

Information Sheet No. 71

Imposition of VAT on building land and on rental income
Introduction

On 3 November 2017 the House of Representatives approved an amendment to the Cyprus VAT Law N.95(I)/2000, which was published in the Official Gazette on 13 November 2017, regarding the imposition of VAT at the standard rate of 19% on the following supplies:

- Sale of undeveloped building land by persons who exercise economic activities (effective as of 2 January 2018)
- Leasing or rental of immovable property for business purposes (effective as of 13 November 2017)

In addition, the use of the reverse charge mechanism is now extended for transfers of land and buildings (before first use) which are made within the scope of loan restructurings or foreclosures.

1. Supply of undeveloped building land

As of 2 January 2018, the sale of **undeveloped building land** by a person, intended for the erection of one or more fixed structures, is subject to VAT at the standard rate of 19%, when the supply is carried out **as part of that person's economic activities**.

Subsequently to the amendment of the legislation, the Commissioner issued regulations for the purpose of clarifying what constitutes "**undeveloped building land**". As per the regulations, the definition is wide and essentially covers the majority of land, including plots, land which resembles plots, land outside of development areas but with a planning or building permit for large or special types of development (e.g. casinos, golf courses), new plots created due to land reclamation, etc. The definition specifically excludes plots in livestock zones or in areas not intended for development (e.g. environmental protection, archaeological or agricultural).

In addition, the Commissioner has issued an Interpretative Circular which provides guidance as to the definition of "**economic activity**". According to the Circular, this is taken to mean any economic activity that is exercised independently and in any place, regardless of the intended purpose or the outcome of such activity. This includes all activities of producers, merchants, service providers, miners, farmers, freelancers, as well as the exploitation of tangible or intangible property for the purpose of generating income of a lasting nature.

To determine whether an economic activity is being carried out, it is necessary to assess whether the activity is a serious occupation or a systematically practiced and actively pursued profession, whether it is measurable in terms of quantity and value, whether it is carried out based on sound business principles and practices, etc.

The Circular further clarifies that an **isolated transaction**, without evidence to suggest an intention to exercise a business on a continuous basis, shall not be considered as economic activity. An example of an isolated transaction, as provided by the Circular, is the sale of inherited land by an individual once every seven to ten years.

Moreover, the fact that the profits from the sale of land are subject to Income Tax or Capital



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Gains Tax (as the case may be) is not relevant for determining whether a transaction constitutes an economic activity.

The Circular also clarifies that in case where **the transferor is a company** and the land being disposed is included in the assets of the company, then the disposal will always be considered a VAT taxable supply by default, irrespective of the nature of the activities carried out by the company.

Finally, it is noted that any transfers concluded prior to 2 January 2018, or for which a sale contract was filed with the Department of Lands and Surveys or with the Tax Commissioner prior to 2 January 2018, are excluded from the imposition of VAT. In such cases, any payments made as consideration after 2 January 2018 are exempt from VAT.

2. Leasing of commercial property

As of 13 November 2017, the leasing/ rental of immovable property to a **taxable person** for the purpose of carrying out **taxable business activities** is subject to VAT at the standard rate of 19%, with the exception of buildings used for residential purposes.

The Commissioner issued an Interpretative Circular for the purpose of providing clarity as to the application of the legislation. According to the Circular, VAT is imposed only on new contracts, concluded from 13 November 2017 onwards. Any contracts concluded prior to that date will continue to be exempt from VAT, unless they are cancelled and replaced by new ones. Contracts with automatic renewal clauses, or which provide for automatic increase of the rental amount, are not considered to be new contracts for this purpose and as such will continue to be exempt from VAT.

Taxable person

A lessee will be considered a taxable person, provided that his taxable supplies constitute at least 90% of his total supplies. Otherwise, the lease/ rental payment will be exempt from VAT. Upon signing of the relevant contract, the lessor is obliged to obtain evidence and to verify the lessee's status in this respect. The lessor's obligation is limited only to the time of signing of the contract, and he is not obliged to continuously monitor the lessee's status after that.

In cases where the lessee is a pure holding company, then the lease/ rental is exempt from VAT, since such companies are not considered to be carrying out taxable business activities and thus they do not have the right to register for VAT.

Right to exempt

The obligation to charge VAT applies only for lessors who are themselves taxable persons and are registered under the normal VAT regime (making taxable supplies in excess of €15,600).

Notwithstanding this, a lessor may elect not to impose VAT on a particular lease, by submitting form TD1220 with the Commissioner within 10 days from the signing of the lease agreement. The option can be exercised either for the entire property, or for a functional part of it. The election is irrevocable and cannot be amended at a later date. However, if there is a subsequent change in the ownership of the property, the new owner may decide whether to impose VAT or not.



Taxable business activities

The term “taxable business activities” is not explicitly defined in the VAT legislation, but they should be taken to mean any transactions that are not considered as exempt under the VAT Law or that are not outside the scope of the VAT Law.

Right of lessor to claim input VAT

Where a lease agreement is subject to VAT, the lessor has the right to claim input VAT that was incurred on the construction/ acquisition and maintenance of the building. In such cases, the input VAT is adjustable over a ten-year period commencing either from the date when the building was constructed/ acquired or when it was put into first use (whichever is the earliest, and depending on the VAT status of the lessor at that time) and can be claimed on a pro-rata basis for the years remaining until completion of the aforementioned 10-year period.

3. Reverse charge mechanism

As of 2 January 2018 and up to 31 December 2019, the reverse charge mechanism applies on transfers of ownership of undeveloped building land or new buildings (before first use), where such transfers are made by one taxable person (the seller) to another taxable person (the recipient), and where such transfers occur within the scope of loan restructurings or foreclosures.

In such cases, the seller of the property (i.e. the borrower) would not be able to account for the relevant VAT, for obvious reasons. Thus, the legislation has been amended so as to effectively transfer this obligation to the recipient of the property (i.e. the lender), who will need to account for the VAT under the reverse charge mechanism. The recipient (lender) would then be able to claim the VAT back.

NOTES:

The above is intended to provide a brief guide only. It is essential that appropriate professional advice is obtained. P.G. Economides & Co Ltd will be glad to assist you in this respect. Please do not hesitate to contact us.

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