurring expenditure under the urban renewal scheme was extended from 31 December 2004 to 31 July 2006. This provision was subject to a commencement order as the extension in respect of expenditure on commercial and industrial projects was subject to approval by the European Commission under State aid rules.

Multi-storey car park scheme
The final qualifying date for incurring expenditure under the multi-storey car park scheme was extended from 31 December to 31 July 2006.

Rural Renewal, Town Renewal/Living Over the Shop Schemes
The final qualifying date for incurring expenditure under the schemes was extended from 31 December 2004 to 31 July 2006 and full planning

application had to be received in the relevant planning authority by 31 December 2004. This extension is subject to a commencement order or the extension in respect of expenditure on commercial and industrial projects was subject to approval by the European Commission under State aid rules.

Park and Ride Scheme
The termination date for the qualifying period for the Park and Ride scheme was extended from 31 December 2004 to 31 July 2006. A full planning application had to be received by a planning authority by 31 December 2004 in order to quality for the relief.

Business Expansion Scheme (BES) and Seed Capital Scheme (SCS)
The BES and the SCS were extended for a further three years until 31 December 2006. The maximum amount a company could raise under both schemes was increased from €750,000 to €1 million. The increase in the limit and extension in time form 5 February to 31 December 2006 were subject to a commencement order in the light of potential State aid issues raised by the European Commission.

Appendix (3)

2006

Hotels, holiday Cottages and Third Level Buildings

Capital allowances were not available in instances whereby all the expenditure on hotels, holiday cottages or third level buildings may be 'incurred@
(payable) after the proposed 31 July 2006 termination date, even though the majority of the construction/refurbishment work may have been completed prior to that date. To remedy this, the Bill provided that the relevant capital allowances regime will be available for that portion of construction work completed before the termination date, regardless of the actual date of payment for construction work.

Transitional measures for certain schemes

In the Budget, the Minister announced that a range of existing property-based tax schemes would be discontinued subject to transitional measures. Under these transitional arrangements, which were provided for in the Finance Bill, full relief was allowed for qualifying expenditure up to end-December 2006 (as compared with the end-July 2006 deadline that currently applies for several of the schemes)
Expenditure in 2007 would qualify for relief at 75% of the normal rate, with 50% of the normal relief allowed for expenditure in the period January to end-July 2008. No relief would apply for expenditure after that date. The transitional measures will apply for existing pipeline projects accordingly, in addition to satisfying all the relevant schemes conditions e.g. as regards planning, projects must have incurred at least 15% of qualifying expenditure i.e excluding site costs before end-December 2006 in order to qualify for transitional relief beyond that date.

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Appendix (4)

Urban Renewal Scheme

The first Urban Renewal Scheme was introduced in 1986 to address the increasingproblem of dereliction and decay affecting large parts of the inner city areas throughout the State. At that stage, many of these areas had sustained large population declines, as growth and development were increasingly concentrated in the suburbs. The core objective of the Scheme was to encourage urban renewal and redevelopment by promoting investment and reconstruction of buildings in designated areas.

The current Urban Renewal Scheme, which was put in place in 1998, followed a detailed review of the previous urban renewal schemes carried out by KPMG.1 The study found that the schemes had been highly successful in attracting investment to designated areas. This conclusion was subsequently confirmed by an academic study, which compared the experience of tax based incentives in Dublin and Chicago.2 It concluded that "tax incentives have played an important role and there is little doubt that the scale of physical renewal in Dublin would not have been achieved in their absence".

However, the KPMG study also found that some of the architectural/design elements had been of mixed quality, and the pattern of development was often piecemeal and not targeted at areas most in need. In addition, it was considered that the incentive schemes did not address issues central to the regeneration and sustainability of these areas, such as employment, the lack of public amenities, education and youth development. The KPMG review and the academic study also highlighted issues such as dead weight, and the displacement of investment from non-designated areas.

The KPMG study led to several changes, when the 1998 scheme came to be designed viz.

- The adoption of a more structured approach to the process of designating areas for urban renewal;
- A focus on areas most in need of renewal; and
- A more selective approach to applying the various incentives.

For the new Urban Renewal Scheme, local authorities were requested to draw up Integrated Area Plans (IAPs) in respect of each urban area that they wished to include in the Scheme. Priority for selection was to be given to physically run down areas, which also suffered from high levels of social disadvantage. In order to minimise the resultant cost to the Exchequer, the plans also promoted the optimum use of existing infrastructure. A total of 78 Integrated Area Plans were submitted to the Minister for the Environment and Local Government. The Integrated Area Plans were assessed by a broad based Expert Advisory Panel set up by that Minister for the purpose of making recommendations in relation to the designation of areas. Work on assessing the Integrated Area Plans was completed in 1998. The Expert Panel recommended designation in respect of 49 of the 78 integrated area plans submitted. The designations cover a total of 43 cities and towns.

Unlike previous urban renewal schemes, a selective approach to the areas and the incentives available was adopted. In some instances, only one or two incentives apply in many small sub areas within individual Integrated Area plans and, in other cases, the incentives are often limited to residential tax incentives only. The Expert Panel recommended Section 23-type relief (Rented Residential) for new house construction in a very limited number of cases, for which it was considered absolutely necessary to achieve Integrated Area Plan objectives. A less restrictive approach was taken in respect of refurbishment of older buildings.

The residential elements of the Scheme were introduced from the 1st March 1999 and the Industrial/Commercial elements from the 1st July 1999.

Town Renewal Scheme

In 1999, The Minister for Housing and Urban Renewal announced a new Town Renewal Scheme. The Town Renewal Scheme focuses on the restoration, consolidation and revitalisation of the built fabric of smaller towns (towns with populations of between 500 and 6,000). The main objectives of the scheme are to counter the continuing trend for people moving out of towns, to make the town environment more attractive as a place to live, to restore older buildings and to help promote a wide range of commercial, leisure and social activities in towns. In recent years, many smaller towns and villages had begun to serve as dormitory or weekend centres with many vacant or under utilised upper floors and derelict sites. Tax incentives for a range of residential and commercial development were introduced on the same lines as for the Urban Renewal Scheme.

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There were 226 towns potentially eligible to participate in the Scheme and one hundred of these were designated. The selection and designation process was similar to the process undertaken for the Urban Renewal Scheme. Local authorities were asked to submit a Town Renewal Plan to an Expert Advisory Panel before December 1999. This panel advised the Minister for the Environment and Local Government regarding the towns and sub areas within towns that were suitable for designation under the scheme. The areas and sub-areas designated for relief under the Scheme were announced by the Minister for the Environment and Local Government in late July 2000, and the residential elements of the Scheme were introduced with immediate effect. The commercial elements of the Scheme were introduced from 6thApril 2001, following agreement with the European Commission. Under the Scheme, capital allowances were made available to small and medium sized enterprises only.

Rural Renewal Scheme

This is a pilot initiative of rural renewal aimed at developing the Upper Shannon region. It extends to all of the counties of Leitrim and Longford as well as certain areas in counties Cavan, Roscommon and Sligo on a District El District Electoral Division basis

The scheme has been in operation for rented residential projects since June 1998, for owner-occupied residential properties from the 6th April 1999 and for certain commercial and industrial projects since July 1999. The delay in introducing the business elements of the scheme was due to difficulties encountered in securing EU Commission approval. The Commission, in approving the scheme specified that investors active in certain sectors including the agricultural and financial services sector could not avail of the reliefs available under the scheme. The Commission also excluded property developers from claiming relief under the scheme.

Living Over the Shop Scheme

The KPMG study concluded that the Living Over the Shop Scheme, with the exception of Cork, had not been successful for several reasons such as security, legal issues, fire and building regulations and access problems. In order to ensure a greater measure of success, the new Scheme, which commenced in 2001, extended to streets outside the integrated areas designated under the Urban Renewal Scheme. The reliefs apply to specific lengths of streetscape, which were recommended by authorities in the five county borough areas and approved by a special panel of experts.

Nature of the Tax Reliefs

Tax Incentives Available
The incentives provided under the Urban, Town and Rural Renewal Schemes are as follows:

Industrial Buildings and Commercial Premises

Allowances can be claimed on the cost of construction or refurbishment of commercial buildings. An initial allowance of 50 per cent of expenditure may be claimed by both the owner-occupiers and lessors with an annual allowance of 4 per cent thereafter up to 100 per cent. Alternatively, an accelerated allowance of up to 50 per cent of expenditure may be claimed by owner-occupiers only with an annual allowance of 4 per cent thereafter up to 100 per cent.

Rented Residential Accommodation

Relief is granted against all rental income for the cost of construction (excluding site costs) of rented residential accommodation.
Relief is also granted against all rental income for the cost of conversion into rented residential accommodation of a building which had not previously been in use as a dwelling or the conversion into two or more houses, of a building which had not previously been used as a dwelling, or had been used as a single dwelling. Relief is granted against all rental income for expenditure incurred on refurbishment of a building, which before and after refurbishment contains one or more residential units.

Owner Occupier Residential Accommodation
Owner-occupiers of residential accommodation may claim a deduction of 5 per cent per annum for 10 years in the case of construction expenditure and 10 per cent per annum for 10 years in the case of refurbishment expenditure. The individual incurring the expenditure must be the first owner and occupier of the dwelling after the expenditure has been incurred and the dwelling must be the sole or main residence of the individual.

Allowable Expenditure

The qualifying expenditure on which tax relief was claimed is the actual cost of construction, refurbishment or conversion work excluding the site costs of a property. Costs in relation to an individual's own labour do not qualify. Grants and other payments received directly or indirectly from the State, any board established by statute or any public or local authority are deducted in arriving at the amount of the expenditure, which qualifies for relief. Legal fees in respect of the purchase of a residential property, and stamp duty payable on such a purchase do not qualify for tax relief.

Where a newly constructed or refurbished property is purchased from a developer or a builder the value of the gross tax break to the purchaser is calculated as the price paid to developer or builder multiplied by the fraction A / (B + C),
Where:

> A = Qualifying construction expenditure incurred in the relevant period
> B = Total construction expenditure on that property
> C = Expenditure on acquisition of the site.

In the case of refurbished properties, A and B represent the refurbishment costs with C being the costs of the building inclusive of the site before refurbishment. Where the property is purchased from a person not carrying on the trade of a builder or is not a developer then the build costs will normally equal the gross tax relief as gross relief is the lower of:

- The direct cost of construction, excluding site costs and costs attributable to the
- purchase of the site, or
- The amount produced by the above formula.

In a property market with rising prices the direct construction costs will be the lower of the two (i.e. the formula will not apply).

Qualifying Periods
The qualifying period for the Schemes extends to 31st July 2006. In the case of the Urban and Town Renewal Schemes, this is the third extension of the qualifying period, with end-dates of 31st December 2002 and 31st December 2004 previously specified. With regard to the Urban Scheme, the July 2006 date applies to developments where the local authority has certified that 15 per cent of total expenditure has been incurred by 30th June 2003. For developments under the Town, Rural and Living over the Shop Schemes, to benefit from the extension of the qualifying period, an application to the planning authority must have been made before 31st December 2004.

The main reason for the extension from 2002, 2004, and 2006 and on as per KPMG were the constant delays in site acquisition legal issues, planning matters through Local Authorities and An Bord Pleanala these in many cases took years to process. A good example of that is the Central Bank building on the Old Anglo site which is now going on about eight years

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Appendix (5)

Memo

The Urban Renewal scheme which, as I stated to the committee, commenced in 1986. It was based initially on American concept of rejuvenating deprived and derelict parts of US cities and large towns. In my view and a view supported by several professional and academics the programme has been enormously successful.

The reality is that run down derelict areas have low economic activity, leading to high unemployment and often high crime rates and few opportunities for the young population.

To give an example that I am familiar with. I worked as an activist and a public representative in the area of the Dublin Docklands, Sherriff Street area and the North and South Quays for almost forty years. This area now houses the Irish Financial Services, a large number of companies engaged in providing national and international legal services, as well as the Irish Aviation services, though this latter pint is not as well known. The area is a hub of employment and thousands of jobs are based here.

Equally important, the area now has an excellent third level college the National College of Ireland, which focuses on providing opportunities to people of different levels of educational attainment. The area also has the headquarters of the old Cert training service and now has several hotels of high quality, as well as restaurants and bars, all generating employment.

The area now houses the International Conference Centre with positive spin effects for the local community and national economy, bringing enhanced employment opportunities to the local area.

There is a cultural aspect to this rejuvenated area with the exceptional facilities of the 3Arena and the Bord Gais Theatre, both of which attract tens of thousands of people annually to the area.

None of these projects would have ever seen the light of day without property tax incentives and related incentives from 1987 to 2007. The same applies to the entire Temple Bare area and the rejuvenating areas of Cork, Waterford, Galway, Limerick and endless other towns.

In the Budget 2006, Minister Cowen announced that a range of then existing property based schemes would be discontinued subject to transitional measures. These were set out in the Finance Bill tapering the qualifying expenditure and concluding in July 2008, thus allowing an orderly and legally sound cessation of the tax reliefs.

I feel it is vitally important to note that on an going basis over the years the tax incentives were been continually monitored by not only the relevant Department i.e Environment and Finance but several other reviews, such as the KPMG study on the Urban Renewal Schemes, which was completed shortly after I became Taoiseach. Other reviews included:

Tax based mechanisms in Urban Generation Dublin and Chicago models. Urban studies Volume 39 No 2002.

Indecone reviews of Property based Tax Incentive Schemes.

Goodbody Review of Area base Tax Incentive Renewal Schemes.

Internal Review of Certain Tax Schemes d

Department of Finance 2006.

Review by the Office of the Revenue Commissioners was ongoing.

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