

VAT ON PROPERTY

- ▶ Trying to solve the VAT puzzle when it comes to the supply of Property , gives meaning to the words of **Lord Justice Sedley's decision in Royal & Sun Alliance v C&E commissioners (Court of Appeal) 2001:**
- ▶ “Beyond the everyday world ... lies the world of VAT; a kind of fiscal theme park in which factual and legal realities are suspended or inverted.”

VAT – The Basics

- Applies on the supply of taxable goods and services □ No sticking VAT for fully accountable persons – (they can reclaim it)
- VAT is absorbed by businesses (banks, insurance companies etc.) engaged in exempt activities and private individuals

- ▶ The Objectives of the New System
 - ▶ □ To regularise VAT on the leasing of property
 - ▶ □ To provide a capital goods system for property in the VAT Net
 - ▶ □ To move our system closer to the common system of VAT

- ▶ New concepts for the New System
- ▶ □ The new system is based on an array of new concepts. Some are relatively simple, others are very strange in an Irish context.
- ▶ □ Some are defined, others must be labelled so they can be identified.

- ▶ Taxable Person / Accountable Person From the 1 st of July, 2008;
- ▶ □ A “Taxable Person” is a person engaged in economic activity (including exempt activities for VAT purposes)
- ▶ □ An “Accountable Person” is a person who is obliged to register and account for VAT
- ▶ □ Many vendors and purchasers of property and landlords may find that they are obliged or encouraged to register for VAT
- ▶ □ Solicitors/Accountants must be able to advise them accordingly

- ▶ Connected Person
- ▶ Very widely defined linkage for anti avoidance including relations, partners, common controlled companies, trustees, settlors, beneficiaries are used in determining whether a sale of developed property is mandatorily taxable and to deny a landlord the right to charge VAT on an occupational lease in certain circumstances.

- ▶ Freehold / Freehold Equivalent Interest Freehold – Self Evident A Freehold Equivalent Interest - is a lease which bestows effective economic ownership of a property (an ownership lease). □ Contrast this with an occupational lease
- ▶ which is a lease of property under which the rent is merely a payment for the use of the property let.

- ▶ Why is the distinction significant?
- ▶ □ Because the consideration of the grant of a lease which is a Freehold Equivalent Interest may be taxed as the supply of immovable property (13.5%) and the consideration for the grant of an occupational lease may be taxed as a service (23%)

- ▶ Completed” and ”Occupied”
- ▶ □ “Completed” means the development of the property has reached such a state, apart from any finishing or fitting out works, that the property can be used for the purposes it was designed and the utilities and services required are connected.
- ▶ □ “Occupied” means occupied and fully in use following completion and where the property is let, occupied and fully in use by such tenant
- ▶ □ The dates these occur are part of the VAT history of a developed property.

- ▶ **Deductibility Adjustment**
- ▶ A Deductibility Adjustment is a recalculation of the VAT liability of a property owner triggered by an event, such as an exempt sale or a letting where the option to tax is not exercised or change of taxable use.
- ▶ Final deductibility adjustment applies on a time apportioned basis over the VAT life or the property. An interval deductibility adjustments can apply in respect of that interval only. A deductibility adjustment can be in favour of the Revenue or of the tax payer.

- ▶ VAT, Property and Development

- ▶ As a general rule, the supply of a property is not taxable unless it has been developed or acquired in a developed condition. A property is developed for VAT purposes if it has undergone:
 - ▶ □ Construction works on a building (generally 4 walls and a roof);
 - ▶ or
 - ▶ □ Operations to effect material change of use. Under the new system “Refurbishment” is defined as “development to a previously completed Building”.

- ▶ Examples of Undeveloped Property
- ▶ □ The sale of a Greenfield site (unless services are laid to it or it is sold in conjunction with a development agreement); or
- ▶ □ An old building, such as a Georgian building, which has not been the subject of construction work or engineering or other operations to effect a material change of use.

- ▶ Adjustment Period The period of 20 intervals (20 years approximately) since the date a property was developed; or, □ If acquired after development, subject to a right to claim VAT on the acquisition, the period of 20 intervals (20 years approximately) from that acquisition
- ▶ □ If refurbished (and held by the refurbisher), the period of 10 intervals (10 years approximately) from the refurbishment.

VENDOR

- ▶ Conditions of Sale under the New Regime – Acting for a Vendor
- ▶ □ Have presentable VAT records when drafting the contract. □ You must identify the VAT status of property
- ▶ □ Remember the supply of a freehold equivalent lease is a sale of immovable goods.
- ▶ □ The sale of an occupational lease can be taxable at 23% on the premium.
- ▶ □ Is your client a taxable person?

- ▶ Watch for the Tax Traps If a vendor is selling “unnew” property and fails to exercise the option to tax, he will suffer a, clawback of VAT on the sale.

- ▶ Is your client an accountable person?
- ▶ □ Does your client have partial deductibility? □ Is the purchaser a taxable person?
- ▶ If not, the option to tax the sale of unnew freehold/freehold equivalent is not available.

PURCHASER

- ▶ Conditions of Sale under the New Regime – Acting for a Purchaser
- ▶ □ Make sure you review the VAT records and satisfy yourself that the VAT treatment is appropriate.
- ▶ □ Identify the VAT status of the property.
- ▶ □ Is your client a taxable person? □

TAX TRAPS/PLANNING

- ▶ Reward for the Vigilant Tenant Landlord's adjustment periods are finite. If a tenant with partial deductibility knows the date of expiration of his Landlord's adjustment period, he can ask his Landlord to cancel the option to tax the lease on that date. No VAT will then apply on the rent.
- ▶ He may ask for an option to pay the Landlord to cancel when the VAT cost to the Landlord is low. Tax trap for Landlord if property is still new or nearly new.

- ▶ Plan Ahead
- ▶ Include VAT planning in any strategy for the sale, purchase or leasing of property. If you wait until after a transaction has been agreed, planning for VAT may no longer be an option.



Pre July 2008

- Be developed
- Dispose of a 'taxable interest'
- In the 'course of business'
- For long leases – Economic Value Test

- Mr Murphy acquired a site and built a shopping centre. Sells it in Feb 2008 – VAT is charged 13.5%
- Sale of home – no VAT (not in the course of business)
- Insurance Company acquired office in 2003, sells in 2006, no vat (was not entitled to an input credit (cannot recover vat as insurance companies are not vat registered entities)
- Developer builds houses on land which the farmer owns. Ms Murphy buys the house – 1 contract to buy site from farmer, 1 contract for the construction, As these are connected, the farmer must charge vat on the sale of the sites
- Ms Murphy buys an undeveloped site from a farmer – with a view to eventually building a house – no vat on site sale



Development

- Farmer spends 300k adding access road to agri land, fencing, drainage – not ‘developed’ as it did not ‘materially alter’ – land was a farm before and a farm after the works
- Clear a site, layout roadways, sweage system – land is ‘materially altered’ from agri-land to development site – vat charged if sold



Sale commercial property

- Daffodil Ltd acq prop for 15M plus vat in 2012, recovered 2.025M, use in the trade, sell in 2022, no development, no longer 'new' no vat on sale – exempt
- **BUT tax life 20yrs** – the sale is 10yr into the tax life, 10/20 of the input vat clawed back – 1.0125M
- They could '**opt to tax**', reverse charge, box T1 & T2 of purchasers vat return

- Ms Murphy vat registered Mr Dentist vat exempt
- Sells building 4M to Dentist 2022 (vat exempt). Claimed 125k input vat on purchase 2012. Also 10k of vat on costs of sale.
- Selling with no Vat – 4M – clawback of vat ($125k \times 10\text{yrs}/20\text{yr life} = 62,500$) plus vat on sale costs (10k) – 72,500 due back to Revenue – Ms Murphy will want to avoid vat clawback and ‘opt to tax’
- Opt to Tax: Dentist pays 4,540,000 (cannot recover 540k vat), no clawback of Ms Murphys vat claimed in 2012 and she can claim 10k vat on sale costs
- Both parties agree a price & sell without opting to tax
- Dentist pays 4,306,250 instead of 4,540,000 (saving 233,750). Ms Murphy gets increased sale consideration – 306,250 & pays Revenue 72,500 of clawed back vat – net: 233,750

- Opt to tax
Purchaser beware!

- It brings an otherwise VAT exempt property into the VAT net
- The purchaser must monitor the use of the property for the next 20 years or until sold
- The purchaser will have an exposure to VAT costs for any VAT exempt use of the property over the next 20 years
- If the purchaser wants to sell at any time in the next 20 years he will have to get the purchaser from him to agree to a joint option, otherwise he will incur VAT costs
- The purchaser has effectively created a capital good for which he must maintain a capital goods record
- If next purchaser is vat exempt who refuses 'opt to tax', then client is left with irrecoverable vat cost

The benefit of the joint option is for the vendor either avoiding VAT costs, or, alternatively, recovering VAT previously disallowed, with, as far as I can see, no benefit but risk for the purchaser.

- Solicitors advising a vendor – normally push for Special Condition 3 to remain intact
- Eg Spec Cond 3 clarifies consideration is net of VAT, if deleted, the vendor does not have the right to collect VAT from the purchaser
- Requisitions on Title: raise as pre contract queries, will draw out the current and historical vat issues
- Purchaser/less should request they be provided by vendor/landlord

- Dr Mary wished to buy a property that is vatable but as she is exempt, she cannot claim the vat.
- Her husband buys it, reclaims the VAT
- Husband then leases it to Dr Mary, 'opts to tax', vat applies to the rentals
- **HOWEVER**, as they are 'connected' and she has less than 90% recovery, 'opt to tax' is not allowed, thereby he cannot claim the vat on purchase

The practitioner acting for the purchaser, on receipt of the draft **Conditions of Sale** from the vendor, receives responses to the **Pre-Contract VAT Enquiries** so that the practitioner can fully evaluate the risks or benefits for his or her client from the VAT treatment of the property as determined by the VAT history of the property/legislation, and the consequences for his or her client from the VAT treatment proposed by the vendor, the exercise of the joint option to tax.

Note:

- where sale of property is **taxable** (e.g. a new building) then the seller has to charge, and collect, the VAT from the purchaser. The purchaser then has to apply to Revenue for a refund of that VAT – cash flow timing disadvantage.
- Where sale is **exempt**, and the parties opt to tax the sale, then the purchaser must self-account for the VAT due and there is no cash flow disadvantage.

- Property Lettings (excluding Residential Lettings)
 - Occupy land under a lease (is a letting) or license (supply of a service)
- Letting – exempt from vat unless ‘opt to tax’
- Beware – include a vat clause in the lease to allow landlord ‘collect vat due on the rent’
- No option to tax where;
 - where (a) the landlord and tenant are connected persons and the tenant cannot deduct at least 90% of the VAT chargeable on the letting,
 - (b) the landlord, even though he is not connected to the tenant, occupies the property or is connected to the person occupying the property and the occupant cannot deduct at least 90% of the VAT chargeable on the letting

- Where a landlord has not included an explicit option to tax in a lease, the inclusion of a VAT clause in the lease may in itself be sufficient to exercise the option to tax. For example a basic VAT clause might say *“The rent is exclusive of VAT”* or *“the tenant will pay any VAT chargeable”*. Would such clauses be sufficient to exercise the landlord’s option?
- UK Court of Appeal in *Wynn Realisations Ltd v Vogue Holdings Inc.* This case involved the sale of a property and the contract of sale said that the sale price was exclusive of VAT. Both parties thought the sale was exempt and no VAT was charged by the vendor. It turned out that both parties were incorrect and that the vendor should have charged VAT to the purchaser. The Court said that the effect of the contract was that, if VAT was payable, the price provided by the contract was exclusive of it.
- A basic VAT clause only operates to make sure that the supplier can collect VAT from the purchaser if the supply is taxable. However, it is going a lot further than this to argue that the inclusion of a VAT clause can operate to make a supply taxable when the supply is not inherently taxable but would only be taxable upon an express option on behalf of the landlord. Certainly a prudent landlord that wishes to opt to tax **should include a provision in the letting agreement that expressly states that the landlord will charge VAT on the rent (not merely that he can charge VAT)**. This can be incorporated into a general VAT clause or be a stand-alone provision of the agreement.

- Landlord should know the VAT history and development of his property.
 - A commercial lease might contain an obligation for the tenant to **advise the landlord** of the details of any development works (for VAT purposes) carried out during the tenancy, and their cost.
- Refurbishments by a tenant can be contentious in lease clauses.
- A tenant, to ensure no VAT costs on a surrender, should seek to include a clause obliging the landlord to take over any tenant's refurbishment. On the other hand, a landlord should not buy into any such obligation, and attendant risk, and should not agree to such a clause. A compromise clause may be the agreement of the landlord to look at such a takeover, if and when the situation arises.

- **Transfer of Business Relief**
 - If the sale of property would have been chargeable to VAT but for TOB – For the purposes of the capital goods scheme:
 - The vendor is treated as if it had made a supply chargeable to VAT
 - The purchaser is treated as if VAT had been charged on the acquisition
 - If the sale of the property would have been exempt from VAT but for TOB – For the purposes of the capital goods scheme:–
 - The purchaser steps into the shoes of the vendor for the purposes of the capital goods scheme
 - The vendor must hand over the appropriate capital goods records relating to the property to the purchaser
 - The purchaser then runs down the remainder of the capital goods adjustment period clock

TOB relief applies to the sale of all tenanted properties including properties that are partially tenanted or were previously tenanted. i.e.

- TOB relief applies to the sale of properties being sold subject to and with the benefit of, opted leases, un-opted leases, legacy leases, leases subject to a waiver of exemption, partially let properties with vacant units and vacant properties that were previously let on a continuing basis.
- TOB relief does not apply to the sale of a **vacant** property that was **not previously let**, e.g. the sale of a newly developed vacant property. TOB relief also applies where a property which has been let on a continuing basis is sold to a tenant who is an accountable person.
- TOB relief applies where a vacant property has been **used for the purposes of a business in the past** and has the necessary qualities and attributes to be used for a similar business again immediately after transfer.
- TOB relief applies to the transfer of a portfolio of distinct properties including some that are let or have been let on a continuous basis where the portfolio is being **sold in one lot** to the one purchaser. If the portfolio of properties is being divided and sold to more than one purchaser, as you would expect, each sale must be treated separately.

- The purchaser is **not necessarily required to be an accountable person in respect of the business being acquired** but must be an accountable person in some capacity. In the past it was understood that for TOB relief to apply the purchaser had to be an accountable person in respect of the business being acquired. Provided the purchaser has applied for a VAT registration number, even if it has not yet been received, the vendor may apply TOB relief.
- TOB relief cannot apply to the transfer of land or properties held as **trading stock**. However, as above with the let properties, TOB relief may apply where that stock has been exploited for the purposes of obtaining income on a continuous basis
- TOB continues to apply to the sale of a partnership/co-ownership interest. Revenue have been reviewing the VAT treatment of co-ownerships in the context of TOB relief and do not intend changing the VAT treatment in the foreseeable future.

- Long Leases – **pre July 2008**
 - Mary entered into a lease for her business – 30yrs, annual rent 300k. No valuation obtained – what is the vat?
 - Formula method – $(30 \times 75\% \times 300k) = 6.75M @ 13.5\% = 911,250$ OR
 - Multiplier method – $(21.27 \times 300k) = 6.381M @ 13.5\% = 861,435$
 - Lowest chosen (assuming no EVT) eg if site bought for 1M and developed for 5.5M – total 6.5M, then Formula method is the only option permitted
 - 4A/4B used to ease cashflow
- **POST JULY 2008**
 - 999yr (freehold equivalents)
 - Vat life – 20yrs
 - No 4A, no capitalisation, no EVT, no waiver of exemption
 - Option to Tax

- Mark buys property 10M plus vat in 2016, dev work 150k in 2017, sells 16M in 2018. Property is not 'new' again as dev works <25% of selling price of 16M
- John acq property 10M in 2018, lets it to a tenant for 8mths, vacant, then let again for 18mths, now up for sale – second sale since completion, property is <5yrs but is old , aggregate occupation of more than 24 mths
- NOTE – Residential properties – built by developers for sale remain 'vatable' until sold regardless of the 2 and 5 year rules

- Capital Goods Scheme
 - Completed properties – 20yr vat life, Refurbished properties – 10yr vat life
 - ‘vat life’ = ‘adjustment period’ where the owner reviews his usage of the capital good and make adjustments to the amount claimed at the outset
 - 100k vat claimed at the outset
 - End of yr1, 90% of vat recovery entitlement – 10k paid back to Revenue
- Big – Swing in taxable use
 - Software Ltd buys building 6M plus vat 810k, after 10 yrs it ceases software sales and starts training – 10/20 of 810k is paid back to Revenue as more than 50 percentage points move, 10 intervals still remain
- CGS records must be maintained

- CGS – Lettings
 - May 2008, Mary leased a newsagents premises. Term 25yrs, rent 200k pa. Market valuation 2M, she incurred 270k vat on the lease. Surrender lease in July 2017. What is vat due on legacy lease?
 - $T \times N/Y$,
 - $270,000 \times 12/20 = 162,000$
- Rent to Buy
 - Mr Builder builds houses, purchaser pays 5k up front, 800 per month rent for 2 years, option to buy during or at end of this 2yrs period. Mr Builder recovered 25k on each house.
 - Upfront payment 5k = grant of an option – inclusive of 13.5% vat, monthly 800 = vat exempt residential letting
 - For each interval (year) of the 20 years, 1/20 of the input vat of 25k is clawed back as it is put to an exempt letting
 - Purchaser doesn't exercise option, Mr builder sells to A N Other, vat applies

- Mike acquired new prop in 2012, reclaimed vat 1M, adj period = 20yrs. Used for taxable purposes, in 2019 sold it to his company. Property is 'old' ..parties agreed to 'opt to tax' (adj amount was 700k (13 out of 20 remaining plus 1) Value had declined, vat on sale 400k, Mike must pay 300k to Revenue.
- Mike can avoid this if his company steps into his shoes and take on a high vat value than it is actually paying for the property – connected party sale is disregarded for VAT purposes ensuring no new CGS begins at time of sale
- TOB continues to apply to the sale of a partnership/co-ownership interest. Revenue have been reviewing the VAT treatment of co-ownerships in the context of TOB relief and do not intend changing the VAT treatment in the foreseeable future.

- Sample invoices

ABC Limited
XXXXX
Co Dublin

To: XYZ Ltd
XXXXX
Co Limerick

Date: 10 July 2021

VAT Registration No: IE 1234567K

Invoice number: 51

Transfer of all lands comprised in Folio 1234L and Folio 4567L €3,000,000.00
VAT at 13.5% arising on a reverse charge basis €405,000

As the parties have exercised the option to tax the sale in accordance with Section 94(5) of the VAT Consolidation Act 2010. The Purchaser shall self-account to the Revenue Commissioners for the VAT arising in relation to the disposal in accordance with Section 94(6) of the VAT consolidation Act 2010.

Total Due €3,000,000.00

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Total Due €3,405,000.00

VAT Registration No: IE 1234567K

Invoice number: 51

- Surrender of lease Letter

VAT Act 2010 Section 95(9)(a)
[Please note this is not a VAT invoice]

Issued by: Surrenderor
Issued to: Surrenderee
Date: 11 June 2013
Property: XXX

This document is issued in accordance with Section 95(9) of the VAT Act 2010, in respect of the disposal of the interest of the Surrenderor under a lease dated X February 2007.

In accordance with the provisions of Section 95(8)(b) of the VAT Act 2010, the Surrenderee is required to self account for the VAT arising on the disposal of the lease as indicated below and the Surrenderor hereby confirms the following:

Amount of VAT to be accounted for on the surrender of the lease: €XX,XXX.

For the purposes of Section 95(9) of the VAT Act 2010, as amended, the Surrenderor hereby confirms that there are XX full intervals remaining in the adjustment period for the lease.

Signed

- CGA Record

Capital Goods Record

(Complete items 1 to 8 on acquisition/development of the capital good)

1. Owners name and address ()
2. Tax Number ()
3. Location of capital good ()
4. Description of capital good ()
5. The amount of the total tax incurred ()
6. The amount of the total tax incurred which is deductible ()
7. The date on which the adjustment period begins ()
8. The number of intervals in the adjustment period ()

(Complete items 9 to 12 after the Initial Interval)

9. The initial interval proportion or deductible use ()
10. The total reviewed deductible amount ()
11. The proportion of deductible use for each interval ()
12. Adjustment after initial interval ()

(Complete item 13 after Second Interval)

13. Adjustment after second interval ()

(Complete item 14 after Third Interval)

14. Adjustment after third interval ()

REPEAT 14 AS NESSECARY FOR SUBSEQUENT INTERVALS