

ANNEX E

VAT on Property Transactions

1. Introduction

A review of the current system of applying VAT on property transactions has been carried out. The review concluded that significant changes are required to the system and made recommendations in that regard. The aim of the proposed change is to simplify the rules for VAT on property while ensuring a more equitable treatment for taxpayers. The new rules will apply to both commercial and residential property supplied in the course of a business and are designed to be broadly revenue neutral. The VAT charge on sales of new residential property will be unchanged. Rent on residential lettings will remain exempt without an option for taxation. Extensive consultations have been undertaken both by the Revenue Commissioners and the Department of Finance, including a public consultation process.

2. Current System

The current rules for VAT on property transactions tax the supply of a property if it has been developed since 1972 and if the supplier has had an entitlement to a deduction for the VAT incurred on acquisition or development of the property. The effect of this is twofold. It applies VAT to new residential property as such properties pass to a consumer; these properties then fall out of the VAT net. In the case of commercial properties however, where the use is for a taxable business, the trader must charge VAT indefinitely on any sale. This contrasts with the position for properties that are subject to a long lease where the freehold reversion falls out of the VAT net. This can lead to difficulties in ascertaining the taxable status of a property particularly in relation to older properties that may have been subject to a number of transactions and where records may not be readily available.

Leases of ten years or longer in duration are treated as a supply of goods and taxed upfront. The basis for calculating the VAT charge (the capitalised value of the lease) and the anti-avoidance legislation that underpins it are regarded as complex. Short-term leases (less than ten years) are treated as an exempt supply of a service.¹ However, a taxpayer may waive the exemption on such leases and choose to charge VAT on the rents. The landlord is then entitled to deduct the VAT costs on the acquisition or development of the property.

3. Need for change

The review concluded that the current system is complex and imposes a significant compliance burden on ordinary transactions. Broadly the same revenue yield and taxation effect could be achieved through a revised simpler system of applying VAT on property transactions. The system needs also to be brought more into line with the EU requirements under the VAT Directive.

¹ This means that the landlord is not entitled to deduct the VAT costs on acquiring the property and that there is no VAT charged on the periodic rents to the tenant.

4. New System

Provision will be made in the Finance Bill for the introduction of a new system for applying VAT to property transactions. The new rules will apply to both commercial and residential property, supplied in the course of a business.

The main changes include ceasing to charge VAT on the capitalised value of leases in excess of ten years, removing old properties from the VAT net by confining the period during which VAT will apply to the supply of new properties to a maximum of five years and making some changes to the treatment of leases. In addition a Capital Goods Scheme² (CGS) will be introduced for property transactions; this will ensure that the VAT deductible will be proportionate to the business use of a property over a twenty-year period.

The main provisions will include:

- The supply of buildings – whether by the sale of the freehold or via a very long lease (a “freehold equivalent”) - will be taxable only while the building is considered “new”. For this purpose, a building will be regarded as “new” for a period of up to five years following completion. The first supply of a building within five years after completion will always be taxable. Subsequent supplies within five years after completion will also be taxable except where the building has been occupied for two years or more at the time of supply. An existing building that is substantially refurbished or is adapted for materially altered purposes will be considered “new” following such work and sales of those buildings will be subject to the rules for sales of new buildings.
- The supply of “old” buildings will be exempt from VAT, but there will be an option to tax such supplies. Where the option to tax is exercised, VAT will be charged on the actual consideration, subject to any specific anti-avoidance rules that deal with artificially reduced considerations. The option will be exercised jointly by the vendor and purchaser. VAT will be accounted for by the purchaser, under the reverse charge mechanism.
- The supply of “building land” will be taxed in the same way as it is taxed currently. The VAT treatment of undeveloped land (e.g. farm land) will not be affected. Land that is sold in connection with a contract to develop it will continue to be taxable.
- Most leases will be exempt from VAT but leases that represent effective ownership will be treated in the same way as supplies of the freehold.
- There will be an option to tax rents on commercial buildings where the landlord and tenant are not connected persons. The option may be exercised by the landlord and provision will be made for cancellation. Where the option is cancelled while the building is still subject to the CGS, a CGS adjustment will apply. Anti-avoidance measures will ensure that no unjustified advantage arises on the cancellation of an

² A Capital Goods Scheme is a mechanism provided for in EU law to regulate the VAT credit a person gets on a property.

option. ‘Connected persons’ will be given a broad definition so as to prevent abuse of the option to tax facility.

- A Capital Goods Scheme will be introduced. Deductibility for input VAT relating to a property will be initially allowed by reference to the use of the property for the first twelve months of full use. The CGS will require an annual review by the taxpayer of the use to which a property is put over the following twenty years (in terms of taxable or exempt use). Where there is a change in use, an adjustment of deductibility will be required. The adjustment will reflect the difference between the use in the initial twelve months of use and the use in the year in question. Ultimately, the proportion of VAT allowed to be deducted will reflect the actual use of the property over the twenty-year period.

5. Transitional Measures

Transitional measures will provide that there will be a smooth shift from the current rules to the new rules so as to minimise any adverse effects on taxpayers. The transitional rules will apply to a number of categories of transactions.

- Supplies of properties that are over twenty years old and have not been made “new” by refurbishment or adaptation for materially altered use will have no VAT liability attached to them.
- The supply of properties less than twenty years old will be subject to the new rules – if the property is considered new, the supply will be taxable; otherwise, a CGS adjustment will apply unless the parties exercise the option to tax the supply.
- A change of use of commercial properties less than twenty years old will be subject to a CGS adjustment.
- VAT incurred by a tenant (prior to the introduction of the new system) on the capitalised value of a long lease (that is a lease of ten years or more) will be subject to the rules of the CGS where the VAT was incurred within the last twenty years.
- Where a waiver of exemption applies in relation to a short-term letting the landlord will, subject to conditions, be given a number of options, that will entail either cancelling the waiver of exemption using the current rules or continuing to tax the rents until the lease expires. Any further lettings will be fully subject to the new rules.

6. Implementation

The detailed provisions enacting the new system for applying VAT to property transactions will be contained the Finance Bill 2008. The new system will take effect from 1 July 2008.