Irish Tax Institute

Leaders in Tax

VAT - Falls in Property Values

Waiver-of-exemption Cancellation Deficit

The VAT waiver of exemption rules set out in Section 96 VAT Act provide for a "voluntary" cancellation of a waiver of exemption [Section 96(3)] or a "forced" cancellation of waiver of exemption [Section 96(12)] where a taxpayer ceases to hold any property covered by its waiver of exemption. In both cases, on cancellation of the waiver (voluntarily or forced), taxpayers are required to calculate the difference between (a) the amount of VAT recovered in respect of the property the subject of waiver and (b) the amount of any VAT charged on the short term letting of the property under the waiver, plus (as permitted per Revenue policy) any VAT arising on a subsequent sale of the "waived" property. Where (b) is less than (a) the difference is payable to Revenue as a "waiver deficit payment".

In a normal functioning property market, one would expect that where a property has been acquired, leased for a number of years and then sold, the VAT charged on lease and on sale of the property would exceed the VAT incurred on purchase of the property and there would be no waiver deficit. However, in today's market, where falls in the value of commercial property of 80% to 90% are not uncommon, there are bona fide property sales where significant "waiver cancellation deficits" are arising on sale of a property (even where VAT is charged on the sale), solely because of the fall in market values of the property. In many cases, rather than a voluntary cancellation of a waiver of exemption, the sales are forced upon a landlord for financial reasons triggering a "forced" waiver cancellation under Section 96(12).

In a case where VAT transfer of business relief applies, it has been Revenue practice to allow the remaining VAT capital goods scheme (CGS) value of the property to be taken into account in reducing the waiver deficit. However, this is still not sufficient in many cases and there is also no equivalent relief for sales of property in a non transfer of business context.

The old VAT on property system, and specifically the economic value test provisions per section 4(3)(A) VAT Act 1972 (as amended), contained reliefs designed to deal with an "unforeseen change in market conditions" affecting a fall in the market value of property. There is no equivalent relief under the new VAT on property system.

There is also a more fundamental objection about the ability of a Member State to use its right under Article 137.2 of the Recast VAT Directive to "lay down the detailed rules" (regarding a waiver of exemption), to introduce a concept that effectively seeks a retrospective adjustment of input VAT where the asset is, at all times, applied for VATable use (e.g. VATable rent or VATable sale). We find it very hard to see (absent cases of avoidance), that law being upheld before the ECJ.

We believe that, at a minimum, Irish VAT law should be changed so that where a waiver deficit arises solely by reason of a fall in MV, the taxpayer is not penalised. Consideration should also be given to whether Ireland had any right at all to impose a claw-back in a case where a property continues to be used for VAT taxable purpose (and where the transactions take place at arm's length).

Connected Party Sales

Section 64(8) (a) VAT Act provides for a VAT clawback where a property is sold with VAT to a connected party at a price which is less that the VATable cost of acquisition (and development) of the property to the seller. The amount payable is reduced by a time based formula to take account of the period that has elapsed since acquisition/development.

These rules were originally intended as a VAT anti-avoidance measure to deal with connected party sales occurring at below market value and were, we assume, intended to apply as an exception rather than as a general rule. However, in today's market these rules are applying as a general rule to many connected party sales which occur at market value.

This issue has dealt with to some degree by virtue of section 64(9) VAT Act under which where the purchaser can agree to "step into the shoes of the seller" and take responsibility for the remaining VAT capital goods scheme life of the property, thus avoiding the clawback for the transferor. However, in order to avoid a VAT clawback for the transferor, the transferee, who may (because of market conditions) have paid a significantly lower market value price, becomes burdened with the remaining capital goods scheme **"VAT value"** of the property, which is usually significantly higher than the actual VAT arising on sale of the property and in some cases even exceeds the value of the property itself.

A review of the general appropriateness of these rules in light of current market conditions is warranted.

Section 94(2) and Minor Development.

While not having as significant an impact as the waiver of exemption rules, the de-minimis rule in Section 94(2) should again, in light of today's market, be reviewed.

Section 94(2)(d) and (e) provide a de-minimis rule that "minor development" on an "old" property can be disregarded and does not have the effect of bringing the property back into the VAT net. Development is regarded as minor where (a) the cost of the development is less than 25% of the sale price of the property and (b) the development does not and is not intended to adapt the property for a materially altered use.

The 25% test does not take account of current market conditions, and development which previously would be regarded as minor when originally carried out on a property, can now be regarded as "significant development" (breaching the 25% test) bringing a property back into the VAT net solely because of the fall in market value of the property. This threshold needs to be reviewed.

Restricted Application of Joint Option for Taxation (section 94(5) VAT Act)

Where falls in property values apply in sale scenarios where a joint option for taxation is prohibited they can result in VAT costs which we would contend are inconsistent with basic VAT principles. The problem is that a capital goods scheme VAT liability could arise for an amount greater than VAT applicable to the market value of the property.

The first example is where a receiver, liquidator or mortgagee in possession sells a property to a party connected with the owner. Section 94(7)(d) VAT Act prohibits the application of a joint option for taxation. In some cases the position will be compounded as the purchaser may be engaged in taxable activities and would have some (perhaps full) VAT recovery entitlement if a joint option for taxation did apply to the sale.

The second example is where the purchaser is not a taxable person. A joint option for taxation is not possible as section 94(5) restricts its application to sales to taxable persons. This scenario is not likely to arise frequently but ITI members are aware of some cases. The cases involve properties which were originally used for business purposes and the purchasers converting them for use for residential purposes.

A simple remedy is to remove the restrictions.