



19% VAT imposed on building land

Chelco VAT experts, Alexis Tsielepis and Panayiotis Panayi analyse the long-overdue and what turned out to be unavoidable introduction of Value Added Tax (VAT) on the sale of building land and examine the 5 Ws of the Law: Who, What, Where, When and Why.

The Cyprus House of Representatives voted on 03/11/2017 a new VAT Law, namely 'Ο περί Φόρου Προστιθέμενης Αξίας (Τροποποιητικός) (Αρ.3) Νόμος του 2017', (hereinafter the 'amending law'), which amends the main VAT Law N.95(I)/2000, (hereinafter the 'main VAT Law').

It was published in the Official Gazette of the Republic of Cyprus on 13 November 2017 and will come into force on 2 January 2018.

The new law introduces VAT at the standard rate for the sale of building land and the leasing/rental of business premises as per the conditions included in the law. It also introduces the reverse charge mechanism for VATable supplies of land and property under a loan restructuring/force-sale arrangement, which will mostly impact financial institutions.

Impact

This new amending law introduces the following changes:

1. Building land is now subject to VAT at 19%

Cyprus eventually had to adhere to its obligations to subject the supply of building land to VAT. On its accession to the EU on 1 May 2004, Cyprus had received a derogation (Article 383 of the VAT Directive) to continue exempting building land until 31 December 2007. However, Cyprus failed to apply VAT on building land until the current amendment.

The amending law changes the Eighth Schedule of the main VAT Law to subject building land to VAT. Specifically, the supply of undeveloped building land intended for the erection of one or more fixed structures is subject to VAT at the standard rate of 19% when the supply is part of a person's economic activities.

Once again a number of questions remain unanswered, which is surprising to say the least given the importance of this amendment in the VAT legislation. For example, how is the term 'undeveloped building land intended for the erection of one or more fixed structures' to be defined? When does it NOT form part of a person's economic activities? More clarification is required. Such clarifications will come in the form of Regulations that as per the law can only be approved by the House of Representatives. Given that in most cases such processes are slow to come about, it may not be possible for legal certainty to be provided to businesses by 2 January 2018, especially at a time when the immovable property sector is seeing a significant recovery.



2. Leasing of commercial property for business purposes is now subject to VAT at 19%

Cyprus finally makes use of the option-to-tax afforded in Article 137(1)(d) of the VAT Directive, although rather bizarrely, it is an opt-out rather than an opt-in mechanism being introduced in the legislation.

Specifically, the amending law impacts the Eighth Schedule of the main VAT Law. It constitutes the rental/leasing of business premises (i.e. all properties other than residential properties) subject to VAT at the standard rate of 19% when it is a B2B transaction and the recipient is engaged in taxable activities.

The lessor will have the right to elect for such transactions to continue to be exempt under a procedure to be notified by the Commissioner but if this right is exercised it cannot be retracted at a later stage.

This provision is in force for agreements signed as of 13 November 2017, date on which the amending law was published to the Gazette. Only leases or rents entered into on or after the 13 November 2017 are affected.

This provision raises a number of questions which are not addressed in the main legislation, such as how the term 'engaged in taxable activities' is to be defined, who has the responsibility of auditing whether the recipient is engaged solely in taxable activities, what happens in cases where the activities include in a year exempt transactions without the right of deduction, and many other questions. We understand the Commissioner of Taxation is working on a Circular that will address many of these points. We urge the Commissioner to quickly release the Circular as the law is now already in force and without the clarifications no legal certainty can be attained by businesses.

3. VAT discharged under reverse charge in case of loan restructuring or forced transfer of property to lender

This provision was enacted in order to facilitate the payment of VAT in cases where the taxpayer is no longer in a sustainable financial position, with a bank having to take possession of the property which was held as a guarantee against the loans provided. In such cases, the bank would not effect a payment to the taxpayer but take ownership of the property. The taxpayer would still be supplying property to the bank and have to discharge VAT where this was due, but clearly would not be in a position to pay any VAT. For this purpose, the obligation to discharge the VAT in such situations is transferred to the recipient (being the bank), through this provision.

Specifically, the amending law introduces article 11D to the main VAT Law which imposes the reverse charge mechanism for transactions whereby ownership of new buildings or land subject to VAT, is transferred from the borrower to the lender as part of a loan restructuring or under forced transfer conditions. The provisions enacted go beyond what is permissible by the VAT Directive which through Article 199(1)(g) only permits the use of the reverse charge on the supply of immovable property sold by a judgment debtor in a compulsory sale procedure. However, the provisions are considered beneficial under the current climate that has seen the banking sector come through one of the worst periods in its history, following the 2013 banking crisis imposed on Cyprus by the EU.



The conditions for new article 11D to apply are:

- a. Taxable person supplies goods to recipient;
- b. Goods fall under the scope of para.(1) of article 11D (i.e. new buildings, building land intended for erection of one or more fixed structures);
- c. Recipient at the time of the supply is a taxable person acquiring the goods as part of its taxable activities.

When the above conditions are met, the recipient of the goods is obliged to apply the reverse charge mechanism and discharge the VAT due on the transaction as if it was its own supply. Always bear in mind that reverse charge is not an option but a downright obligation that determines which party discharges the VAT for a specific transaction.

This provision will come in force as of 2 January 2018 and will remain in force for a limited period of time, currently being until 31 December 2019.

Pending Issues

The VAT Authorities are expected to issue guidance soon to confirm various specifics and procedures of the new law. For example some of the questions to be answered are:

- How do we define when a seller is acting as a taxable person or not when selling land (i.e. one off sale of a building plot by an individual will be treated as economic activity and be subject to VAT)?
- How do we define non-developed building land?
- How do we prove intention of use for the land to be sold/purchased?
- What will be the procedure to elect to exempt rental income? What will be the case until such a procedure is put in place? Will a business be forced to VAT register and apply VAT until such an election is duly notified/approved by the Authorities?
- How does the landlord know and confirm whether their tenant engages in taxable activities? What is the responsibility of each party and what happens in case the activities of the tenant change in the future?
- What happens to the input VAT incurred for properties that will now be rented out and the rent will be VATable? Will the current rules for recovery of input VAT prior to registration apply (i.e. 6 months for services, 3 years for goods)?

As the property development and management industries are huge contributors to the Cyprus economy, the ripple effects of this new amendment to the VAT Law will surely impact many businesses and investments across the island. Although, there are still things that need to be confirmed and details to be ironed out, we have a good picture of what will happen and we can start assessing the potential impact on your business.

Make sure you get your VAT right before the Authorities do it for you, to avoid unnecessary penalties, costs and administrative burden. Chelco VAT is here to help.



NOTE

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