VAT on Property

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The VAT on property regime has changed dramatically with effect from 01/07/2008. The new scheme is quite complicated and though what follows is an outline of the main provisions for the purposes of examination, this article should not be considered exhaustive in relation to examination requirements.

This article deals with property supplied or let after 01/07/2008. However, students should also be aware that as the “old regime” applies to transactions before that date such transactions are examinable for 2009.

In general the new provisions relate in the main to the sales of property and the letting of property (although any initial examination of this area exam would not focus on sales of uncompleted property). The new provisions also introduce a new concept – the capital goods scheme.
All of these areas are examinable.

SALES OF PROPERTY

Sales of completed property can be divided into two categories - sales of new and old property. Completed property is property which can be used for the purposes for which it was designed.

New property

1. The sale (supply) of a completed property which is:
    a. A new freehold or a freehold equivalent (e.g. a leasehold of 99 years or greater) and
    b. Which is developed and sold (supplied) in the course or furtherance of a business, is subject to VAT .

What determines then whether a property is “new” or “old”?

- The first supply of a completed property within five years of its completion of development is subject to VAT, (five year rule).
- Any subsequent supply of a property that occurs within five years of its completion is subject to VAT if it takes place within two years of occupation and if a prior sale was subject to VAT and took place between unconnected parties, (two year rule).

Example
A develops a site, which is completed in August 2008. The property is sold to B in December 2008, who occupies it immediately. The first supply is within five years of completion. Therefore it is a taxable supply.

Example
B then occupies the premises for three years and sells in December 2011 to C. The sale by B is within 5 years of completion (August 2008) but not within two years of occupation. The sale is not subject to VAT.

Old Property
In the main, sales of “old” property (for example a building sold six years after completion) are exempt from VAT. Where a sale is an exempt sale, and the property is sold within its VAT life, there is an adjustment under the capital goods scheme (see below).

However, where the sale of property is exempt from VAT the seller and purchaser can exercise a joint option to tax the sale. In such circumstances, the purchaser accounts for VAT on the sale on a reverse charge basis.

Example
The sale by B to C above is exempt but provided there is a joint election to tax the sale, C is chargeable on the reverse charge basis and there is no adjustment under the capital goods scheme.

If a property becomes old i.e. if it does not satisfy the five or two year rule it can be made “new” again by further development.

Example
If above B did not sell to C immediately but developed the property first, the property would become new again and a sale to C within 5 years after development would be taxable.

Development does not include minor development. Minor development is work that does not materially alter the use of the property and which is less than 25% of the consideration for the sale of the property. Students should be aware that this is an important concept in deciding whether an old property has been made new. For example an old property purchased after July 2008 and which is either materially altered or where the development cost is greater than 25% of the consideration for the supply of the property is subject to VAT on its sale

It must also be noted that the sale of residential properties by their developer/builder (or a party connected to the developer/ builder) even where the two and five-year rules do not apply, is always taxable.

LETTING OF PROPERTY (Let after 01/07/2008)

The distinction between the VAT treatment of long leases and short leases no longer applies. In addition the previous VAT treatment applicable to the creation of long leases has also been removed. From 1 July 2008 long leases are not subject to VAT on their capitalised value.

Landlord's Option

The letting of property is exempt from VAT but the landlord may opt to tax a letting. The option under the new regime applies on a letting by letting basis and is not a general option applicable to all lettings. Under the old regime, a landlord could not opt to charge tax on a letting by letting basis. A waiver of exemption meant landlords had to charge VAT on rent on all properties let on a short lease. The landlord may now opt (or not opt) to tax each letting separately. Where such an option is exercised in respect of a property, the rental payments will be subject to the standard rate of VAT.

The option can be exercised either by entering a written agreement with the tenant to tax the rent or by issuing a notice to the tenant.

Circumstances Where The Landlord's Option Is Not Available

The option is not available where the landlord and the tenant are connected. However, this restriction does not apply where the tenant is entitled to deduct at least 90 per cent of the VAT chargeable.

In addition, no option is allowed if the property is occupied by any party connected to the landlord irrespective of the tenant's entitlement to VAT recovery or whether the lessor and lessee are unconnected.

<u>Example</u>

D develops a property which is completed in August 2008 and lets it in December to E. E in turn sublets to D's brother F who carries on a take-away business from the premises. Though D & E are unconnected and F can deduct more than 90% of the VAT chargeable, the option cannot be exercised.

In addition, the option does not apply where the property is occupied for residential purposes.

CAPITAL GOODS SCHEME

In general there will be VAT implications under the capital goods scheme where either there is a change in the taxable use of the property during its VAT life or there is an exempt sale during that period. In general, where a property is owned by the same person without any adjustment in the VAT use as regards taxable or exempt purposes there is no adjustment required.

Change in Use

The purpose of the Capital Goods scheme is to allow for the deduction of VAT in accordance with the taxable use of the property over its VAT life. Where there is a change in the taxable use of a property there will be an adjustment under the capital goods scheme.

VAT Life
Generally, the VAT life of a developed property is 20 years, (20 intervals).
The first interval is a period of one year and subsequent intervals tie in with the owner's accounting year end. At the end of each interval, the owner must review the use to which the property is put for that period and make an adjustment, if appropriate. Where the proportion of input credit is less than the proportion of the VAT deduction when acquired or developed then an adjustment is due. The initial period is the first period end 12 months after the property is completed (in the case of a person who constructs a property) or is acquired. In this instance any adjustment is to the full amount of the VAT deducted. This is a reference amount. An adjustment for a second or subsequent interval is only a proportionate adjustment in relation to the reference amount.
This is best illustrated by example

<u>Example</u>
X acquired a property which was completed after 01/07/2008 and immediately carried on the business of bookkeeping services from the premises. X deducted all VAT (say €100,000). Mid way through the year X started to carry on an exempt business from the same premises in addition to the bookkeeping service. He estimates that the property is used 50% for each business for the second part of the year.
The initial adjustment is:
100,000 – ((100,000 X 100% 6/12) + (100,000 X 50% 6/12)) = 25,000

The ratio remains 50:50 for the full second year.
The adjustment is for the second interval is:

$$\frac{100{,}000 \text{ X } 75\%}{20} - \frac{100{,}000 \text{ X } 50\%}{20}$$

=1,250

In the third interval the ratio changes to 40:60 - taxable:exempt
The adjustment is for the third interval is:

$$\frac{100{,}000 \text{ X } 75\%}{20} - \frac{100{,}000 \text{ X } 40\%}{20}$$

=1,750

Exempt Sale During VAT Life
Where there is an exempt sale of a property during its VAT life, there is an adjustment under the Capital Goods scheme.
Z acquired a property and immediately carried on a fully taxable business from the premises. It deducted VAT of €100,000. X sells the property after six years but there is no joint option to tax. The adjustment is:

$$\frac{100{,}000 \text{ X } 15}{20}$$

i.e. the formula is the VAT deducted X the number of intervals remaining plus 1 divided by the VAT life.

TRANSITIONAL PROVISIONS

These relate to properties completed prior to 01/07/2008 but sold or let after that date. There are a number of transitional provisions including the following:

Sale of freehold Property
Where a freehold (freehold equivalent) property which was acquired or developed prior to 1 July 2008 is sold, the sale will be exempt from VAT if the seller was not entitled to a VAT deduction on the acquisition or development of the property. However the purchaser and vendor may jointly opt to tax the sale of the property. Where a sale is exempt, an adjustment must be made under the capital goods scheme.

Where the vendor was entitled to deduct VAT the normal 5 and 2 year rules apply.

Other Transitional Measures
Certain other transitional measures apply where a waiver of exemption is in place prior to 1/07/2008 and where a long lease is in place prior to 01/07/2008 and is assigned after that date.