

VAT on Property – A New Beginning

Introduction

Following on from the Revenue report of its review of VAT on property transactions published in March 2007 the new legislation is finally with us with the enactment of Finance Act 2008 on 13th March. The new rules will apply to property transactions on or after 1st July next. The implications of the new rules should be considered for all property transactions negotiated before the 1st July as it may be more beneficial to delay the transaction until after 1st July particularly in the case of older properties as these properties may not be subject to VAT at that point.

The following paragraphs give a brief overview of the impact of the new rules on property transactions that will apply from 1st July and are intended only as a guide. Professional advice should be sought in relation to the particular circumstances of every transaction.

Capital Goods Scheme

The most significant change is the introduction of a Capital Goods Scheme and the concept that a property has a fixed life for VAT purposes. The capital goods life of a new property is 20 years and the capital goods life of a refurbished property is 10 years.

The VAT credit is claimed on acquisition of the property. However this credit is reviewed on an annual basis throughout the 10 or 20 years capital goods life. If the property, or a part of, is put to an exempt use during the 20 year cycle or if there is an annual change in the mix of taxable and exempt business supplies there will be a clawback of VAT proportionate to the taxable/non-taxable use of the property for each particular year.

New Building – Commercial

A new building will be subject to VAT if the first sale of the building occurs within five years of completion of the development.

A second or subsequent sale of a building within five years of development will only be subject to VAT if the property has not been occupied for more than an aggregate of twenty-four months in the five year period.

A building over five years old may be considered new if it has been substantially refurbished or adapted for materially altered use. A building will be considered substantially redeveloped if the cost of the redevelopment exceeds 25% of the sale proceeds.

The VAT rate applying to the sale of new property is 13½ % of the sale price.

New Building – Residential

The first sale of residential property will always be subject to VAT. If the property has been let by the developer while awaiting sale there will be an adjustment of input credit under the capital goods scheme and a subsequent sale will be subject to VAT.

Old Building

The sale of an old building is exempt from VAT. However under the capital goods scheme a clawback of VAT may arise for any unexpired portion of the 20 year capital goods life of the building. In the case of commercial property there is an option to tax the sale if the vendor and purchaser jointly agree to exercise the option. Where the option to tax is exercised the purchaser will self-account for the VAT on the sale price.

Land

Undeveloped land will not be subject to VAT unless it is sold in conjunction with an agreement to develop the land.

Leasehold Property

Under existing rules that apply to 30th June the VAT charge on leasehold property depends on whether the lease is for a period of less than or greater than 10 years. A lease of less than 10 years is exempt from VAT and a lease of 10 years or more is chargeable.

For leases entered into after 1st July the term of the lease is immaterial as all leasehold property is exempt from VAT.

However where the lease is one of non-residential property the landlord has the option to tax the supply and the rent receivable will be subject to VAT at the 21% rate.

The option to tax will not apply where the landlord and tenant are connected persons **and** the tenant does not have an entitlement to 90% recovery of input VAT.

A freehold equivalent lease that effectively transfers ownership of the property e.g. a 999 year lease will be treated as the supply of a freehold property. A freehold equivalent interest is deemed to be transferred where 50% or more of the original market value of the property is paid in the first five years of the lease.

Transfer of Business

Where property is transferred as part of the transfer of a business the transfer is exempt from VAT and this exemption will continue to apply after 1st July. The vendor will give the purchaser a capital goods record for any property in the business and the purchaser will assume the obligation under the capital goods scheme.

Transitional Measures Post 1/7/2008**Freehold**

If the property was developed prior to 1988 and has not subsequently been redeveloped then it will not be in the VAT net.

The supply of properties less than 20 years old will be subject to the new rules. If the property is considered new the supply will be taxable. If the property is not new a Capital Goods Scheme adjustment will apply.

Leasehold

Where a lease created before 1st July 2008 is assigned or surrendered a VAT liability will arise if the tenant assigning or surrendering the lease was entitled to recover VAT

when the lease was created. The liability is a fraction of the VAT recovered on creation of the lease to reflect the unexpired term of the lease. The landlord should self account for the VAT liability and has the option to tax a subsequent supply of the property.

If the tenant did not have an entitlement to recover VAT when the lease was created the surrender or assignment is exempt. An option to tax is not permitted.

Holiday Homes

The letting of holiday homes is a service for VAT purposes. Where the income from letting exceeds the threshold amount of €37,500 there is an obligation to register for VAT. Where the income from letting is under the threshold amount the owner can elect to register for VAT.

Where the election to register is made before 1st July 2008 and is cancelled after that date the existing rules for calculating the VAT liability will apply. Where the property is acquired after 1st July 2008 and the election subsequently cancelled the VAT liability will be calculated as a capital goods adjustment.

Waiver of Exemption

No new waivers of exemption can be put in place after 1st July. From the 1st July existing waivers may cease to apply to lettings between connected persons if the VAT on the rent is not at a certain minimum level and the tenant does not have an entitlement to recover 90% of input credits.

Conclusion

Careful consideration should be given to the closing date for property deals negotiated prior to 1st July. In particular it may be more beneficial to delay closing the sale of pre 1988 properties until after 1st July.

If a tenant is entitled to VAT recovery they can self account for the VAT charge on the capitalised value of the lease using the 4A/4B procedure if the lease is signed or they take occupation of the property before the 1st July. If the lease is signed after 1st July the tenant will pay VAT bi-monthly on the rent payable under the lease at the rate of 21%.

Review all leases between connected persons with regard to the level of the rent and the tenants entitlement to deductibility. If a lease in these circumstances is under negotiation consider if there are benefits in concluding the transaction before 1st July.

Consideration is required as to whether it is in the landlord's interest to opt to tax any lettings after 1st July. This may be the case where leases are surrendered or assigned and the property is let on a second or subsequent lease and where the VATable interest is not significant.

A capital goods record for all property currently subject to lease and for all freehold property developed since 1988 will have to be established and maintained. This record must be reviewed on an annual basis and any adjustments for entitlement to VAT recovery made as necessary.

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