Advising on VAT on property transactions - a step by step guide

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As property transactions generally carry high-values, extreme care should be taken when providing VAT advice relating to the sale or letting of property. VAT on property is complex and is a key area on the Professional 2 (P2), Advanced Taxation syllabus.

This guide outlines the main principles of the Irish VAT on property regime in place since 1 July 2008.[1] It aims to inform P2 Advanced Taxation candidates on how to address the majority[2] of VAT on property scenarios examinable at this level. It is beyond the scope of this guide to deal with every aspect of the VAT on property rules. [3]

Section 1 VAT advice on the sale of property

When is the sale of a property subject to VAT?

1. **When the following 3 conditions are satisfied:**
   - **I. The property has been developed**
   - **II. The property is considered new AND**
   - **III. The property is supplied for consideration in the course of business**
2. **When the person supplying an old property and the purchaser jointly opt to have the supply subject to VAT.**
3. **Where a property is sold and, in connection with that sale, there is a contract between the purchaser and another person to develop the property.**
4. **When there is a sale of residential property by a developer or builder.**

1.1 <u>Property is developed, new and is supplied in the course of business</u>

When a property is developed, considered new and is supplied in the course of business, VAT must be charged on the supply of that property.

1.1.1 When a property is developed, other than minor development, such development essentially makes a property 'new' (see 1.1.2 below) for VAT purposes. Development includes the:

- construction, demolition, extension, alteration or reconstruction of any building **or**
- the carrying out of any engineering or other operation in, on, over or under the land to adapt it for materially altered use.

[1] The Revenue 'VAT on property and construction' guidelines were last updated in August 2017 and are available from https://www.revenue.ie/en/vat/vat-on-property-and-construction/index.aspx

[2] Candidates must also be aware of the VAT and property chapter in their core text. Details of the core text is included in the learning resources section of the P2 Advanced Taxation Syllabus.

[3] All legislative references in this article are relevant for the 2018 exam cycle. Legislative adjustments in the Finance Acts for subsequent years may alter the guidance provided in this guide.

Development does not include:

- work on maintenance and repairs. Such as, fencing, land drainage, laying of roads for agricultural purposes **or**
- the obtaining of planning permission for development

Minor development <u>does not</u> make a property new. Minor development includes:

- development on a building that does not adapt the building for a materially altered use, provided that the cost of such development does not exceed 25% of the consideration for the supply of the building.

Example 1 – building adapted for a materially altered use

During 2015, Michael carries out construction work on a warehouse he owns. The construction activities turn the warehouse into a residential property. Michael then sold the property in 2017.

The work has adapted the property for a materially altered use, changing it from a commercial building to a residential building. As the sale takes place within five years (see 1.1.2 below) of the completion of the development, and the development is not considered as minor development because the building was adapted for a materially altered use, VAT must be charged on the sale of the property.

Example 2 – 25% test

Angela purchased a hotel at a cost of €450,000 plus VAT of €60,750 in May 2012. Angela carried out development work to the hotel, which was completed on 15 December 2012 and cost €150,000. On 1 May 2016, she sold the hotel for €1,250,000.

As the cost of the development work does not exceed 25% of the consideration of €1,250,000, the work done is considered minor development. When the property is sold on 1 May 2016, as the development in the five years before sale is considered minor development, the sale will be exempt from VAT.

However, it may be desirable for Angela and the purchaser to jointly opt to tax the sale (see 1.2 below) to ensure that Angela does not suffer any capital goods scheme adjustment (see 3 below) now that the sale is exempt.

Example 3 – 25% test

Assume the same facts as Example 2 but the development work completed on 15 December 2012 cost €550,000.

As the cost of the development exceeds 25% of the consideration of €1,250,000 it is not therefore considered as minor development. The property is developed and has been made new as the development work was carried out in the five years before 1 May 2016. When Angela sells the property on 1 May 2016, she must charge VAT on the sale.

1.1.2 The supply of a property is taxable only if the property is considered new.

Two tests are relevant to establish whether a property is considered new. Test 1, should be used when the supply under consideration is the first-ever sale of the property on completion[4] . Test 2, should be used when the supply under consideration is the second or subsequent sale since the time the most recent development of the property was completed.

The supply of a property will be liable to VAT if either of the following rules applies:

Test 1. The five-year rule – a property is considered new for a maximum period of five years from the date on which the property itself or a development (see 1.1.1 above) of the property is completed.

Test 2. The two-year rule – where a completed property has been supplied at least once (to someone other than a connected party), the period for which the property is considered new is limited to a period of two years following the occupation of the property.

Example 4 – five-year rule & two-year rule

Donegal Ltd builds a warehouse on a site which is completed on 1 June 2012. Donegal Ltd sells the property to Elish Cooper (an unconnected person) on 1 August 2012. As the sale is made in the course of a business by Donegal Ltd and is within the period when the property is considered new (first sale within five years of completion), VAT must be charged on the sale.

Elish Cooper used the warehouse for her business from 1 November 2012 to 30 June 2013 (eight months). She sold the building to France Ltd on 30 June 2013. The warehouse is still considered new at this time since the sale is made within five years of completion and the property has not been occupied for a period of 24 months following completion. VAT must be charged on the sale to France Ltd.

France Ltd occupies the warehouse on 1 October 2013 but sells the property on 1 March 2015 after occupying the warehouse for seventeen months. At this point there has been an aggregate of more than 24 months occupation (8 + 17 = 25). Therefore, the property is no longer considered new. The sale is exempt from VAT. However, it may be desirable for France Ltd and the purchaser to jointly opt to tax the sale (see 1.2 below) to ensure that France Ltd does not suffer any capital goods scheme adjustment (see 3 below) now that the sale is exempt.

1.1.3 The phrase "in the course of business" is very broad. Business means any economic activity.

A transaction entered into in a private capacity is not done in the course of business. For example, the sale by an individual of their private home, is not done in the course of business. However, where a landlord/investor sells a property that was used or intended for letting, they are regarded as making a sale in the course of business.

1.2 When the joint option to tax is exercised

Where a property is supplied when it is no longer considered 'new', the supply is an exempt supply. However, the seller and the purchaser may opt to make the supply taxable. The joint

[4] Completed means that the development of the property has reached the stage where the property can be used for the purposes for which it was designed. For a property to be deemed complete, all utility services must be connected to enable the property to be used for the purposes for which it was designed.

option to tax is a shared decision and must be exercised by an agreement in writing between the parties to the transaction. It usually is included, as a clause, in the sales contract.

Where the option to tax is exercised, the purchaser, and not the seller, is responsible for accounting to Revenue for the VAT payable, under the reverse charge system. The purchaser should register for VAT if they are not already registered.

Example 5 – Joint option to tax

Denis Doherty is a publican and he acquired a newly completed pub building in 2010 for €1,000,000 plus €113,500 VAT. Denis recovered all of the purchase VAT as the pub building was to be used for the purposes of his pub trade. In 2018, Denis decides to dispose of the pub premises to Big Pubs Ltd for €1,750,000. Denis did not carry out any development work to the property since he acquired it in 2010. The property is no longer considered “new” for VAT purposes as the sale to Big Pubs Ltd will be the second supply of the property. As Denis has occupied the premises for the purposes of his business for at least 2 years, the building is no longer regarded as new for VAT purposes. Denis does not have to charge VAT on the sale of the property as the sale of the property is exempt from VAT. If no VAT is charged on the sale by Denis, Denis will incur a capital goods scheme adjustment (see 3 below).

However, if Big Pubs Ltd (the purchaser) agrees, the joint option to tax the sale can be exercised. VAT will then be charged on the sale of €236,250 (€1,750,000 x 13.5%). As a result of the joint option to tax being exercised, the VAT will be dealt with under the reverse-charge system. Hence, Big Pubs Ltd will self-account for the VAT in its VAT return. Details of the joint option to tax the sale should ideally be included in the sale agreement.

1.3 When the property is sold in connection with a contract to develop

Supplies of property made in connection with an agreement to develop the property are always subject to VAT.

1.4 When a residential property is sold by a developer

Where the property is residential property, the supply by the person who developed it in the course of business (i.e. a property developer) or by a person connected with the property developer is always subject to VAT.

Section 2 VAT advice on the letting of property

Lettings[5] are exempt from VAT.

A landlord who makes an exempt letting is not entitled to deduct VAT incurred on the acquisition/development of the let property.

A landlord may opt to tax a letting, however there are some lettings restricted from this option (see below). The option to tax applies to individual lettings of properties. By opting to tax a letting the landlord is entitled to deduct VAT incurred on the acquisition/development of the let

[5] Letting property includes leasing and letting. It does not include supplies of freehold equivalent interests (i.e. very long leases e.g. a 999-year lease).

property. However, the landlord must also charge VAT at the standard rate (currently 23%) on the rental payments receivable from the tenant.

Example 6 – option to tax lettings

Adam purchases a new building from a developer in 2016 for €227,000 including VAT. Adam intends to let the building to commercial tenants (who are VAT registered) and so he intends to opt to tax the lettings. Adam registered for VAT on the basis that he will make taxable lettings of the property and reclaims the €27,000 VAT he was charged on purchase (€227,000 - €227,000/1.135). Adam will have to charge 23% VAT on the rental payments receivable from the commercial tenants.

If Adam's prospective tenants are:

- not VAT registered,
- carry on a VAT exempt business (e.g. doctor, dentist, funeral director or financial services), or
- carry on a business which would only allow them partial recovery of the VAT charged on the rents,

then Adam's option to tax the lettings would have real cost implications for the tenants. He therefore may find it difficult to attract such tenants or have to reduce his rent to encourage them to undertake such a letting which is subject to VAT.

In order for a landlord to confirm the option to tax a letting, a written provision of the intention to subject the rents to VAT must be included in the letting agreement or the landlord must issue a document to the tenant stating that VAT is chargeable on the letting.

As noted above, there are restrictions on the option to tax rents. The option to tax cannot apply:

1. Where the property is occupied for residential purposes.
2. Where the letting is between connected[6] persons. However, if the tenant is entitled to deduct at least 90% of the tax chargeable on the rent, this restriction does not apply.
3. Where the property is occupied by the landlord, or a person who is connected with the landlord. However, if the occupant is entitled to deduct at least 90% of the tax chargeable on the rent, this restriction does not apply.

Example 7 – restricted letting

JB Tithe Ltd develops a residential building in 2016 which is to be sold. The company reclaims all the VAT charged in respect of the development of the building. JB Tithe Ltd is finding it very difficult to sell the property and is considering renting it to tenants. JB Tithe Ltd cannot opt to tax a residential letting. If JB Tithe Ltd goes ahead with the residential letting the company must make a Capital Goods Scheme (see 3 below) adjustment in each VAT period for which the letting is made (see example 10).

[6] The definition of 'connected' is very wide.

Section 3 Capital goods scheme (CGS)

The CGS ensures that the VAT deductibility for a property reflects the use to which the property is put over the VAT-life of the property. Some of the key points regarding the CGS are outlined below:

- The CGS does not apply to anyone who acquires a property on which VAT is not chargeable.
- Anyone engaged in a fully taxable activity (e.g. a business with 100% VAT recovery entitlement or a landlord who is opting to tax a letting) is entitled to deduct all VAT charged on the acquisition/development of a property to be used in the business.
- Anyone engaged in partly exempt activities (e.g. a business with 50% VAT recovery entitlement) is only entitled to deduct a percentage of VAT charged on the acquisition/development that corresponds to the percentage of taxable use.

The key terminology of the CGS includes:

- ***VAT-life/adjustment period*** – the CGS provides that, in most cases, each property/capital good will have a VAT-life of 20 intervals. In respect of 'refurbishment'[7] the VAT-life is 10 intervals.
- ***Initial interval*** – the first 12 months following completion or acquisition.
- ***Second interval*** - begins on the day after the initial interval ends and ends at the end of the property owner's accounting year in which the initial interval ends. This is the only interval that will be less than 12 months.
- ***Subsequent interval*** - each interval after the second interval until the end of the VAT-life.

The mechanics of the CGS are outlined below:

- At the end of the first 12 months (i.e. the initial interval) following completion/acquisition, a review must be carried out. If the proportion of taxable use of the property during the initial interval differs from the proportion of the VAT reclaimed/deducted on the acquisition/development of the property, a CGS adjustment is required.
    - A negative CGS adjustment will be required where too much VAT was reclaimed. An amount will have to be paid to Revenue.
    - A positive CGS adjustment will be required where too little VAT was reclaimed initially. A reclaim of VAT can be made from Revenue.

- During the remaining VAT-life of the property, a review on the second and subsequent intervals will be required. Where there is a change in the proportion of use for taxable purposes for any interval in comparison with the proportionate use during the initial interval, a positive/negative CGS adjustment will be required.

[7] Refurbishment refers to development work carried out on a previously completed building. A new capital good is created (i.e. the refurbishment) to the value of the cost of this development work.

Example 8 - negative CGS adjustment

Graham Accounting Ltd (GAL) purchased a commercial property on which VAT is charged on 1 May 2015. The VAT amount was €500,000. GAL recovered all of the VAT on the basis that it would be carrying on 100% taxable accounting and tax activities. GAL's accounting year end is 31 December.

Initial interval	1 May 2015 to 30 April 2016
Second interval	1 May 2016 to 31 December 2016
Third interval	1 January 2017 to 31 December 2017

Total tax incurred	€500,000	
Base tax amount	€25,000	(€500,000/20)

At the end of the initial interval, GAL calculates it is only entitled to 90% recovery as the company has started to provide financial services advice (which is an exempt activity). GAL must repay €50,000 to Revenue.

Total reviewed deductible amount	€450,000	
Reference deduction amount	€22,500	(€450,000/20 intervals)

At the end of the second interval, GAL calculates that it still has an 90% VAT recovery. It, therefore, requires no CGS adjustment.

At the end of the third interval, GAL calculates that its VAT recovery rate decreases to 60% as the company is generating more sales from financial services activities.

Base tax amount	€25,000	
Interval deductible amount	€15,000	(€25,000 x 60%)
Reference deduction amount	€22,500	

As the interval deductible amount is less than the reference deduction amount, GAL must repay €7,500 to Revenue.

Example 9 – positive CGS adjustment on disposal

Beta Ltd incurred €175,000 of VAT on the acquisition of a newly completed property on 1 May 2013 and immediately let the property. The company did not reclaim an input credit for this VAT as it did not opt to tax the lettings. Beta Ltd sold the property after four CGS intervals.

Beta Ltd will not be required to charge VAT on the sale of the property as this is the second or subsequent sale of the property and it has been occupied for 24 months. However, if Beta Ltd and the purchaser jointly opt to tax the sale, Beta Ltd will be entitled to reclaim 80% (16/20) of the €175,000 VAT incurred on the acquisition of the property. As a result of the joint option to tax being exercised, the VAT will be dealt with under the reverse-charge system.

Example 10 – property developer renting out property which was developed for sale

Jimmy, a developer, completed the construction of a house in 2012. After three CGS intervals the property remains unsold and so he decides to sign a lease with a tenant for four years.

Jimmy cannot opt to tax the letting as it is a residential letting. Therefore, a CGS adjustment will be required as lettings are exempt. As the house is being rented by the property developer (i.e. Jimmy), he is liable to repay 1/20th of the VAT deducted on the development of the property at the end of each CGS interval for as long as the property is rented (up to a maximum rental period of 20 years). When the property is eventually sold, it will be subject to VAT.

Section 4 Other VAT on property issues

4.1 Interaction of CGS and VAT transfer of business relief is claimed

VAT transfer of business relief[8] effectively deems the transfer of a business to fall outside the scope of VAT. Therefore, where the conditions are satisfied for the relief, no VAT is chargeable on assets such as inventory, plant and machinery, intangibles and property. However, care must be taken where a purchaser acquires a property as part of a transfer of a business. The VAT status of the property needs to be established in order for the purchaser to understand where they stand in respect of the CGS on the property (if any CGS applies).

If, ignoring transfer of business relief, the property sale would have been VAT exempt (e.g. as the property is not considered new):

- The purchaser "steps into the shoes" of the seller for the purposes of the CGS and the purchaser inherits the adjustment period.
- However, the purchaser will not inherit any CGS where the property has no CGS attaching to it.

If, ignoring transfer of business relief, the property sale would have been liable to VAT (e.g. as the property is considered new):

- The seller is treated, for the purpose of the CGS, to have made a taxable supply of the property.
- The purchaser is deemed to have been charged the VAT that would have been charged in the absence of the relief.
- The amount of VAT that would have been charged is treated in the hands of the purchaser as the "total tax incurred" (see Example 8 above) for the purposes of the CGS.
- The purchaser must calculate how much of the "total tax incurred" would have been deductible/reclaimable if they had been charged that VAT. This will depend on the purchaser's VAT recovery position.
- The difference between the amount charged and the amount deductible/reclaimable is paid to Revenue.

4.2 Group VAT registration – intragroup transfers of property

The supply of property from one company to another within a VAT group is excluded from the usual VAT group relief provisions. Therefore, if VAT should be charged on the sale of the property (see 1 above), the group company making the sale must charge VAT and issue a VAT invoice to the purchasing group company. Depending on the VAT recovery position of the purchasing company, the input VAT on the purchase should be reclaimed.

[8] Section 20(2)(c) and section 26 VAT Consolidation Act 2010