

# Study on the application of Value Added Tax to the property sector

Executive summary and Country overviews

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# Introduction

This binder contains the Executive summary, conclusions and recommendations and 15 Country Overviews. These documents are part of the Study on the application of Value Added Tax to the property sector. This study was performed, following a public invitation, for the European Commission.

The Executive summary, conclusions and recommendations is the concluding chapter of the Final Report of the above-mentioned study. The Country Overviews give a brief description of the national taxation systems applicable to the property sector in order to get an understanding of and a first insight into national situations. The country overviews therefore provide for brief explanations (headlines) of the background, (recent) changes, main principles, complexity, problems, distortions and possible changes to the VAT treatment of construction, land and property in each of the European Member States. We note that the Executive Summary and Country Overviews form an integral part of the report issued and must therefore be read in this context.

The study is carried out by consultants of Arthur Andersen in the EU Member States, with the office in Amsterdam acting as the co-ordinating office. It is inevitable that this survey was only possible with a joint effort of members of the Indirect Tax Group and Real Estate Services Group located in the various EU Member States. The Study is based on the legislation in force in December 1997.

**ARTHUR  
ANDERSEN**

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## Introduction

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# Executive summary, conclusions and recommendations

## **1 EXECUTIVE SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

Below we include an executive summary of the final report. Furthermore, we summarise the most important conclusions and recommendations of the final report chapter by chapter. In this respect we note the following. Any change to the VAT treatment of property transactions may affect a large number of different parties, commercial and private. As the introduction of a new regime will inevitably favour some businesses more than others, we feel that it is important to manage the switch as carefully to minimise disruption and to enable company budgets to be prepared with a degree of certainty. Furthermore, any changes to VAT on property need to show consideration for business planning. This means that an open approach with a long time frame for implementation is required. Moreover, we advise any new rules to accompany transitional provisions. While this may cause a rush of VAT planning measures, the effect of such steps cannot continue indefinitely.

### ***1.1 Chapter I: Definition of Immovable Property***

#### *1.1.1 Executive summary*

Although the term immovable property is used in the Sixth Council Directive, it does not include a definition. However, from the Sixth Council Directive can be derived that certain items qualify as immovable property. In general, land and structures fixed to or in the ground qualify as immovable property in every Member State.

#### *1.1.2 Conclusions and recommendations*

Immovable property transactions are in most Member States based on concepts employed in the national (civil) laws. The application of the origin principle causes (additional) difficulties because of the different concepts employed in the national laws.

In order to achieve a more uniform approach, we prefer to draft legislation by means of regulations instead of directives. Moreover, inequalities between Member States will be reduced if terms used in the regulations are defined precisely.

With regard to immovable property transactions this means that terms as immovable property, accommodation in the hotel sector, permanently installed equipment, right in rem, lease, etc. may not longer be interpreted from a Civil Law perspective, but it is preferable to give a definition in the VAT regulation.

In this respect we advice to develop a clear definition of the terms immovable property, building, land and building land into the VAT legislation.

## **1.2 Chapter II: Taxable Person**

### *1.2.1 Executive summary*

In all Member States the general definition of "taxable person" is in principle in line with Article 4 Sixth Council Directive. Also, the exploitation (i.e. letting and leasing, exploitation of rights in rem) of immovable property for the purpose of obtaining income therefrom on a continuing basis qualifies the person as a taxable person in every Member States. Two Member States require the exploitation to result in taxable supplies.

With regard to occasional transactions a distinction has been drawn. In all Member States a person qualifies in principle as a taxable person when he supplies immovable property which attributes to his business on an occasional basis in the course or furtherance of his business besides his regular activities. However, Article 4(3) Sixth Council Directive only refers to the situation where a person supplies immovable property on an occasional basis. From this perspective seven Member States (Belgium, Denmark, Finland, France, Luxembourg, Portugal and Spain) implemented Article 4(3) Sixth Council Directive.

In seven Member States (Austria, Denmark, Finland, Germany, Ireland, Netherlands and the UK) two persons or more can be treated as a single taxable person for VAT purposes if these persons are closely bound to another by financial, economic and organisational links. Most of these Member States do not tax internal (immovable property) transactions from one member of the single taxable person to another.

Public bodies may qualify as a taxable person for activities or transactions in which they do not engage as a public authority in all Member States excluding Ireland<sup>1</sup>. However, not in all Member States public bodies are considered to be a taxable person with regard to the letting and leasing of immovable property.

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<sup>1</sup> We refer to paragraph II.5.2.2. Public bodies may be qualified as taxable person by order, however no order has been made to date.

In respect of the supply of immovable property a distinction has been drawn between the supply of "newly constructed" buildings, the supply of "old" buildings, the supply of building land and the supply of land other than building land. Between the Member States there is variety in considering public bodies as taxable person in respect of each of such supplies.

### 1.2.2 *Conclusions and recommendations*

#### Occasional transactions

To get a neutrality of VAT within the EU we prefer that Member States treat as a taxable person anyone who carries out on an occasional basis supplies of immovable property. However, only the following supplies will affect the neutrality of VAT.

1. The supply of residential buildings, or parts thereof, and the land on which they stand, before first occupation.
2. The supply of buildings, other than residential buildings, or parts thereof, and the land on which they stand, until the adjustment period for (immovable) capital goods has expired.
3. The supply of building land.

Therefore, Member States may limit to treat as a taxable person any person who carries out on an occasional basis one of the above-mentioned transactions.

To limit the persons who have to VAT register and file VAT returns occasionally, the notary for instance can act as a fiscal representative on behalf of any person who qualifies as a taxable person with respect to occasional transactions.

## 1.3 *Chapter III: Taxable Transactions*

### 1.3.1 *Executive summary*

Article 5 and 6 Sixth Council Directive make a distinction between a supply of goods and a supply of services.

In 13 Member States (with the exception of Ireland and the UK) a supply of goods means the transfer of the right to dispose of tangible property as owner. The transfer of a freehold interest and the transfer of economic ownership are the most important immovable property transactions. In several Member States other transactions (for example: the transfer of rights in rem, leasing) may qualify as a supply of goods.

In Ireland and the UK certain interests in immovable property are

considered to be tangible property. In eight Member States rights in rem giving the holder thereof a right of user over immovable property are considered to be tangible property. In four Member States shares or interests equivalent to shares giving the holder thereof de jure or de facto rights of ownership or possession over immovable property are considered to be tangible property.

In eight Member States the handing over of works of construction may qualify as a supply of goods.

A great complexity arises when it is not entirely clear-cut whether what is being supplied is a service or a good. Differences in classification could give rise to discrepancies as regards the exemptions, the taxable amount, the time at which the charge to tax arises, the rate of tax and the rules for collection.

### 1.3.2 *Conclusions and recommendations*

#### **1.3.2.1 Rights in rem**

We agree with the approach that transactions concerning rights in rem (giving the holder thereof a right of user over immovable property) involves the transfer of the right to dispose of the property as owner. However, in most Member States not only the transfer of a right in rem is considered to be a supply of goods but also the establishment, assignment, alteration and cession of rights in rem. To avoid inequalities between the Member States, it seems in our view preferable to introduce a list of transactions to be treated as a supply of goods.

Rights in rem (giving the holder thereof a right of user over immovable property) should be considered to be tangible property. To avoid inequalities between the Member States, a list of rights in rem, giving the holder thereof a right of user over immovable property, should be introduced.

However, the most practical solution to harmonise the system would be not to consider as tangible property rights in rem, giving the holder thereof the right of user over immovable property. As a result, transactions concerning rights in rem are considered to be the supply of services (i.e. the letting and leasing of immovable property). This means that VAT due can be spread over the whole duration of the contract and does not need to be paid as soon as the supply occurs. This will not lead to a distortion of competition or other problems if the treatment of the supply of immovable property on the one hand and the letting and leasing of immovable property on the other is homogeneous.

#### **1.3.2.2 Interests in immovable property**

In our view interests in immovable property are only considered to be a supply of goods in one of the following two situations.

1. The lease qualifies as a finance leasing contract. This is the case if immovable property is handed over, pursuant to a contract for the use of the property for a specified period, usually with no possibility to unilateral termination by the user. The user has at the end of the contract the option of purchasing the property or to continue the lease contract. The price to be paid for exercising the option is a nominal amount bearing no relation to the economic value of the property at the time of the exercise of the option.
2. The creation of an interest is considered to be the transfer of economic ownership.

### **1.3.2.3 Immovable property shares**

To avoid unjustified planning opportunities, shares or interests equivalent to shares giving the holder thereof de jure or de facto rights of ownership or possession over immovable property or part thereof may be treated as tangible property to avoid different tax regimes on a transaction which leads to the same economic results. However, this will only apply in very rare cases where there is an undeniable relationship between the sale of shares and the immovable property in question.

### **1.3.2.4 Works of construction**

In case of contract work it is frequently not entirely clear-cut whether what is being supplied is a service or a good. Although a list of operations would be very helpful to classify construction works as a supply of goods, such a list may run into difficulties because of the different concepts employed in national laws. Therefore, the most practical solution to harmonise the system is in our view to treat construction activities as the supply of a service. However, special measures are needed, such as adjustment rules on services and the Danish system as mentioned in paragraph X.7.5.2.1.

### **1.3.2.5 Self supplies**

The self supply rule has been introduced to counter perceived VAT avoidance. There are two different types of self supplies.

- A. Self supply of construction services.
- B. 'Developers' self supply (including the redevelopment of existing buildings).

The 'developers' self supply, especially in case of the redevelopment of

existing buildings, may lead to a complexity of the applicable provisions. In our view the 'developers' self supply can be phased out if the following two conditions are fulfilled.

1. The supply of building land is taxed in an early stage.
2. The adjustment rules on (immovable) capital goods apply to certain construction services.

## **1.4 Chapter IV: Place of Taxable Transactions**

### *1.4.1 Executive summary*

In accordance with Article 8(1)(b) Sixth Council Directive, in all Member States, the place of supply of immovable property is the place where the immovable property is situated.

In all Member States the place of supply of services connected with immovable property, as referred to in Article 9(2)(a) Sixth Council Directive, is the place where the property is situated.

In general there are three problem areas in respect of the place where immovable property transactions are subject to VAT.

1. Foreign entrepreneurs who perform immovable property transactions in another Member State may have a liability to VAT register in this Member State.
2. Difficulties for the tax authorities in ensuring that foreign suppliers register and remit VAT in respect of services connected with immovable property.
3. Defining the concept of services connected with immovable property. Differences in VAT treatment between Member States may cause distortions.

### *1.4.2 Conclusions and recommendations*

If the origin-principle will be introduced for immovable property transactions the following has to be taken into account.

1. Immovable property can not be dispatched from one Member State to another.
2. Immovable property transactions are subject to a real estate transfer tax, a stamp duty or a similar tax in the country where the immovable property is situated.
3. The different concepts in national (civil) law.

With respect to immovable property transactions, the origin principle can

in our view only be realised if the VAT rates and the other VAT rules are completely harmonised. Because of the major impact, complete harmonisation will be difficult to realise. Moreover, the necessity of transitional provisions for existing buildings may have a negative impact on the introduction of the origin principle. Therefore, it may be preferable to retain the situs principle for immovable property transactions. One of the disadvantages of the situs principle is VAT registration in more than one EU Member State if an investor owns immovable property in more than one Member State. However, in this respect we note that foreign investors normally make use of local offices which fulfil the administrative obligations in the country where the immovable property is situated. Such a local office is also liable for filing the VAT returns, etc. In our view the origin principle may create administrative disadvantages as the necessary administration will be kept by the local office in the country where the immovable property is situated, but the transactions are subject to VAT in the country where the supplier (foreign investor) is VAT registered.

To avoid double taxation as a result of differences in classification of services connected with immovable property a list of operations would be very helpful (we refer to **IV.5 ANALYSIS**)

## **1.5 Chapter V: The Supply Of Immovable Property**

### *1.5.1 Executive summary*

The supply of "newly constructed" buildings and of the land on which they stand is taxed in eight Member States. The supply of "old" buildings and of the land on which they stand is only taxed in France, Ireland and Italy. The supply of building land is taxed in four Member States. The supply of land which has not been built on other than building land is exempt from VAT in all Member States. Six Member States allowed taxpayers a right of option for taxation with respect to the supply of immovable property.

In Finland, Greece, Austria, Denmark and Sweden the supply of immovable property is always exempt from VAT. Only in Greece no special provisions have been introduced to avoid cumulation of VAT.

1.5.2 *Conclusions and recommendations*

**1.5.2.1 Definition of building**

In our view building can include any permanent structure fixed to or in the ground. Besides 'real' buildings such as houses, office buildings or barns, the term building should also include bridges, tunnels, roads, viaducts, locks, squares, artificial grass field and athletics tracts, etc.

To create certainty a clear definition of the term building is preferable. To avoid inequalities between the Member States a list of structures would be very helpful.

**1.5.2.2 Supply of buildings**

1.5.2.2.1 PRIVATE DWELLINGS FOR RESIDENTIAL PURPOSES

We suggest to tax any supply before first occupation of private dwellings for residential purposes, or parts thereof, and the land on which they stand.

To avoid inequalities between the Member States the following has to be indicated:

1. When is a "newly constructed" private dwelling for residential purposes, or part thereof, occupied?
2. What is meant by part of a private dwelling for residential purposes?

1.5.2.2.2 "NEWLY CONSTRUCTED" COMMERCIAL BUILDINGS

We recommend to tax by virtue of law the following supplies of "commercial" buildings, or parts thereof, and the land on which they stand:

1. Any supply before first occupation.
2. The first supply after first occupation during a period of X years (for example: two years) elapsing between the date of first occupation and the date of first supply after first occupation.

To avoid tax abuse between (un)connected parties, the following three anti-abuse provisions can be introduced if the recipient is not entitled to deduct input VAT fully and the consideration paid is too low in relation to the investment costs.

1. Minimum taxable amount.
2. Limitation of input VAT deduction on investment costs.
3. Levying of a real estate transfer tax, a stamp duty or a similar tax.

To avoid inequalities between the Member States we suggest to indicate the following:

1. When is a “newly constructed” commercial building, or part thereof, occupied?
2. What is meant by part of a commercial building?

Member States may not determine the conditions of application of the criterion of “newly constructed” buildings to transformation of buildings.

#### 1.5.2.2.3 COMMERCIAL BUILDINGS, WHICH ARE NOT “NEWLY CONSTRUCTED”

The supply of buildings, or part thereof, and the land on which they stand, which are not “newly constructed” (“old” buildings) is exempt from VAT. To avoid cumulation of VAT with respect to the supply of “old” buildings within the adjustment period, special measures have to be introduced. As the option to tax mechanism may create a higher VAT burden, a very complex regulation and “overkill” effects, we recommend to revoke Article 13C(b) Sixth Council Directive in so far it concerns the transactions covered in (g) and (h). We prefer the introduction of the Austrian/French or the Danish system, or a combination thereof.

### 1.5.2.3 The supply of land

#### 1.5.2.3.1 DEFINITION OF (BUILDING) LAND

One criterion of land is that it has not been built on. Therefore, the following does not qualify as (building) land.

1. Land on which an incomplete building stands.
2. Land on which a building for demolition stands.

We recommend not to tax the supply of land as land is neither consumed nor produced. However, we advise to tax by virtue of law the supply of building land, as building land is more valuable if it is prepared for construction or if it has been officially designated or zoned for building purpose or if such building has been legally authorised pursuant to a building permit.

The European Court of Justice decided that the Member States themselves have to define what constitutes building land (Case C-468/93, Gemeente Emmen). To create certainty a clear definition is necessary. In our view physical improvements combined with an objective criterion (i.e. the presence of a building permit) is desirable to determine whether or not land, which has not been built on, is considered to be building land. Firstly, to avoid cumulation of VAT if physical improvements are already made although at the moment of supply of the land a building permit has not been granted. Secondly, as a result of the presence of the building permit, the question whether or not a plot of land has been improved does not need to be answered in a number of cases. This combined approach is in accordance with the wording of Article 4(3)(b) Sixth Council Directive.

## **1.6 Chapter VI: Letting And Leasing Of Immovable Property**

### *1.6.1 Executive summary*

According to the main rule the letting and leasing of immovable property is exempt from VAT. Letting and leasing is defined as the supply by the lessor to the lessee with the right to use immovable property (or parts thereof), during a given period and at a certain consideration. As an exception to the main rule, all Member States subject to VAT the providing of accommodation in the hotel sector, the letting and leasing of sites for parking and the hire of safes. The letting and leasing of permanently installed equipment is taxable in all Member States except for Denmark. Denmark exempts the letting or leasing of permanently installed equipment and machinery as an integrated part of the immovable property, which is as main rule exempt from VAT in Denmark.

11 Member States apply further exclusions to the scope of the exempt letting and leasing of immovable property. 11 Member States allow taxpayers a right of option for taxation in cases of the letting and leasing of immovable property, which would otherwise be exempt from VAT. Subsequently ten Member States restrict the right of option.

For example, the restriction in France is that the option only applies in case of the letting of unfurnished buildings used for business purposes.

The letting and leasing of private dwellings is generally exempt from VAT, however, in four Member States the letting of private dwellings can be subject to VAT. With respect to the letting and leasing of commercial buildings, there are in general three different VAT regimes. These different regimes are as follows: always taxable, always exempt or option to tax.

Member States have the right to waive the exemption of letting and leasing of immovable property. In principle, the option to tax has two purposes.

1. To avoid any cumulation of VAT with regard to the lease in the commercial, industrial and professional sector.
2. To avoid distortion of competition between traders buying immovable property and traders renting immovable property.

In most Member States which allow an option to tax the option can be revoked voluntarily, however in some Member States a revocation is only possible after a certain period of time.

In most Member States some formalities, such as filing an application, have to be fulfilled for the application of the option to tax mechanism.

## 1.6.2 *Conclusions and recommendations*

### 1.6.2.1 **Definition of letting and leasing of immovable property**

To create certainty a clear definition of letting and leasing of immovable property is necessary. In our view the term letting and leasing means that the lessor supplies the lessee with the right to use immovable property (or parts thereof) during a given period and at a certain consideration. The term letting and leasing includes the following.

1. Tenant surrendered his lease and returned the immovable property to his immediate landlord.
2. The letting by the hour of courts in a sports complex, including the use of changing rooms, toilet and washing facilities, the cafeteria (depending on the decision of the ECJ in the case "Happy Sports").

### **1.6.2.2 The letting and leasing of immovable property**

We recommend to exempt from VAT the letting and leasing of private dwellings for residential purposes. If the letting and leasing of immovable property is taxed the following problems may arise.

1. A higher administrative burden as the number of persons liable to VAT will increase.
2. A higher lease price.

We suggest to tax by virtue of law the letting and leasing of commercial buildings (i.e. buildings other than buildings used for residential purposes) to taxable persons, who are entitled to a 100% input VAT deduction.

Exempt letting and leasing of commercial buildings does not create a neutral situation between owners and lessees, who are wholly or partly entitled to deduct input VAT incurred. To avoid these inequalities the option to tax mechanism has been implemented. The option to tax is unique as the parties involved (and not the government or the tax authorities) decide on the VAT liability of a transaction. Because of this flexibility, the option is one of the most favoured aspects of the current system. However, where the building is rented via a related lessor, the lease price can be kept very low in relation to the investment costs (tax abuse). Therefore, special measures have to be introduced to avoid tax abuse. In our view (a combination of) the following measures can be taken to avoid tax abuse.

- A. VAT avoidance mechanism.
- B. Minimum taxable amount.
- C. Minimum lease price.
- D. The lessee should be entitled to deduct input VAT for X% or more.
- E. Extension of the adjustment period.
- F. Single taxable person between related lessor and lessee.
- G. The lessor has a limited right to deduct input VAT.

## **1.7 Chapter VII: Chargeable Event And Moment Of Chargeability**

### *1.7.1 Executive summary*

Article 10 Sixth Council Directive describes the chargeable event and the moment when tax becomes chargeable. In all Member States the chargeable event generally occurs and the tax generally becomes chargeable when goods are delivered.

The moment goods are delivered normally is when the right to dispose of tangible property as owner is transferred.

Some Member States consider the supply of interests in immovable property, rights in rem over immovable property and shares giving the holder rights of ownership over immovable property as supply of tangible property. For these supplies the chargeable event is indicated. 13 Member States also consider hire purchase and sale of goods on deferred terms in respect of immovable property as a supply of goods. The letting and leasing may qualify as a supply of services. In that case the chargeable event occurs each time a payment is received or an invoice is issued, whichever is the earlier. However, in some Member States the leasing of immovable property may qualify as a supply of goods. Among these latter Member States different moments of chargeability may exist. By way of derogation from the general provisions, some Member States have provided that tax becomes chargeable at deviating moments. This may be no later than the issue of the invoice or the document serving as invoice, no later than the receipt of the price, or within a specified period from the date of the chargeable event where an invoice (or document serving as invoice) has not been issued.

#### *1.7.2 Conclusions and recommendations*

The questions may arise when VAT should become chargeable in case of a supply of goods or a supply of services, which give rise to successive payments (for example: leasing contract, hire purchase, sale of goods on deferred terms, rights in rem). If the immovable property transaction qualifies as a supply of goods, we recommend that VAT is chargeable as soon as the supply occurs. If the immovable property transaction qualifies as a supply of services, the chargeable event can be spread over the whole duration of the contract.

### **1.8 Chapter VIII: Taxable Amount**

#### *1.8.1 Executive summary*

In general, in all Member States the taxable amount is based on the total consideration received including subsidies, or contributions from other parties, directly linked to the price of supplies of goods and services. The taxable amount also includes all taxes, commissions, costs and charges and incidental expenses charged by the supplier to the purchaser or customer, but excludes the VAT chargeable. However, the amounts received as repayment for expenses paid out in the name and for account of the purchaser or customer, and which are entered in the books of the supplier in a suspense account, are not included in the taxable amount.

In France and Belgium additional rules apply. In Belgium, Greece, Ireland and The Netherlands VAT legislation contains special rules regarding the taxable amount of rights in rem or other interests in immovable property. France introduced a special provision with regard to immovable property shares.

In all Member States, the hire purchase or the sale of goods on deferred terms qualifies as a supply of goods. In this respect it is important to note whether the interest paid constitutes the consideration for a VAT exempt financial activity. In Austria, Denmark, Finland, Greece and Sweden the supply of immovable property is exempt from VAT without the possibility to opt to tax. Therefore, from a VAT point of view it is not relevant whether or not the finance costs are included in the taxable amount in case of immovable property transactions.

In 13 Member States finance costs as a result of late payment are not included in the taxable amount. Only in France and Greece finance costs, which are directly linked to a taxable transaction, are taxable under the same regime as the underlying transaction. In ten Member States (Belgium, France, Germany, Ireland, Italy, Luxembourg, The Netherlands, Portugal, Spain and the UK) interest charged for a deferred payment until the moment of actual delivery is to be included in the taxable amount. As a result, the interest paid does not constitute the consideration for a (exempt) financial service. In the other five Member States (Austria, Denmark, Finland, Greece and Sweden) the supply of immovable property is exempt from VAT without the possibility to opt to tax. Therefore, from a VAT point of view it is not relevant whether or not the finance costs are included in the taxable amount in case of immovable property transactions.

In respect of private use and self supplies of goods, the purchase price of the goods or of similar goods or, in the absence of a purchase price, the cost price, determined at the time of supply shall be the taxable amount. This may lead to a distortion of competition if the cost price is lower than the open market value. In seven Member States (Denmark, Greece, Ireland, Italy, Luxembourg, The Netherlands and Spain) the taxable amount can be based on other criteria.

Only in Belgium the open market value is used as the taxable amount in the case of a self supply of services. In Denmark, Greece, France, Ireland, Sweden and the UK the taxable amount is based on the cost price.

### 1.8.2 *Conclusions and recommendations*

In principle, we advice to base the taxable amount on the consideration paid. However, as anti-abuse provision with respect to the supply of “newly constructed” buildings, the supply of building land and the letting and leasing of immovable property a minimum taxable amount, based on the cost price or the open market value, may be introduced.

## **1.9 Chapter IX: VAT Rates**

### **1.9.1 Executive summary**

The standard rate of VAT is fixed as a percentage of the taxable amount and is the same for the supply of goods and the supply of services. The standard rate varies among the Member States. Under certain conditions Member States may introduce reduced rates. 7 Member States implemented a reduced rate for the supply, construction, renovation and alteration of housing, as part of a social policy. A reduced rate for accommodation provided by hotels and similar establishments including the provision of holiday accommodation and the letting and leasing of camping sites and caravan parks may also be implemented. 12 Member States implemented such a reduced rate. 5 Member States implemented other reduced rates applicable in connection with immovable property. Differences in VAT rates among the Member States for certain supplies may cause distortions of competition if the origin principle is introduced.

### **1.9.2 Conclusions and recommendations**

#### **1.9.2.1 Reduced rate on social housing**

The question arises whether the application of a reduced rate on the supply, construction, renovation and alteration of housing provided as part of social policy is the most effective way to support low incomes. Perhaps, a direct subsidy by the government to the low incomes is more effective.

If a reduced rate is implemented, we recommend to define the concept of what constitutes social policy (and therefore the scope of any reduced rate). If the origin principle is not implemented with respect to immovable property transactions, Member States can apply reduced rates according to local social needs and market conditions.

#### **1.9.2.2 Reduced rate on accommodation**

Member States have the freedom to define the concept of the provision of accommodation in the hotel sector. To avoid inequalities between the Member States a definition of the provision of accommodation in the hotel sector (or in sectors with a similar function) can be given.

## **1.10 Chapter X: Deduction Of Input VAT**

According to the Sixth Council Directive the Member States have to grant the right to a deduction or a refund of VAT insofar the economic activities are carried out in another country. All Member States grant the taxable person a right to a deduction of input VAT insofar as the economic activity is carried out in another country, provided that the taxable person would be eligible for deduction of input VAT if the economic activity had occurred in the concerning Member State. This condition may lead to differences when the economic activity is exempt with the right to opt to tax. This is especially the case when immovable property, situated in another country, is supplied or leased. In only twelve Member States a right to a deduction of input VAT is granted to a taxable person who has established his business in another Member State insofar it concerns immovable property transactions (see figure X-1).

All Member States implemented the principle of immediate deduction. Nine Member States give refund of VAT in case the amount of authorised deductions exceeds the amount of VAT due for a given period. The main rule in the other Member States is a carry forward system.

Member States may, for cyclical economic reasons, totally or partly exclude all or some capital goods or other goods from the system of deductions. Until May 8, 1997 Italy excluded the right of input VAT deduction for investments in immovable property by a real estate management company. By circular letter of May 8, 1997 the Italian Ministry changed its position.

#### *Pro rata deduction*

Goods and services to be used both for transactions in respect of which VAT is deductible, and for transactions in respect of which VAT is not deductible, only such proportion of the VAT shall be deductible as is attributable to the former transactions (pro rata deduction). Based on Article 19 Sixth Council Directive there are several methods to calculate the pro rata deduction, for example:

1. the general pro rata apportionment;
2. a direct attribution to business sectors;
3. the actual use of goods and services; or
4. a combination of these methods

In all Member States the pro rata calculation is based on one or more of the above mentioned methods. In 12 Member States the turnover attributable to the supplies of immovable property is excluded from the pro rata calculation, provided that these turnovers are only of an auxiliary nature.

Ireland has no legislative provisions to exclude occasional immovable property turnover from the pro rata calculation. However, in practice agreement can be obtained from the Revenue Commissioners if the calculation results in a distortion. Finland and Germany do not base the pro rata calculation on turnover but on actual use.

#### *Adjustment of initial deduction on capital goods*

If the initial deduction is incorrect in relation to the ultimate use of the goods and services for which the deduction was claimed, the initial deduction shall be adjusted. In case of immovable capital goods, adjustment is spread over a period of five years including that in which the goods were acquired or manufactured. Member States may base the adjustment on a period of five full years starting from the time at which the goods are first used. The annual adjustment shall only be made in respect of one-fifth of the VAT imposed on the goods. The adjustment period can be extended up to 20 years.

The capital good scheme has been introduced in 13 Member States. There is no capital good scheme, as described in Article 20(2) Sixth Council Directive, in Finland and Ireland. The Sixth Council Directive has not defined the concept of (immovable) capital goods. With respect to the 13 Member States it is of importance what is meant with the concept of immovable capital goods. In general land and structures fixed to or in the ground, such as buildings, roads and bridges qualify as immovable capital goods. To this main rule some exceptions apply. In nine Member States works of construction may also qualify as immovable capital goods. In Germany and The Netherlands rights (in rem) over immovable property are considered to be immovable capital goods.

Member States are free to define the concept of capital goods (Article 20(4) Sixth Council Directive). However, this solution has created inequalities between the Member States.

The adjustment period can be spread over a period of five years but can be extended up to 20 years. Member States may base the adjustment period over the following two periods:

1. A period of five years (extended up to 20 years) including the year in which the goods were acquired or manufactured.
2. A period of five full years (extended up to 20 years) starting from the time at which the goods are first used.

In 13 Member States a supply of immovable property during the adjustment period may lead to adjustment of the initial input VAT deduction. If so, the adjustment shall be made only once for the whole period of adjustment still to be covered.

## 1.10.2 *Conclusions and recommendations*

### **1.10.2.1 Immovable property transactions carried out in another country**

Article 17(3) Sixth Council Directive (transactions carried out in another country) has been implemented differently in various Member States. This may create a distortion of competition.

### **1.10.2.2 Time of refund**

Immovable property transactions may result in cash flow problems if it takes some time before the VAT paid is refunded to the purchaser. This could mean that the purchaser has to borrow additional funds from banks to cover the VAT amount. To avoid this cash flow problem a reverse charge mechanism can be introduced. The merit of a reverse charge mechanism is that a fully taxable purchaser suffers no cash flow cost on the purchase of immovable property.

### **1.10.2.3 Exclusion of deduction for capital goods**

A general exclusion of deduction for capital goods is in our view undesirable as this will lead to cumulation of VAT. However, the introduction of a limitation of input VAT as anti-abuse provision might be considered. However, as a result of Case 50/87 (Commission versus France), a new anti-abuse provision may be necessary.

### **1.10.2.4 Adjustment of initial deduction on immovable capital goods**

A harmonised adjustment period is necessary to avoid inequalities between the Member States. As anti-abuse provision one can suggest to oblige Member States to extend the adjustment period up to 20 years for (immovable) capital goods.

In our view an adjustment period of 20 full years starting from the time at which the goods are first used is more in accordance with economic reality than a period of 20 years including the year in which the goods were acquired or manufactured.

#### **1.10.2.5 Supply of immovable property during the adjustment period**

An exempt supply of immovable property during the adjustment period may lead to cumulation of VAT if no special measures are introduced. The option to tax mechanism is not the most effective way to prevent cumulation of VAT. The option to tax mechanism may create a higher VAT burden, “overkill” effects and a very complex regulation. To avoid cumulation of VAT, we suggest to introduce the Austrian/French system (additional invoice of the adjusted VAT) or the Danish system (waiver of the adjustment VAT).

#### **1.10.2.6 The concept of (immovable) capital good**

To create certainty the concept of capital goods must be harmonised. In our view (immovable) capital good includes:

1. Land which has not been built on.
2. Buildings.
3. Certain works of construction, with the exception of repair and day-to-day maintenance.

#### **1.10.2.7 Waiver of capital goods scheme**

If the application of the capital adjustment scheme is foregone, the taxable person recovery rate may not fairly reflect the allocation of goods to taxable/non-taxable use. Therefore, we recommend to revoke Article 20 (5) Sixth Council Directive.

### **1.11 Chapter XI: Persons Liable For Payment Of VAT**

#### *1.11.1 Executive summary*

According to the main rule of the Sixth Council Directive, the supplier is liable to pay the VAT. In case the supplier is resident abroad Member States may adopt arrangements whereby the VAT is payable by another person. By way of derogation of the Sixth Council Directive, several Member States were authorised to introduce a reverse charge mechanism. 5 Member States implemented a specific reverse charge mechanism for immovable property transactions.

### 1.11.2 *Conclusions and recommendations*

The purchase of immovable property may create a cash flow problem if it takes some time before the VAT paid is refunded. To avoid the cash flow problem we suggest to introduce a reverse charge mechanism. The merit of a reverse charge mechanism is that a fully taxable purchaser suffers no cash flow loss on costs on the purchase of immovable property.

To avoid that foreign entrepreneurs should VAT register in the country where the immovable property is situated a reverse charge mechanism or a similar provision can be introduced.

## 1.12 *Chapter XII: Other Taxes*

### 1.12.1 *Executive summary, conclusions and recommendations*

In all Member States immovable property transactions are also subject to a real estate transfer tax, a stamp duty or a similar tax. If the supply of immovable property is taxed by virtue of law a double taxation exists if the acquisition of this immovable property is also subject to a real estate transfer tax, a stamp duty or a similar tax. As a result, further taxation can be withheld in cases where VAT is payable on the supply of immovable property. Moreover, the levying of a real estate transfer tax, a stamp duty, or a similar tax may negatively effect the following transactions.

1. The transfer of “newly constructed” buildings and building land from one member of a single taxable person to another.
2. The transfer of “newly constructed” buildings and building land as part of the transfer of a going concern.

To avoid these negative effects, we recommend to exempt the acquisition from a real estate transfer tax, a stamp duty or a similar tax when the immovable property is transferred from one member of the single taxable person to another if an exemption would apply if a single taxable person did not exist. A similar provision can be implemented if the immovable property is part of a going concern.

If the supply of an “old” building takes place within the adjustment period for immovable capital goods, the transferor is normally obliged to pay back to the tax authorities part of the initial VAT on the purchase price. We indicated several options to avoid cumulation of VAT. In our view the adjustment VAT may not be included in the taxable amount for real estate tax purposes insofar the recipient is entitled to deduct this adjusted VAT incurred.

# Country Overviews

The main purpose of the country overviews is to give a brief description of the national taxation systems applicable to the property sector to get an understanding of and insight into the national situations. The country overviews therefore provide for brief explanations of the background, (recent) changes, main principles, complexity, problems, distortions and possible changes to the VAT treatment of construction, land and property in each of the European Member States. The overviews form an integral part of the report and must thus be read in the context of the report.

In alphabetical order the national systems of the European Member States are described.

<b>Country</b>		<b>Country</b>	
1	Austria	9	Italy
2	Belgium	10	Luxembourg
3	Denmark	11	The Netherlands
4	Finland	12	Portugal
5	France	13	Spain
6	Germany	14	Sweden
7	Greece	15	United Kingdom
8	Ireland		

# Austria

## IMMOVABLE PROPERTY

The Austrian VAT Act does not contain a definition of real estate or immovable property. The tax exemption in section 6 relates to real estate in the meaning of section 2 of the Real Estate Transfer Tax Act. The Real Estate Transfer Tax Act relates to real estate in the meaning of the Civil Code. Within the scope of the Civil Code, land will mean a part of the surface of the earth and qualifies as immovable property. Buildings are considered as part of the land. Consequently, it is in principle not possible to dispose of buildings (e.g. to sell buildings) without the land on which they are built. Real estate („Grundstück“) therefore means land and buildings.

Only in case of rights in rem (so the right of superficies or building licenses), the building (or the building license) will be considered as a separate asset and can therefore be sold or rented without the land on which it is built.

## VALUE ADDED TAX (“Umsatzsteuer“)

### Background

Until the year 1971 a gross turnover tax system applied in Austria. With the VAT Act 1972 a VAT system applied for the first time. The legislation intended to avoid the disadvantages of a gross turnover system. Consequently, all transactions between entrepreneurs are in principle tax neutral, so that only final customers are burdened with VAT.

The basic definitions such as taxable turnover, taxable persons, entrepreneurs, input VAT deduction, etc. are still in force. Therefore, a lot of Court decisions, ministerial decrees and papers in tax reviews are still of importance.

Since sales of real estate are subject to real estate acquisition tax (real estate transfer tax), these sales have been tax exempt for VAT purposes in order to avoid double taxation. As the exemption is a so-called fictitious exemption, it is not allowed to deduct input VAT and deducted input VAT has to be adjusted. Since the non-deductibility of input VAT meant a big disadvantage compared to the advantage of the tax exempt turnover, the provision was abolished by decision of the Constitutional Court (see below).

In order to implement the provisions of the Sixth Council Directive, a new VAT Act has been in force since January 1, 1995 (VAT Act 1994). With regard to immovable property, the basic definitions, the tax exemption for sales, the provisions concerning non-deductibility, the adjustment of input VAT and the possibility to invoice adjusted input VAT have not been changed.

However, the provision regarding letting and leasing of immovable property has been changed. According to the main rule, the letting and leasing of immovable property is exempt from VAT. The exemption is an exemption without credit. In order to avoid distortions of competition, a right to opt for VAT taxable lease has been implemented. Based on a provision in the treaty of accession, the reduced VAT rate of 10% is applicable to every provision with reference to tenancy agreements (except the letting of garages and the delivery of energy).

### **Main principles**

#### **Taxable turnover (paragraph 1)**

Paragraph 1 Umsatzsteuergesetz 1994 (UStG 1994), i.e. Value Added Tax Act 1994 describes the turnover which is basically taxable to VAT. According to paragraph 1 (1) Z 1 the supply of goods and the supply of services is taxable, if the supply is performed by an entrepreneur (see paragraph 2) in Austria against payment within the scope of his establishment (enterprise). The turnover is even taxable, where the turnover is performed by legislation or by order of the authorities.

Furthermore, the application by an entrepreneur is considered as taxable turnover, when the entrepreneur uses goods or services, which have been in use for business purposes, for private purposes. This legislation seems to be similar to article 5 paragraph 6 of the Sixth EU-Directive. So-called self supply rules do not apply under the Austrian legislation.

#### **Entrepreneur (paragraph 2)**

As mentioned above, described activities are only taxable if they are performed by an entrepreneur. An entrepreneur is a person who performs business work independently. All different types of business (establishment) are considered as one enterprise for VAT purposes. The entrepreneur has to act regularly. This means that a person who occasionally performs work will not be considered as an entrepreneur. A person who rents only one apartment to another person and performing no other services, is considered as an entrepreneur for VAT purposes.

However, note that activities which are not expected to create profit in the long run, do not qualify a person as entrepreneur for VAT purposes. This means that these persons are obliged to repay deducted input VAT. To simplify the consideration, a Directive has been issued by the Ministry

of Finance (so-called „Liebhaberei-Verordnung“). This Directive states that the entrepreneur can be obliged to repay deducted input VAT in case of permanent losses in case the activities are a closely connected to the private sphere of the entrepreneur..

Austria has implemented article 4(4) Sixth Council Directive in its national legislation, by which two persons or more can be treated as a single taxable person for VAT purposes. The internal transaction is considered to be outside scope of VAT.

Public entities qualify as VAT entrepreneur if they perform business activities. The letting and leasing of immovable properties by public entities is under the Austrian VAT act considered a business activity.

### Supply of goods (paragraph 3)

According to the Austrian VAT act, the transfer of the economical ownership is a taxable supply . In case the supplier supplies goods and services uno actu (e.g. constructional work), the transaction is basically considered as supply of goods. Only if the main focus of the turnover is the supply of services and the entrepreneur uses goods only as auxiliary material, the whole turnover will be considered as supply of services and not as supply of goods (e.g. construction firm to maintain the roof of the house and uses some new bricks and some nails).

### Supply of services (paragraph 3a)

All activities, which do not qualify as a supply of goods, are considered to be a supply of services under the definition of paragraph 3a UStG. The establishment and transfer of a right in rem are in principle qualified as a supply of services. Only in connection with the right of superficies (including building licenses) it is not quite sure, whether the relating activities are treated as a supply of goods or a supply of services. However, this does not really matter because the place at which the chargeable event takes place is quite the same and the tax exemptions (see below) refer to other definitions for rights in rem.

A supply of services relating to immovable property is performed at the place where the relating real estate is situated. Consequently, if a building or land is leased, the leasing takes place at the real estate location.

## Tax exemptions (paragraph 6)

The former mentioned turnover is basically taxable but may be exempt under the regime of paragraph 6. For turnover in connection with immovable property all the exemptions are so called fictitious exemptions. This means that the turnover is tax exempt and the entrepreneur is not allowed to deduct input VAT or is obliged to adjust deducted input VAT when performing the exempt turnover. According to paragraph 6 (1) Z 9 lit a) UStG all turnover of immovable property is tax exempt. The legislation refers to the definition of immovable property in paragraph 2 Real Estate Transfer Tax Act. According to the Real Estate Transfer Tax Act immovable property means land, buildings on the land owned by a third party which are deemed to remain for a longer period of time on this land, so-called building licenses (this means the right to erect and have a building owned by a third party).

With regard to paragraph 12 the entrepreneur is not allowed to deduct input VAT when performing a tax exempt turnover as described. E.g., if a company acquires land (without VAT) and constructs a building on this land by ordering a constructor (the constructing firm will charge 20% VAT for their work) and the company sells the land and the building after finishing the construction work, no VAT deduction is allowed.

In case the company uses the building for taxable activities, it is allowed to deduct the input VAT but it will have to adjust this deductible VAT according to paragraph 12 (10) UStG, if the usage changes in tax exempt turnover (sale) within 10 years. Thus, the tax exemption led to distortions of competition because the disadvantage of the non-deductibility or adjustment of input VAT was often much higher than the advantage of a tax exemption of the turnover. As a consequence, the Constitutional Court abolished the mentioned legislation. The abolished part of the legislation has been implemented into the VAT Act without any changing, but in addition a new section (paragraph 12 (14)) has been implemented. Paragraph 12 (14) allows the entrepreneur to invoice not deducted or adjusted input VAT to the purchaser who is allowed to deduct this amount as input VAT (for problems and distortions see below adjustment of input VAT).

If an entrepreneur decides to use his business building for private purposes the application is treated as basically taxable turnover but is exempt under paragraph 6 (1) Z 9 lit a) UStG.

The leasing and letting of immovable property is basically tax exempt under paragraph 6 (1) Z 16 UStG. However, there are a number of exceptions to this main rule.

A. By virtue of law

1. leasing and letting of accommodation;
2. leasing and letting of machines being part of a plant or factory, even if they are linked to the real estate;

3. leasing or letting of hotel rooms;
4. leasing or letting of space or garage for vehicles;
5. leasing for camping purposes.

#### B. By virtue of option

Since the supply of services (leasing or letting) is basically tax exempt, no input VAT deduction is allowed or deducted VAT has to be adjusted.

To avoid distortions of competition, paragraph 6 (2) has been implemented into the VAT Act, which grants an option to the entrepreneur to treat the tax exempt turnover as taxable. This means that the turnover is taxable at the normal rate of 20% and the entrepreneur is allowed to deduct VAT or does not have to adjust deducted VAT.

The entrepreneur is allowed to opt for taxation for each building or apartment or land he is leasing or letting. The entrepreneur can opt independently; co-operation from the lessee is not required. In addition, he is allowed to opt whenever he wants to do so. So he can switch between taxable and tax exempt turnover as often as he wants. If he decides to treat the turnover tax exempt the adjustment rules apply.

In addition, please note that the activities of taxable persons, who do not generate turnover, that exceeds ATS 300,000 a year, are basically tax exempt (paragraph 6 (1) Z 27). However, the entrepreneur is allowed to opt for taxation. This option is binding for a period of at least 5 years and does only apply, when a written form sheet is sent to the financial authorities.

#### Tax rates (paragraph 10)

The normal tax rate is 20%.

The tax rate for the supply of services which are not tax exempt under paragraph 6 (1) Z 16 UStG (see above) is 10%.

#### Deduction of input VAT (paragraph 12)

The entrepreneur is allowed to deduct input VAT that is invoiced by another entrepreneur on an invoice, which meets the requirements of paragraph 11 UstG, for the supply of goods and services, that are performed in Austria for business purposes.

Basically, the supply of goods and services is considered to be performed for the establishment (enterprise) of the entrepreneur, if they occur for business purposes of the entrepreneur.

However, if the supplies are not used for business purposes of the entrepreneur at a rate of minimum 10%, the goods and services are not considered to be used for business purposes of the entrepreneur and therefore the entrepreneur is not entitled to deduct the paid input VAT at all. The minimum 10% rate is considered to be corresponding to article 27 of the Sixth Council Directive (simplification).

However, for an immovable property transaction an exceptional rule is applicable. The supply of goods and services is considered to be performed for the establishment (enterprise) of the entrepreneur in so far as the relating costs are treated as allowances under the Income Tax Act. Assuming that the building is used for 60% for business purposes and 40% for private purposes. The costs will under income tax point of view be deductible at a rate of 60%. From a VAT point of view, the building will also be considered to be used for business activities at a rate of 60%. At this rate input VAT can therefore be deducted. Please note that if the building is used for less than 20% for business purposes no deduction under income tax point of view is possible. The whole building will not be considered as used for business purposes of the entrepreneur.

Please note that if immovable property is used for private purposes, it does not entitle the entrepreneur to deduct input VAT. In case the entrepreneur later decides to use the same immovable property solely for business purposes, the entrepreneur is not allowed to deduct or adjust the input VAT paid. Thus, the prior use for private purposes will lead to a distortion of competition since input VAT, which is not recoverable would however have been deductible if the immovable property was from the beginning used for business purposes.

Paragraph 12 (10) to (13) UStG provides legislation concerning the adjustment of deducted VAT. Especially in the case that immovable property has been used for taxable turnover, but is now used for tax exempt turnover, the adjustment rules apply.

The adjustment period amounts 10 years from the time that the immovable property is first put into use. The adjustment period ends 9 calendar years following the year of first use. The basis for adjustment with regard to immovable property is 10% of the initial deducted input VAT per year. For other assets, the adjustment period is 5 years, subsequently 20% per year.

Example: A company acquires a building, deducts VAT at an amount of 100 and uses the building for their own business purposes (the company performs taxable turnover) for a period of 3 years. Commencing the fourth year the building is used for leasing or letting (tax exempt) and a company does not opt.

Consequences: In the years 4-10 deducted input VAT has to be repaid at an amount of 10 per year.

If the company sells the building after 3 years (tax exemption paragraph

6 (1) Z 9 lit a) UStG) then it is clear that the building cannot be used for taxable turnover in the future by this entrepreneur. Therefore, the whole remaining VAT (70%) is to be repaid.

As mentioned above, this tax exemption was very problematical since distortions of the competition could not be avoided. In comparison to letting and leasing, the Austrian VAT act did not implement a taxable supply with respect to the sale of immovable property. In that case paragraph 12 (14) UStG applies. The seller is allowed to invoice the adjusted VAT (70) to the purchaser. The invoiced VAT is considered as part of the purchase price (and therefore triggers real estate transfer tax). The seller does not treat the turnover as taxable but only invoices the adjusted VAT to the purchaser. The purchaser is basically allowed to deduct this amount (70) as input VAT. Distortions of competition can be hereby avoided because all the adjusted VAT is deductible if the purchaser is basically allowed to deduct input VAT (this means that he performs taxable turnover). Thus, the purchaser is only burdened with the adjusted VAT if he is not allowed to deduct VAT.

The adjustment of deducted input VAT may lead to distortions because of the period of 10 years. After 10 years a lessee who is tax exempt may receive tax exempt rental payments and the lessor is not obliged to adjust deducted input VAT. On the other hand, an extension of the period to 20 years as provided by Article 20(3) of the Sixth Council Directive would not really solve the problem (after 20 years the same situation will apply) but would have very negative impacts. Of course it is very difficult to adjust input VAT which has been deducted 20 years ago.

#### Reverse charge (paragraph 19)

The reverse charge system only applies for the supply of services which are mentioned under paragraph 3a (9) and (10) UStG. Since the supply of services in connection with immovable property is mentioned in paragraph 3a (6) UStG (as described above) the reverse charge system cannot apply for services performed in connection with immovable property.

### **OTHER TAXES ON IMMOVABLE PROPERTY**

#### **Real estate transfer tax ("Grunderwerbsteuer")**

Real estate transfer tax is levied on the transfer of immovable property. According to a definition in paragraph 2 the tax is levied on land, buildings (which are considered as part of the land according to civil law) and the right of superficies including building licenses.

The tax is also triggered if only the economical ownership is transferred.

Real estate transfer tax is calculated on the purchase price (consideration) at a rate of 3.5%.

In addition, the unification of 100% of shares of a company, which holds real estate or the transfer of 100% of the shares in such company is subject to real estate transfer tax. In this case the basis for the transfer tax is the assessed (standard) value of the transferred real estate.

Please note that real estate, which is subject to real estate transfer tax is tax exempt for VAT-purposes according to paragraph 6 (1) Z 9 lit a) UStG.

### **Inheritance and gift tax ("Erbschafts- und Schenkungssteuer")**

If real estate is transferred on death by means of inheritance, deeds and wills, lifetime gifts, tied gifts etc., the transaction is subject to inheritance and gift tax. The rate arises from 2% to 60% depending both on the value of the inheritance or the gift and on the relationship of the beneficiary to the deceased or the donator.

Please note that transactions being subject to inheritance and gift tax are basically tax exempt for real estate transfer tax purposes.

### **Stamp duties ("Gebührengesetz")**

Rental agreements concerning immovable property are basically subject to 1% stamp duty (paragraph 33 no. 5 Stamp Duty Act). Where the contract has been concluded for a definite period of time the rental payments for that time are chargeable amounts.

If the contract is concluded for an indefinite period of time the chargeable amount is the amount of rental payments for 3 years.

Please note that only a rental agreement in writing triggers stamp duty.

### **Share transfer tax ("Börsenumsatzsteuer")**

If shares in a company (which owns real estate) are transferred, share transfer tax will be attracted. The rate is 0.15% for shares in a joint stock company, 2.5% for shares in a limited liability company and also for the interest of a limited partner in a limited partnership. The tax depends on the value of the transfer shares.

### **Real property tax and land value duty (“Grundsteuer” and “Bodenwertabgabe”)**

Real estate is subject to real property tax (land tax) at a rate of approximately 0.8%. The tax is levied on the assessed (standard) value.

Undeveloped land, of which the assessed (standard) value exceeds OS 200,000, is subject to land value duty at a rate of 1% of the assessed value.

Please note that these two taxes are property taxes and not transfer taxes.

### **PROBLEM AREAS AND DISTORTIONS OF COMPETITION**

#### **Entrepreneur**

As mentioned above a person whose business is not expected to create profit in the long run is not considered as entrepreneur for VAT purposes. According to decrees issued by the Ministry of Finance the leasing or renting of an apartment is considered as linked to the private sphere. The same applies if an entrepreneur leases three different apartments in three different houses. Where the entrepreneur leases three apartments in one house the activity will not be considered as linked to the private sphere. As you see these treatments are somewhat peculiar. Of course it is difficult to foresee which consequences will apply when renting accommodation under the VAT point of view. Additionally, the Administrative Court and the Constitutional Court recently published a couple of decisions with regard to the renting of immovable property. The Ministry of Finance de facto ignored parts of these decisions in their practical understanding but now informed that they would like to issue a new decree which should cover the new decisions of the Courts. However, this issue is rather problematically and can lead to distortions of competition.

#### **Fictitious tax exemption**

Where the company wants to use the building for taxable turnover it is allowed to deduct the input VAT but will have to adjust this deductible VAT according to paragraph 12 (10) UStG if the usage changes in tax exempt turnover (sale) within 10 years. Thus, the tax exemption led to distortions of competition because the disadvantage of the non-deductibility or adjustment of input VAT was often much higher than the advantage of a tax exemption of the turnover. As a consequence, the Constitutional Court abolished the mentioned legislation. The abolished part of the legislation has been implemented into the VAT Act without any changing but in addition, a new section (paragraph 12 (14)) has been implemented. Paragraph 12 (14) allows the entrepreneur to invoice not deducted or adjusted input VAT to the purchaser who is allowed to deduct this amount as input VAT.

### Input VAT deduction - business and private use

The deduction of input VAT in connection with immovable property is probably not in line with the Sixth Council Directive. If a building is used for business purposes and for private purposes only the parts of the costs, which will be considered as allowances under income tax point of view will be deductible with regard to input VAT.

Relating to the Sixth Council Directive all turnover, which is only used partly for business purposes of the entrepreneur would be considered as turnover for business purposes so that the entire input VAT can be deducted (see deduction of input VAT paragraph 2 and 3).

### Input VAT deduction - acquisition for private purposes

If immovable property is acquired for private purposes the entrepreneur is not entitled to deduct input VAT. Where the entrepreneur later decides to use the same real estate for business purposes, he is not allowed to deduct or adjust input VAT. Thus, the prior use for private purposes will lead to a distortion of competition since input VAT is finally non-deductible but would have been deductible if the real estate has been used for business purposes from the beginning.

### Fictitious exemptions (basic effects)

In case of taxable turnover the recipient of the turnover is (finally) burdened with VAT, if he is a consumer. In case of a fictitious tax exemption he is not burdened with VAT but will be burdened with input VAT which will be calculated as part of the price since the performing entrepreneur is not allowed to deduct VAT.

Thus, where the purchaser is a consumer he is finally burdened with VAT which is logical under the main purposes of VAT. On the other hand, where the purchaser performs tax exempt turnover he is not allowed to deduct VAT. This may lead to distortions of the competition but is only the consequence of a fictitious exemption where the exemption leads to the non-deductibility or adjustment of input VAT. However, the exemption may be an advantage for special relations e.g. leasing of immovable property (medical and health care, etc.). On the other hand, we feel that every fictitious exemption is very problematically under basic purposes and goals of the VAT Act. The neutrality of the tax between entrepreneurs and the treatment of the consumers as finally burdened persons is disturbed by every fictitious exemption. In addition, a tax exemption is quite more difficult to handle since the rules of input VAT deduction and adjustment have to be very complicated, especially in their practical application.

### Adjustment period

The adjustment of deducted input VAT may lead to distortions because of the period of 10 years. After 10 years a lessee who is tax exempt may receive tax exempt rental payments and the lessor is not obliged to adjust deducted input VAT. On the other hand, an extension of the period to 20 years as provided by the Directive would not really solve the problem (after 20 years the same situation will apply) but would have very negative impacts. Of course it is very difficult to adjust input VAT which has been deducted 20 years ago.

# Belgium

## IMMOVABLE PROPERTY

Neither the Belgian VAT Code nor the Royal Decrees of the Belgian VAT Code contain a definition of immovable property. As a result, only a factual definition - based on civil law - can be given.

Goods which are immovable by their nature (i.e. land) as well as buildings which are incorporated in the land on which they have been constructed are considered as immovable property. Also, movable property which is inseparably incorporated in immovable property becomes immovable property by its nature. The establishment and assignment of real rights on immovable property other than the legal ownership - i.e. usufruct, building right, easement and long lease - are also considered as the supply of immovable property.

Also, the Belgian VAT legislation does not provide a definition of what is to be understood by the notion "building". According to the administrative comments, each immovable property to which a notional income (*revenue cadastral - kadastraal inkomen*) of a building is attributed by the land registry qualifies as a building. Machinery and equipment are, however, excluded from the notion.

Difficulties may arise in practice in determining whether goods qualify as immovable property (e.g. the scope of "inseparably incorporated") or as a building (e.g. works of infrastructure).

## VALUE ADDED TAX ("Belasting over de toegevoegde waarde")

### Immovable property subject to VAT

Immovable property qualifies as a good for VAT purposes and therefore falls under the scope of VAT. However, a distinction should be made between land on the one hand and buildings on the other.

#### Land

Immovable property, thus including land qualifies as a good in the sense of the Belgian VAT Code. However, the supply of land is by virtue of law exempt from VAT. Similarly, works of infrastructure (sewerage, parking lots, etc.) do not qualify as a building for VAT purposes. Such supplies are considered to be a supply of land.

It should be noted that the notion "building land" is not defined under the Belgian VAT Code.

Also, no special provisions apply for building land, therefore the same VAT treatment is applicable as with respect to the supply of unimproved land.

### Buildings

Buildings qualify as goods for VAT purposes. Only the supply of buildings which qualify as "new" for VAT purposes are subject to VAT. Supplies of buildings that do not qualify as new, are exempt from VAT.

#### *"New" building*

A building qualifies as "new" until December 31 of the year following the year in which the first enrolment of the real estate prelevy (i.e. an immovable withholding tax) took place. In general, the real estate prelevy is enrolled for the first time the year after first occupation (which is in principle also the year in which a new notional income is attributed). If the enrolment of the real estate prelevy is postponed due to the application of an exemption for withholding taxes, the building remains new.

#### *"Renewed or transformed" buildings*

The notion of "new" buildings for VAT purposes covers not only newly constructed buildings; under certain conditions the renovation of an old building can also be created as a "new" building for VAT purposes. To qualify as such, the following conditions must be met:

- i. The renovation of the old building affects the essential elements (nature, structure, destination) of the building. In case of doubt, the VAT Administration accepts that the renovated building is considered as a "new" building for VAT purposes to the extent that the cost price of the renovation cost (VAT excluded) amounts to at least 60% of the sale value of the building (land excluded) after renovation. In a case where the works do not affect the essential elements, the completed building will not qualify as new. In the latter case, the cost price of the works is irrelevant.
- ii. The renovation work must result in a new notional income to be attributed to the building (which will normally be the case if the renovation or transformations affect the essential elements of the building).
- iii. The seller has to prove the scope of the renovation works (e.g. by means of a building permit issued by the municipal authorities).

## Main principles

### I. Supply of immovable property

A supply is the transfer of the right to dispose of a good (as defined in the Belgian VAT Code) as the legal owner.

However, the supply of immovable property is, as a general rule, exempt from VAT. Only the supply of a *new building*, is subject to VAT.

#### *Status of supplier*

Regarding the supply of new buildings, a distinction should be made between supplies made by professional constructors and by other VAT taxpayers or non-VAT taxpayers.

#### 1. The professional constructor

The VAT taxpayer whose *regular* economic activity consists of the construction or the acquisition of buildings with application of VAT in order to subsequently supply these buildings or rights in rem before the period during which the building is considered new, has expired, qualifies as a professional constructor.

The professional constructor has to apply VAT to all his transactions. For a professional constructor, the usual invoicing procedure as well as the usual rules with respect to the payment of the VAT due will apply (see below). Land, however, will never be subject to VAT.

#### 2. Other VAT taxpayers

The VAT taxpayer whose economic activity does not consist of the sale of immovable property but who have occasionally supplied a new building before the period during which the building is considered as new, has expired, does not qualify as a professional constructor for VAT purposes.

Although the VAT taxpayer subjects his regular transactions to VAT, he will have *to opt* for the application of VAT on the supply of the building involved. The “occasional” supplier of immovable property will have to issue a regular invoice for the supply of the new building with VAT. However, the supply cannot be reported in his regular VAT return; instead, he will have to file a *special* VAT return.

#### 3. Non-VAT taxpayers

This category includes all persons who do not qualify as VAT taxpayers (private individuals, passive holdings etc.) who supply a new building, other than in the framework of an economic activity, before the period during which the building is considered as new, has expired.

A non-VAT taxpayer has *to opt* for the application of VAT on the supply

of the buildings involved so that he will be granted the quality of an occasional VAT taxpayer for this transaction. Similarly to the occasional supplier - VAT taxable person (see above) - of immovable property, the non-VAT taxpayer will have to file a *special* VAT return in which this transaction is to be reported.

### Taxable basis

According to article 26 of the Belgian VAT Code, the VAT amount is computed on the total consideration which the supplier receives or should receive from the buyer or a third party, including subsidies when directly related to the sales price. All charges which are incumbent on the buyer are included.

The taxable basis for the supply of the new building may not be inferior to the normal (market) value of the building. This rule is included in the VAT Code to avoid tax evasion schemes consisting of undeclared payments and therefore on which no VAT is computed. The minimal taxable basis does not apply for other immovable transactions (immovable work, the establishment and assignment of real rights) than the supply of new buildings.

If the supply relates to the building as well as to the land on which the building has been constructed, the sales price is to be split between the value of the building (taking into account the minimal market value) on the one hand and the value of the land on the other hand.

### VAT deduction

The general rule with respect to the right to deduct the upstream VAT incurred is also applicable in the framework of immovable property transactions.

#### 1. Professional constructor

Each person whose economic activity consists of the regular supply of immovable property qualifies as regular VAT taxpayer, who destines the received supplies of goods and services for the purposes of his VAT taxable activity so that, in principle, all input VAT incurred relating to its taxable activity may be recovered (taking into account the general deduction limitation rules - e.g. VAT on restaurant and hotel costs, 50% of the VAT on cars etc.).

The professional constructor will recover the upstream VAT incurred through his VAT return.

However, provided that the professional constructor will, in principle, sell the building together with the land on which it stands, and that the sale of land is always VAT exempted, the professional constructor will qualify as mixed VAT taxpayer. Consequently, the right to recover the VAT incurred will be proportionally limited. By way of derogation, the professional constructor could opt to apply the actual use method to compute the recoverable VAT (based on a direct allocation of the VAT incurred).

## 2. Deduction of VAT for occasional VAT taxpayers

The VAT taxpayer whose economic activity does not consist of the supply of new buildings, as well as the non-VAT taxpayer, who opt to apply VAT on the sale of the new building, will be entitled to recover the VAT incurred on the costs which are *directly* related to the construction or the acquisition of the building.

Finally, and similarly to the professional constructor, if a part of land is sold together with the new building, the right to deduct the upstream VAT will be limited in proportion to the value of the land vis-à-vis the value of the new building. Also, the occasional VAT taxpayer could opt to apply the method of actual use.

Furthermore, the VAT taxpayer will only be entitled to offset the upstream VAT against the output VAT from the moment he submits the special “ad hoc” VAT return.

## 3. Adjustment of deduction of VAT on immovable property

If a VAT taxpayer constructs or acquires a building under the VAT regime and intends to use it as a business asset for his economic activity, the new building qualifies as capital good and he is entitled to immediately deduct the VAT incurred through his periodical return. However, for a professional constructor, a new building is considered as a part of his stock.

In principle, capital goods for which the upstream VAT has been recovered may be subject to an adjustment of the initial VAT amount recovered. The adjustment period varies from 5 years (for movable property) to 15 years for immovable property (for which the right to deduct the VAT has arisen after January 1, 1996 - previously, it was 10 years). The adjustment period starts on January 1 of the year in which the right to deduct the input VAT has arisen, irrespective of when the right of deduction actually arose during that year. Alternatively, the adjustment period can start on January 1 of the year in which the building is taken first into use.

If during the adjustment period, the factors on the basis of which the input VAT has initially been recovered, have changed, an adjustment of the VAT is to be carried out for the years of the adjustment period which have not yet expired. No adjustment is to be made if the transaction gives rise to a self supply (see below).

*Example*

The supply of a building in the 10th year is exempt from VAT as it is no longer qualified as new. Since the supply is no longer subject to VAT, the VAT taxpayer has to adjust the VAT deducted initially for 6/15th.

*Self supplies*

If a professional constructor does not sell the building within the period during which the building is considered as new, he will have to carry out a “self-supply”. This “self-supply” will take place, at the latest, at the moment the period during which the building is considered as new, expires. The VAT has to be paid on the self-supply. To the extent that the professional constructor makes use of the building in order to carry out VAT taxable transactions, he will be entitled to recover the VAT paid at the occasion of the self-supply.

II. Real rights on immovable property (establishment, assignment)

According to the Belgian VAT Code, the establishment and assignment of a real right on immovable property qualifies as supply of goods.

For the scope of VAT, the establishment and assignment of such rights is, as a general rule, VAT exempt. In order to be subject to VAT, some conditions have to be fulfilled cumulatively i.e. :

1. the building involved should be considered as new for VAT purposes;
2. the owner of the building who has established or assigned the rights should either be a professional constructor or an occasional VAT taxpayer (option for the application of VAT);
3. the beneficiary should be provided with right to use the building similar to that of an owner;
4. the new building involved should be located in Belgium.

Occasional VAT taxpayers can opt for a VAT taxable establishment, transfer etc. of the right in rem. The deduction of input VAT is in principle based on the price of the establishment or transfer of the right in rem in proportion to the development costs of the building.

### *Description of the real rights*

The following real rights are included :

1. Long lease;
2. Building right;
3. Usufruct;
4. Easement.

### *Status of the owner*

As for the sale of new buildings, a distinction should be made between two categories: the professional constructor and the occasional (optional) VAT taxpayer. We refer to our comments above on this matter.

### *Chargeable event*

As the establishment is considered to constitute a supply of goods, the VAT becomes due for the total amount, at the moment of supply. This implies that, although the party who has established the real right may only receive periodical payments from the beneficiary, the VAT is due immediately and has to be reported in the (special) VAT return relating to the period in which the real right has been established.

### *Taxable basis*

If the real right is granted for a limited period, the taxable base is composed of the annual consideration multiplied by the number of years of the contract. If the period is not defined, a *pro-fisco* value will be determined.

For real rights, no minimal taxable basis is provided in the Belgian VAT Code.

### *VAT deduction*

The general principles explained above are also applicable with respect to the establishment of real rights. As a result, the VAT incurred on the building can, in principle, be recovered by the person who has established the real right with VAT.

However, according the Belgian VAT Administration, the recovery should be limited to the basis of the proportion of the amount charged for the real right compared to the total sales value of the building.

Nevertheless, the full recovery is accepted if the total amount of the payments for the real rights is approximate to the sale value of the building (e.g. for the building right, 95 to 97.5% of the total sales value).

### *Self supplies*

According to a parliamentary question, if a professional constructor establishes a usufruct right which is still into force at the expire date of the period within which the building is considered as new for VAT purposes, the professional constructor is obliged to perform a “self-supply”. The VAT due on the self supply should be computed on the base of the bare legal title.

### III. Financial leasing of immovable property

The immovable financial lease is considered as a VAT taxable transaction to the extent that the conditions mentioned in article 44, § 3, 2, b of the Belgian VAT Code and in the Royal Decree no. 30 are fulfilled.

#### a) Conditions related to the building

- i. The leasing contract must relate to a *building* that qualifies as *new* for VAT purposes;
- ii. The lessor should have built, allowed to be built or acquired the building with VAT;
- iii. The building involved should be built or acquired in accordance with the specifications of the lessee;
- iv. The lessee should use the building in the scope of its VAT taxable activities.

#### b) Conditions related to the contract

- i. The contract may not transfer the legal title on the new building;
- ii. The contract may not in principle be terminated before the expire date;
- iii. The contract should give the lessee the option to buy the building involved at the expire date of the contract;
- iv. The total of the payments made by the lessee to the lessor should, at least, amount to the investment made by the lessor increased by additional costs as well as interests.

#### c) Conditions related to the lessor

The lessor should be a VAT taxpayer specialised in financial immovable leasing. However, the Belgian VAT Administration accepts that a tax payer qualifies as a VAT taxpayer specialised in immovable leasing if the VAT taxpayer is involved in one financial immovable leasing contract.

#### IV. Letting and (operational leasing) of immovable property

Letting and (operational) leasing of immovable property is exempt from VAT. Initially, the text of the 1993 Belgian VAT Code provided for the option to subject immovable letting to VAT, to be implemented by Royal Decree. This provision has however been abolished as of June 1994. As a result, immovable letting is always exempt from VAT in Belgium.

By virtue of law there are a number of exceptions to this main rule.

1. Provision of parking spaces for vehicles;
2. The provision of warehouse facilities (e.g. silos, oil tanks etc.);
3. Provision of accommodation in hotels, motels, the provision of camping places;
4. Hiring out of safes.

#### *Letting of immovable goods together with movable goods*

If immovable goods are let together with movable goods, the rental fee should be split as follows: the part of the rental fee relating to the letting of the immovable good will be exempt from VAT whereas the part of the rental fee relating to the letting of the movable goods will be subject to VAT. However, the letting of furnished rooms or apartments remains fully exempt from VAT.

#### *Ancillary services to immovable leasing*

The following are considered as ancillary services to the letting of immovable goods: air-conditioning, cleaning and maintenance of elevators and common parts, etc. If the ancillary services are rendered in the framework of a letting contract, they are, in principle, exempt from VAT. However, the VAT Administration accepts that the services involved are subject to VAT to the extent that the price is separately invoiced from the rental fee.

#### V. The assignment or the transfer of a right to exercise a professional activity

The assignment (or transfer) of the right to exercise a professional activity allows the beneficiary to exploit a (commercial) space (e.g. the right to sell products in a separate sales stand set up in a super market). Such assignment (or transfer) is from a VAT point of view subject to VAT. The right relates to the (non-exclusive) authorisation to exercise a professional activity as opposed to the granting of the *exclusive* right to use a building, which constitutes an immovable letting. The difference between the two situations should be based upon the factual circumstances as well as on the basis of the terms of the contract agreed upon by the parties.

This service is often used as an alternative for VAT exempt lease, as this service creates entitlement to deduct input VAT.

#### VI. Transfer of immovable property under a going concern

In principle, the sale of a new building qualifies as a supply of goods which is, in principle, subject to VAT. However, according to articles 11 and 18 § 3 of the Belgian VAT Code, the transfer, resulting from a transfer of a totality of goods or a branch of activity, is outside the scope of VAT to the extent that the transferee is a VAT taxpayer. The application of these provisions implies that the transferee is deemed to take over the position of the transferor (e.g. the adjustment period for the capital goods which are transferred continues for the transferee, etc.).

If a new building is part of the branch of activity or of the totality of goods that is transferred, the transfer of the building is also outside the scope of VAT on the basis of the above provisions. If the branch of activity or totality is transferred by a VAT taxpayer other than a professional constructor, the latter has to *opt* to transfer the new building under the procedure of article 11 of the Belgian VAT Code.

#### *Transformation works carried out on the building by the transferor*

Until recently, in the case of the transfer of a business activity if the transferor rented the building, the Belgian VAT Administration imposed the obligation on the transferor to adjust the VAT on the transformation works carried out in the building in which the transferor carried out his VAT taxable activity. The transformation works qualify as capital goods for the transferor.

According to the VAT Administration, the transformation works were incorporated in the building that was rented by the transferor (and which could therefore not be transferred to the transferee). Since the transferor transferred his business activity to a third party, his own business activity ceased. As a result, if the adjustment period of five years of transformation works had not yet expired, the transferor had to adjust the deduction of the input VAT incurred on the transformation works.

Based on several court decisions, the Belgian VAT Administration recently decided to no longer impose the obligation of the adjustment in the case set out above.

## VII. Construction work

Construction work qualifies as a VAT taxable service. Construction work is:

- the development, the renovation, the completion, the furnishing, the reparation, the maintaining, the cleaning and the demolishing, partly or in whole, of an immovable property;
- activities that consist of supplying movable property and attaching it in a way that it will obtain an immovable nature.

Construction work has a material nature. The development of a plan, supervision to construction works, etc. is not considered as construction work.

The applicable VAT rate is 21%. In the following situations, the reduced VAT rate is applicable:

- 12% for social housing provisions and small dwelling houses (of which the surface is less than 190 square metres);
- 6% for construction work to old dwelling houses and dwelling houses of disabled persons.

VAT is due by the supplier. However, with respect to construction work to immovable property, VAT is due by the recipient, if the recipient files a periodical VAT return.

## VIII. Person liable to pay VAT

In general, the VAT due on immovable transactions is to be paid towards the VAT authorities by the supplier.

However, article 20 of the RD no. 1 of the Belgian VAT provides that the Belgian VAT due on real estate work, is to be reported by the recipient, to the extent the latter is a VAT taxpayer who files periodical VAT returns. The recipient will have to report the VAT as VAT payable in his VAT return. The amount of VAT due will immediately be deductible in the same VAT return under the normal deduction rules. As a result, the invoice issued by the real estate worker should not mention VAT, but instead should make reference to the application of the above procedure.

## IX. VAT rates

The standard VAT rate in Belgium is 21%. For some immovable property transactions, reduced rates are applicable if a number of conditions are met : 12% (social housing, small private dwellings) and 6% (immovable work on old private dwellings, on private dwellings for handicapped people or for institutions for handicapped people).

## OTHER TAXES ON IMMOVABLE PROPERTY

### Registration rights (“Registratierechten”)

In principle, transactions regarding immovable property are subject to the proportional registration rights. Registration rights are indirect taxes which are imposed on a certain transaction, due to the registration of the document (notarial deed) in which the transaction is laid down. In principle all transactions are subject to registration duties (sale, letting, lease, establishment of a real right etc.).

However, to the extent that the transaction is subject to VAT, the transaction will in principle be exempt from the proportional registration right and only subject to the fixed registration right of BEF 1,000.

It should be noted that registration rights are not recoverable (except in the case of resale within 2 years - recovery of 3/5th) and therefore represents an actual cost for the buyer. Special computation rules exist for the taxable basis.

The following rates apply :

1. transfer of legal title	12.5%
2. usufruct	12.5%
3. easement	12.5%
4. contribution against shares	0.5%
5. lease, rent, building right and long lease	0.2%

Other reduced rates may apply for the sale of small dwellings (6%), social housing (6%), etc.

## PROBLEM AREAS AND DISTORTIONS OF COMPETITIONS

### Definition new building

The Belgian VAT Code does not contain a definition of a building. In addition, the qualification of a building as new depends upon the first enrolment of the real estate prelevy (immovable withholding tax). According to the Sixth Directive, the period during which a building can be considered as new, may not exceed five years. However, in case of an exemption from immovable withholding tax, the building may remain new under the Belgian VAT legislation for a period exceeding the period provided in the Sixth Directive. In addition, the period during which a building can be sold with application of VAT is limited whilst the period during which the input VAT may be adjusted, equals 15 years. This may lead to double taxation (VAT adjustment and application of registration rights).

### Quality of VAT taxpayer for the letting of garages

Since January 1, 1993, the condition that the letting of parking spaces for vehicles had to be carried out in the framework of an exploitation (permanent organisation) has been abolished. As a result, private individuals who let some garages to third parties obtain the quality of VAT taxpayer and, if an annual turnover is realised of more than BEF 225,000, have to register as such, issue invoices with application of VAT, file periodical VAT returns etc. In practice, the above obligations are not always met.

### No group registration

According to the provisions of the Belgian VAT Code, no group registrations are allowed<sup>2</sup>. As a result, transactions between related parties are subject to the same principles that are applicable to transactions between non-related parties.

This may lead to additional VAT costs where the recovery of input VAT is not allowed due to the fact that the immovable property transaction is exempt from VAT.

### Occasional VAT taxpayers

VAT taxpayers whose activity does not consist of the regular supply of new buildings can opt to supply a new building with application of VAT. This also applies to mixed VAT taxpayers. According to the provisions of the Belgian VAT Code, the VAT incurred on the acquisition of the new building can be *fully* recovered at the moment the option is carried out. This implies that a mixed VAT taxpayer can recover the total amount of the input VAT. This is not applicable if movable capital goods are supplied in which case the limited deduction during the past years is not adjusted (to the benefit of the taxable person).

### Rights *in rem*

It should also be noted that rights *in rem* are considered to be goods for VAT purposes. As a result, the establishment, assignment etc. of real rights constitute a supply for VAT purposes for which the VAT becomes due immediately for the total amount. This implies that the total amount of VAT due is to be paid towards the VAT authorities whilst the transaction price may only be received on a periodical basis. Also, for the application of registration rights, some real rights are treated in the same way as letting and leasing of goods.

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<sup>2</sup> The possibility of group registrations is provided in the Belgian VAT Code; however, the Royal Decree regarding the formalities has never been implemented.

The Belgian VAT Code only provides for a minimum sales value for the sale of new buildings. With respect to the establishment of real rights, such a minimum taxable basis is not applicable in , so that no minimum sale value applies.

### Immovable letting

The letting of buildings is exempt from VAT. However, the Belgian VAT Code contains some services relating to immovable property which do not qualify as a VAT exempt immovable letting (e.g. the provision of the right to exercise a professional activity). This implies that, in practice, parties may requalify the contract into a transaction subject to VAT although the facts do not coincide with the conditions laid down in the VAT Code.

Also, this regularly leads to discussions with VAT inspectors at the occasion of VAT audits.

The fact that the immovable letting in Belgium is exempt from VAT is perceived by the business as very negative as investors in immovable property (with the purpose to let) do not get a VAT recovery. This increases the investment cost with the VAT.

Also, letting contracts create a VAT cost where the building is used by a company member of the same group. In the neighbouring countries, letting between taxable persons is or can be subject to VAT.

### Share deals

In order to avoid the negative effects of the supply of a building (adjustment of the deduction, registration rights etc.), parties may opt to contribute a building into a company and subsequently transfer the legal title of shares of the real estate company. This transaction can however be challenged by the Belgian tax authorities and requalified into a sale of the building, subject to registration rights of 12.5%.

### Prefinancing of VAT

In the case of immovable work, the supplier has to apply the reverse charge procedure. This may imply that the latter is in a VAT credit position. In practice, it takes approximately 5 to 6 months before VAT credits are actually reimbursed by the Belgian VAT Administration.

### Double taxation

In case a(n) (old) building, used a capital good, is sold during the adjustment period, the VAT incurred and initially deducted has to be revised for the years of the adjustment period which have not yet expired. This VAT cost will be represented in the transaction price. In addition, this transaction price is subject to registration rights.

A professional constructor has to carry out a self supply, subject to VAT, at the end of the period during which the building is considered as new. Furthermore, in the case the building is subsequently sold, the adjustment as explained under the previous point applies. In such case the sale will be exempt from VAT and subject to registration rights (12.5%).

In case of leasing, the exercise of the purchase option at the end of the lease agreement constitutes a supply which is subject to the same principles as a regular sale. As a consequence, the minimum taxable basis should be the minimum sales value. This sales value may be substantially higher than the price of the option.

The contribution of new immovable property into a company can be subject to VAT as well as to registration duties (0.5%).

### VAT rates

The Belgian VAT Code contains a number of reduced VAT rates.

The application of the reduced rates is however subject to strict conditions (e.g. for small private dwellings, the total surface may not exceed 190 m<sup>2</sup>). If these conditions are not met, the standard VAT rate becomes applicable.

### Tax evasion

In spite of the substantial number of formalities to be met regarding immovable transactions (authentic deed, responsibility of the notary public, special declaration etc.), it cannot be excluded that for some transactions, part of the sales price is not declared.

Some principles developed by the ECJ may lead to tax evasion (e.g. the maintaining of the real intention to carry out VAT taxable transactions does not have any affect on the deduction of the input VAT).

Services relating to immovable property located in Belgium and carried out between two foreign parties, may lead to tax evasion in the sense that the supplier does not register for VAT purposes in Belgium.

### Recent ECJ court cases

At the occasion of VAT audits, discussions may arise with VAT inspectors on new points of view taken by the ECJ which differ from the positions defended by the Belgian VAT Administration.

### Registration rights

The transfer of the legal title as well as the establishment of the usufruct are subject to 12.5%. In addition, the transaction may also give rise to an adjustment of VAT which is included in the transaction price (double taxation). Also, no system of recovery of registration rights exists (except in the case of resale within 2 years - see above). This implies that in practice, immovable transactions by small investors or private individuals are not carried out whilst for large immovable transactions, the transaction is set up in such a way that the registration rights are avoided (e.g. share deals).

# Denmark

## IMMOVABLE PROPERTY

The Danish VAT legislation does not contain a definition of immovable property. To learn the meaning of the term “immovable property”, one should refer to the Tax Law. Immovable property is defined as the land, the buildings and property accessories installed on the land or the buildings, trees, standing crop, fences, wells and other systems on the land or the building.

## VALUE ADDED TAX (“Merværdiafgiftsloven”)

### Background and recent changes

Since 1967 there has been an option for VAT registration (voluntary registration) for the letting and leasing of immovable property. Furthermore, there is an option for voluntary registration for acquisition and construction of immovable property together with development of land with the purpose of sale to a registered company.

Since 1967 there have also been some changes to several VAT provisions . The main changes occurred in 1969, 1985, 1988 and in 1994.

As of 1969, the construction of immovable property which takes place on own account (i.e. a contractor who constructs a building for own use on his own property) is subject to VAT. Before 1969, such an activity was exempt from VAT.

The changes in 1985 and 1988 concerned the regulations with respect to the options of voluntary registration. Furthermore, the changes concerned how the VAT deduction in connection with both the construction and the letting out of immovable property should be treated.

The change in 1994 concerned the adjustment period. If a company, that has registered voluntarily for the letting of immovable property, owns a new immovable property, that is built by a constructor, it is possible for this company to deduct the incurred VAT, which is charged by the constructor. However, the condition was that the 'newly' constructed building must be leased within 6 months after the building was delivered to the company. If this condition was not met, a repayment of the deducted VAT had to be made by the company to the tax authorities.

The so-called 6 months-rule is no longer applicable. Instead, the tax authorities have introduced that the adjustment period does not start until the immovable property is leased for the first time.

The company should show the VAT authorities that the company actively tries to let the constructed immovable property. If the company does not actively try to lease the immovable property, the total amount of deducted VAT must be repaid to the VAT authorities.

## **Main principles**

### **Supply of immovable property**

The supply of immovable property is exempt from VAT in Denmark without the right of deduction.

### **Letting and leasing of immovable property**

The letting and leasing out of immovable property is as a main rule exempt from VAT without the right of deduction.

However, the following situations are subject to VAT:

- the providing of accommodation in the holiday sector;
- the lease of parking space for vehicles;
- the rent of safety deposit boxes;

The lease of parking space for vehicles is not subject to VAT, if the parking space is being leased out in connection with the lease of accommodation for both dwelling and office space purpose (integrated part of the lease of the accommodation).

To avoid undesirable effects, it is possible to opt for VAT taxation with respect to the letting and leasing of immovable property that are used for commercial purposes. It is not possible to opt for VAT taxation with respect to dwelling houses.

### *Option voluntary registration*

The option for VAT taxable lease is called the "voluntary registration" in Denmark. Opting for VAT taxable lease means that the lessor voluntarily registers for VAT purposes. VAT registration in Denmark is not necessary if the lease is not subject to VAT. To make use of the system of voluntary registration, the lessor should file a request with the tax authorities. Furthermore, the following conditions should be fulfilled:

- As far as it concerns existing buildings, permission should be obtained from the lessee. No permission is needed if it concerns new buildings.
- Voluntary registration applies for a continuous period of at least 2 calendar years. After this period, it is the lessor that can eventually decide to prolong the VAT taxable lease.

## VAT deduction

In Denmark the adjustment with regard to a sale within the adjustment period is computed on the assumption that the seller uses the immovable property for the remaining period for exempt activities. In principle the seller should pay adjustment VAT. However, this VAT due by the seller can under certain conditions be transferred to the purchaser who is treated in that case as the successor to the transferor. The transfer of adjustment period can only be applied to if the purchaser is a registered as a VAT entrepreneur and the purchaser is entitled to deduct at least the same right of input VAT as the seller. In Denmark it is however possible to become VAT registered (voluntary registration) for the supply of immovable property if the immovable property is supplied to a VAT registered company. Furthermore, the purchaser declares to the Regional Customs and Tax Administration that he is willing to undertake the obligation to make any adjustment necessary during the remaining part of the adjustment period. In that case the purchaser takes over all rights and obligations of the seller for that period. In the situation that the purchaser is able but not willing, to undertake the obligation of adjustment, the seller may, instead of paying the adjustment VAT, provide security to the Regional Customs and Tax Administration for the remaining period. If the property is sold once more the adjustment VAT must be paid. The Danish regulation is based on Article 20(3) Sixth Council Directive (last sentence).

However, if the purchaser does not intend to use the whole building for business purposes, he will still be able to take over some of the adjustment obligation. If the purchaser intends to use 80% of the building for business purposes, he can take over 80% of the adjustment obligation from the seller. The remaining adjustment obligation must be repaid by the seller to the Customs and Tax authorities.

No adjustment should be made if the degree of variation in the deductibility is less than 10 in relation to the deductibility percentage at the time of utilisation. For example, if a taxable person who voluntary VAT registers for letting and leasing of immovable property and leases 100% of the building for business purposes, takes out for example 5% of the immovable property for own purposes. Because the degree in the variation is less than 10%, no adjustment shall be made.

The deducted VAT shall not be repaid to the Customs and Tax authorities, if for example the voluntarily registered person is not successful in letting or leasing the immovable property. The adjustment period does not start until the whole or part of the immovable property is being leased. If the voluntarily registered person keeps on trying to lease the remaining part of the building, no adjustment has to be made.

*The adjustment period*

The adjustment period starts at the time that the immovable property is first , including the financial year in which the property has been purchased or come into use. The adjustment period ends after ten full years after first use of the immovable property.

**OTHER TAXES ON IMMOVABLE PROPERTY**

N/A.

**PROBLEM AREAS AND DISTORTIONS OF COMPETITION**

N/A.

# Finland

## IMMOVABLE PROPERTY

Finnish tax legislation contains a general definition of immovable property. In addition, for the meaning of the term “immovable property” one should refer to civil law. According to the VAT Act immovable property is determined as land, building and permanent construction or their part. Furthermore, the normal appurtenance is interpreted as part of the immovable property for taxation purposes. According to the civil law also unextracted minerals and plants attached to immovable property are therefore subject to the same rules in the taxation. According to the VAT Act also certain rights (*in rem*) follow the applicable tax regime for immovable property transactions.

## VALUE ADDED TAX (“Kulutusverot Sekä Tulli”)

### Background

VAT was introduced into Finland by the VAT Act 1994 which came into effect on June 1, 1994.

In the 1994 VAT legislation VAT on services was introduced with some exceptions. In this connection Finland already adapted the rules related to the taxation of immovable property. Taxable services became to include construction works as well. In practice the construction work was subject to taxation as a normal service or according to the self supply rules. The self supply rules were applicable for instance in situations where a new building was sold with the land. Furthermore, in order to avoid distortions of competition the self supply rules were introduced also in situations where a building was constructed for non taxable use. In order to avoid tax avoidance the self supply rule was also applicable to the transfer of a constructed building within 5 years after it was completed. The supply of land and used buildings remained in principle tax exempt. However, there were several exceptions to this main rule. The remarkable exception was option to tax in case of leasing (both financial and operational) of immovable property. This was introduced in order to achieve a neutral situation and avoid hidden VAT in case the building was used for taxable business.

Since the above change took place only a few years ago, there are still a lot of issues which have not been questioned. The tax and court practice is quite limited. Most of the court cases deal with the nature of the activity and its taxability as an exception to the above main rule.

## Implementation of the Sixth Council Directive

In the beginning of 1995, when Finland joined the European Union, the only six months old VAT legislation was subject to changes. In general the 1994 VAT Act followed the principles of the Sixth Council Directive. The rules in relation to immovable property remained mainly unchanged. Only minor corrections were made to these rules in order to implement the Sixth Council Directive.

As mentioned above the current VAT regulation is only a few years old. Therefore, no major anti-avoidance or other changes have been made after 1995.

## Main principles

### General

A taxable person for VAT purposes is anyone engaged in sales activities. This applies also to any person exploiting immovable property. Immovable property transactions are in principle subject to the standard rate of 22% or are tax exempt. In some cases, a reduced rate of 6% will be applicable.

From a VAT perspective, a distinction is made between the supply of construction services (a supply of a new building) and other immovable property. The construction services are subject to standard taxation. The option to tax applies to letting and leasing of immovable property. Other immovable property transactions are in principle tax exempt. Rights *in rem* to immovable property are also treated as a tax exempt supply of immovable property or as a supply of a service (letting or leasing).

### Supply of immovable property and rights *in rem*

#### *General*

The main rule is that the supply of immovable property (including rights *in rem* which are treated as a supply of goods and financial lease) is exempt from VAT. No distinction is made between the supply of a building (including the land on which a building stands) and the supply of land.

However, the supply is subject to VAT if the supply takes place on or within five years after the day on which the “newly constructed” immovable property was first put into use, the costs of development exceed the annual threshold of FIM 120,000 and the input VAT incurred with respect to the development costs should have been recovered. The self supply rule applies.

Only a construction service or a building can be subject to taxation. At the

moment of the supply, the supplier should repay the VAT which has been recovered with respect to the development costs. This VAT amount due will be separately charged to the purchaser. This means that no VAT is levied on the basis of the purchase price. The profit will therefore not form a part of the VAT basis. The supply of land is always tax exempt even though it is transferred with a building subject to taxation.

To get a good insight in Finnish legislation, we explain the legislation by an example.

*Example*

Company A purchases land (purchase price: 1,000,000; no VAT) to develop a building (development costs: 10,000,000; 22% VAT = 2,200,000). Within the 5 years-period, the building (including the land) is sold to Company B (sales price: 13,000,000) who is entitled to deduct 50% of input VAT incurred.

*VAT implications:*

Company A is entitled to deduct input VAT on development costs. Company A is liable to VAT to the amount of 2,200,000 as a result of the self supply rule. Company A issues a separate invoice to Company B for the VAT due. Company B is entitled to deduct 50% of this VAT as input VAT.

Letting and leasing of immovable property and rights *in rem*

General

Letting and (operational and financial) leasing of immovable property (including rights *in rem* which are treated as a supply of services) are exempt from VAT. A number of exceptions on this main rule exist. The following transactions are subject to VAT:

A. by virtue of law:

1. letting of machinery equipment and business installation which do not form a normal appurtenance of the immovable property;
2. lettings in the furtherance of a hotel, boarding and guesthouse, camping and holiday business;
3. letting or leasing of parking space for cars;
4. supply of harbour or airport space for boats and aeroplanes;
5. hire of safes;
6. supply of construction services;
7. supply of ground material such as sand, stones etc., supply of wood, supply of the right to hunt and fish;
8. supply of meeting, sport of exhibition rooms or supply of other comparables;

9. supply of advertisement or information space and supply of space for entertainment, soft drink or other comparable automates;
10. supply of total care of public roads and railways to the Finnish state.

B. by virtue of option:

1. lessor/landlord elect to waive the exemption.

#### *Option for taxable letting or leasing*

The opportunity to opt for a VAT taxable letting and leasing of immovable property only exists if the immovable property is used by the lessor for VAT deductible activities. Immovable property can be used for both taxable and non-taxable activities. The Finnish VAT Act does not provide a regulation in relation to the minimum percentage of use of the building for taxable activities.. However, an exceptional rule is applicable if the recipient is a shareholder of a real estate company. In that case, an option to tax the lease is only possible if the shareholder uses the immovable property completely for activities that entitle the shareholder to deduct input VAT. This limitation is not applicable if the shareholder is the Finnish state.

#### Deduction of VAT

Input VAT incurred on the acquisition and exploitation of immovable property is recoverable if and in so far the property is used for taxable activities. If an immovable property is used for both taxable and exempt activities, VAT can be recovered on the basis of the ratio between taxable and exempt turnover.

### **OTHER TAXES ON IMMOVABLE PROPERTY**

#### **Transfer tax (“Varainsiirtovero”)**

##### General

The following transactions regarding immovable property located in Finland are subject to transfer tax:

1. the acquisition of the legal title of immovable property (land/building/permanent construction) and certain transfers of rights in rem (transfer of right to use land, if this right has to be registered);
2. the acquisition of an interest/shares in real estate companies or in similar structures (i.e. companies of which the objective and actual activity is owning, letting and/or exploitation of immovable property).

Transfer tax levied on the immovable property amounts to 4% of the consideration and is due by the acquirer (recipient). If shares in a real estate company are acquired, the transfer tax is 1.6% of the consideration.

#### Relation to VAT

Basically transfer tax aims to tax transfers of immovable property which are not subject to VAT.

The double taxation is avoided in most cases, but nevertheless it may occur (at least in principle in some cases when a building is sold).

#### Other exemptions from transfer tax

A number of acquisitions of immovable property is exempt from transfer tax. The most important exemptions apply for acquisitions:

1. by public bodies listed in the transfer tax law;
2. as a result of a merger operation or spin-off operation provided that these transactions are tax exempt according to the Corporate Tax Act;
3. as a result of the change in the company form (e.g. incorporation of partnership).

#### Real estate tax ("Kiinteistövero")

##### General

If a person - individual or legal entity - is an owner (or a person comparable to the owner) of the immovable property in the beginning of the calendar year, this person will be liable to real property tax for the whole fiscal year (calendar year). A subsequent sale or a termination of the rental agreement during the fiscal year does not reduce the property tax liability.

The value of immovable property will be determined by the local authorities every year. The taxable value is the value determined according to the Wealth Tax Act in a year before the year of taxation.

The tax rate depends on the municipality in which the immovable property is located. The general tax rate varies between 0.2 - 0.8%. The reduced rate of 0.1 - 0.4% is applicable to the houses used for permanent living.

### Relation to VAT

The real estate tax is payable independently of VAT. Therefore, no double taxation may exist because the real estate tax is not levied on the supply of the immovable property but to the ownership.

### **PROBLEM AREAS AND DISTORTIONS OF COMPETITION**

The main problems in the Finnish tax practice are related to the interpretation of the different matters due to the fact that the history of the legislation is very short.

#### Definitions and related problems

Firstly the definition of the term immovable property and its normal appurtenance is not wholly clear.

Secondly, often it is difficult to determine the nature of the immovable transaction; whether it is tax exempt according to the main principle or if it falls into the taxable category. There is court practice for example related to parking spaces and, supply of accommodation. However, the definition is still unclear. In case of accommodation two competitive opinions have been presented. The one is that in general long term accommodation could be interpreted as tax exempt leasing of land or a building. The other is that if the service is provided in the course of offering additional services normal to hotels or camping places it would be taxable.

It is also difficult to determine when the activities are carried out for business purposes.

#### Problems related to distortion of competition

##### *Option to tax*

Most of the problems have been avoided by introducing the possibility to opt to tax in case of leasing. However, due to the restrictions mentioned in the VAT Act, some problems occur. Firstly, the option to tax cannot be used in long chains due to administrative reasons. This is not a major problem because in practice most of the lease chains are short.

Secondly, the term real estate company does not apply to unlimited liability companies. If an unlimited liability company's purpose would be to carry out similar activities as a real estate company, it would not be able to use the option to tax due to the restriction in the law.

However, this is a minor problem because it is not normal that an unlimited liability company would be formed to carry out such activities instead of a real estate company.

Thirdly, a greater problem relates to the option to tax in general. It can not be cancelled voluntarily, but it continues as long as the requirements listed in the law are fulfilled. Therefore, if the lessee changes his activities so that most of the activities are non-taxable, the tax burden due to the VAT in the lease payment increases.

Furthermore, if the lessee ceases to practice taxable business and uses the property for instance for the private housing, the lessor who is using the option to tax may be subject to the self supply tax (deduction adjustment) even though the lessor cannot have impact on the lessee's decision. It is not clear how long the property could be unused for instance if the lessee changes without the self supply rules to be applicable.

#### *Supply of the ground material*

Supply of the ground material is subject to the standard rate of VAT. However, if the land is supplied instead of the ground material the supply is tax exempt.

#### Problems related to self supply rules

##### *Transfers without compensation*

The wording of the law concerning self supply VAT on construction work (transfer of building) is also unclear. It is not stated clearly if the self supply VAT is also due in case of transfers of immovable property without compensation i.e. inheritance or gift. The general understanding is that also in the above cases the self supply rules are applicable. Furthermore, the timing of the taxable event in case of the transfer due to inheritance is not determined.

##### *Realisation of the property by the public authority*

In case of realisation by the public authority or similar situations, the self supply VAT is due and the owner is the tax liable person. It may be the case that the owner does not pay self supply VAT and it cannot be deducted from the realisation compensation.

However, the buyer may be entitled to the VAT deduction if he receives a document proving the amount which would be due as self supply VAT.

*Person excluded from the scope of self supply rule in relation to immovable property*

The self supply VAT rule is not applicable to the foreigners determined in article 12 in the VAT Act or diplomatic representations. Neither is the self supply VAT applicable to persons constructing their private housing and selling it after few years.

*Taxable base*

The taxable base in case the construction work is subject to the self supply rules is direct and indirect construction expenses. This may lead to the situation where the taxable base is higher than the market price. The tax base determination may also be difficult because the value of the transferred land is tax exempt.

*Scope of self supply rule in case of the later transfer of the building*

When the self supply VAT applies to a building sold or transferred to use not entitling to VAT deductions, a five year period is applicable for the adjustment. The beginning of the five year period may be difficult to determine if the moment when the construction work was completed is unclear.

# France

## IMMOVABLE PROPERTY

The French Tax Code does not contain a definition of the term immovable property. For the meaning of these terms, one should refer to the French Civil Code. Immovable property includes four categories of goods or rights :

1. land and building, strictly speaking, which are immovable property by their nature;
2. personal property the owner of the land places thereon for servicing and exploiting the immovable property, which are immovable property by their purpose;
3. immovable property due to the subject to which they apply, which include intangible rights directly linked to the immovable property (rights in rem, actions for claim, ...);
4. immovable property provided by specific provisions of the law.

Moreover, the French tax authorities provide, that a movable may "become" immovable to the extent that it could not be detached from its attached immovable property without being damaged or without creating damage to this immovable property.

## VALUE ADDED TAX ("Taxe sur la valeur ajoutée")

### Background

Until March 15, 1963, the construction and supply of immovable property were subject to several different taxes. This entailed distortions. The purpose of the above mentioned law was to suppress those distortions.

The law stipulated that transactions, involved in the construction and the supply of buildings, used for or intended to be used for residential purposes for at least three quarters of their total surface area, would be liable to VAT and, as a consequence, would be exempt from registration duties.

The tax legislators wanted to achieve tax neutrality, by making the tax burden independent from the legal schemes adopted by promoters and from the adopted production and marketing networks and by making the price of the buildings subject to uniform tax, regardless of the respective amounts of the various cost elements entering into this price: land, building work, ancillary costs or profits.

The regime established by Article 27 of the Law of March 15, 1963 was substantially amended on January 1, 1968.

Until this date, VAT exclusively applied to building operations with respect to buildings, used for or intended to be used for residential purposes for at least three quarters of their total surface area.

However, practice revealed that the implementation of the rule relating to the use for residential purposes of at least three quarters of the built areas was hardly satisfactory..

It is in this context that Article 14 of Law N°67-1114 of December 21, 1967 (Finance Act for 1968) was drawn up to extend the VAT regime to transactions involved in the construction and the supply of buildings, which are not used for or intended to be used for residential purposes for at least three quarters of their total surface area.

The provisions of this text came into force on January 1, 1968, subject to certain transitional measures provided for by decree N°68-172 of February 22, 1968.

Among the other legal or regulatory amendments which have affected real estate VAT, the following provisions may be cited:

1. article 4-I of Law N° 73-1128 of December 21, 1973 eliminated the requirement of self-supply with respect to buildings constructed with a view to their sale, as this ground for taxation was no longer relevant;
2. article 6 of Law N° 76-1232 of December 29, 1976 reduced the normal rate of VAT to the same level as the interim rates and as a result eliminated the disadvantages of the duality of the tax rates applicable until that time in the context of real property promotion;
3. a ministerial order of December 23, 1977 reduced the tax obligations of promoters and property developers by authorising them to declare their operations under the same conditions as taxable persons subject to the ordinary law rules;
4. the Law of December 29, 1978 adapted French Law to the provisions of the Sixth Council Directive but had virtually no impact on VAT on real property. This is not the case for decree N°79-1163 of December 29, 1979 which was intended to adapt the regulatory provisions relating to the deductions to the aforementioned Directive;
5. finally, also with a view to harmonising European taxation, Article 66 of Law N° 85-1403 of December 30, 1985 eliminated the reduction of the applicable tax basis with respect to VAT on real property and provided for the implementation of new legal rates.

## Anti-avoidance rules

French Tax Authorities did not set up specific anti-evasion or anti-avoidance rules. The main reason is that most of the transactions involving immovable property are concluded before a notary, which is a guarantee of the proper proceeding of the transaction.

Indeed, in case of transaction involving non-professional parties, the notary is responsible for the determination (drafting of the returns) and the collection of the tax.

Moreover, the French Tax Legislation contains several anti-avoidance and evasion provisions, which are applicable to most of the different types of cases such as:

1. the concept of “abuse of law” which entitles the Tax Authorities to challenge any transactions or schemes set up for the sole purpose of avoiding the tax or when the operation is fictitious;
2. the ability for the Tax Authorities to challenge the transaction price in the case where it is abnormally low.

## Main principles

### General

A taxable person is someone who carries out:

- (i) a commercial activity (Article 1 of the French Commercial Code states that persons who carry out acts of trade on a continuing basis are deemed to be merchants);
- (ii) an industrial activity;
- (iii) a craft industry;
- (iv) an activity of the profession;
- (v) an agricultural activity;
- (vi) a civil activity (land renting, patent sales, etc.);
- (vii) a mining activity.

Such activity must be carried out on a continuing basis, i.e. any repeated service or supply of goods.

The person must carry on its activity independently, i.e. under its own responsibility and being entirely free in the organisation of its activity (example: person acting under an agency agreement).

The main rule is that immovable property transactions are VAT exempt. However, under certain conditions, transactions are subject to VAT. In that case, the standard rate of 20.6% is applicable; certain activities (e.g. hostels, camping activities) are subject to a 5.5% VAT rate.

Please note that it is in France not possible to opt for a VAT taxable supply of the title of real properties.

The taxable basis consists of all amounts obtained or which is to be obtained as a counterpart for the transaction or, for the acquisition of lands or buildings. However, in case the fair market price exceeds the agreed sales price, the market price will be considered to be the taxable basis..

From a VAT perspective, 3 different regimes must be distinguished :

1. regime applicable to supplies of building land and newly constructed buildings ("*TVA immobilière*");
2. special regime applicable to real estate dealers ("*TVA marchands de biens*");
3. ordinary VAT rules on supply of services applicable to letting, leasing or other services linked to the immovable property.

### Supply of immovable property and rights in rem

#### *Regime applicable to supplies of building land and newly constructed buildings*

The VAT regime for real property transactions applies to all transactions, other than works of constructions, that contribute to the production of buildings and the supply of new buildings.

Such transactions include sales and capital contribution, transactions concerning rights in rem (treated as good) and shares or interest in a real property company that represent the underlying building land or new buildings.

Once the building is completed, only the first transfer is subject to VAT, and then only if it takes place within five years after completion. An exceptional rule is applicable if the first sale after the completion of the building is made to a real estate dealer. In that case, the resale shall be subject to VAT if it takes place before five years after completion of the building.

#### A. Building land

The term "building land" means any land purchased with the intention to build a building thereon. Such intention may be evidenced by a specific undertaking, or the intervention of certain events (example: request of a building permit or start of the works of construction within four years following the purchase).

#### B. Newly constructed building

This term includes the newly completed buildings as well as any transformed building whose internal structures have been nearly entirely reconstructed.

### Regime applicable to real estate dealers

Real estate dealers are those persons who buy immovable property or shares in real property companies for resale purposes in their own name on a continuing basis.

Their transactions will be subject to VAT under one of two different regimes:

1. in case their transactions involve immovable property falling within the scope of the “VAT on land or newly constructed buildings” (as described above), only such regime is applicable;
2. in case purchases and sales involve other properties (particularly buildings completed for more than five years), another special regime is applicable: in that case VAT will be due on the difference between the sales price (or market value if higher) and the cost price of the property sold.

#### Letting and leasing of immovable property and rights in rem

Letting and leasing of immovable property is considered as a supply of services. These services are in the main rule exempt from VAT, except in the following cases:

1. letting of furnished or equipped business premises;
2. letting of safety-deposit boxes;
3. letting of accommodation in the hotel sector;
4. letting of machines and business installations;
5. letting of parking space;
6. letting of unfurnished business premises may be taxable by virtue of option. This option must be expressly mentioned in the lease contract and the tax authorities should be informed within 15 days after the letting has started. The option lasts for a period of 10 years.

The letting of parking spaces is VAT exempt in case the letting is directly connected with the letting of a dwelling located in the same building or development.

#### Deduction of VAT

Input VAT incurred on the acquisition and exploitation of immovable property may be recovered if the property is used for VAT taxable purposes. In case the amount of authorised deductions exceeds the amount of tax due for a given period, the taxable person is entitled either to carry forward the excess of VAT to the following period, or to ask for a refund to the French Tax Authorities.

If an immovable property is used for both taxable and exempt activities, the taxable person should attribute the property to one of those activities. If such attribution is impossible, VAT should be deducted on the basis of

a pro-rata between taxable and exempt turnover.

In case of change in the use or in the situation of the property, or in case of variation of the business' degree of VAT taxability, an adjustment must be made. The adjustment periods starting point is the date of completion or purchase of the immovable property. It ends at the beginning of the 19th year following the year when the building is completed or purchased.

### Examples

French legislation on immovable property is very complex. In order to get a good insight in French legislation, we explain this legislation by two examples.

#### *Example 1*

1. after completion of a "newly constructed" building, company A supplies a building to real estate dealer B;
2. real estate dealer B supplies this building to Company C;
3. company C supplies this building to Company D;
4. company D supplies this building to real estate dealer E;
5. transactions 1 - 4 take place within the 5 years-period;
6. after the 5 years-period has expired, real estate dealer E supplies the building to Company F.

#### *Tax implications*

1. transfer from A to B: subject to VAT;
2. transfer from B to C: subject to VAT;
3. transfer from C to D: not subject to VAT (in fact, registration taxes will be levied);
4. transfer from D to E: not subject to VAT, registration taxes should be levied (at the rate of 0.60% if E takes the commitment in the deed to resale the good within 4 years); the reason the sale is not subject to VAT is that, even though E would be a real estate dealer, the real estate has already been sold, during the five year period after completion, to a non-real estate dealer;
5. transfer from E to F: can be subject to VAT on the margin derived by E on the sale, if E has taken the commitment, in the transfer deed with D, to resale the real estate within 4 years; F will have to pay a registration tax as for a sale not subject to VAT (except if F acquires the real estate to build a new building; VAT would then apply). In this situation, it should be mentioned that if the sale between D and E had been subject to VAT, E would not have been entitled to deduct such VAT.

### *Example 2*

1. within 5 years after completion of a "newly constructed" building, Company A supplies a building to Company B;
2. company B supplies this building to real estate dealer C;
3. real estate dealer C supplies this building to Company D.

### *Tax implications*

1. transfer from A to B within the five years delay: subject to VAT;
2. transfer from B to C: not subject to VAT, registration tax should be levied; the reason why is that the real estate has already been transferred to a non-real estate dealer;
3. transfer from C to D: can be subject to VAT on the margin derived by C (see example 1 above); however, D will be liable for the payment of the registration tax as for a sale not subject to VAT. In this situation (as for the transfer between E and F in example 1) it is not strictly correct to say that the sale is subject to VAT as the tax levied on the sale price is a registration tax (and not VAT). In fact, the sale is only subject to VAT on the margin derived by the real estate dealer.

## **OTHER TAXES ON IMMOVABLE PROPERTY**

### **Registration taxes ("Droits d'Enregistrement")**

The registration taxes apply to the following transactions:

1. transfer of title of immovable property;
2. certain leasing of immovable properties;
3. transactions related to rights in rem;
4. transfer of title of shares in real estate companies.

The taxable amount taken into account is the amount declared in the deed or the open market value if higher (or an estimate in the absence of a document).

The transfer of immovable property is taxed at four levels: at the level of:  
1) the department, at a rate which depends on the nature and place of the property (average = 15.40% for commercial buildings);  
2) the city, at a rate of 1.2%;  
3) the region, at a rate of 1.6%; 4) the country, at a rate of 2.5% of the tax levied at the level of the department.

A lower rate (i.e. 0.60%) applies when the transaction is already subject to VAT.

In certain cases (e.g. contributions, mergers, reorganisations), the amount of the tax levied is a fixed amount (100 FF., 500 FF. or 1,220 FF.).

## Exemptions

A number of transactions concerning immovable property is exempt from registration taxes:

1. acquisition by public bodies;
2. acquisition by social housing associations;
3. acquisition of building lands.

## **Tax on lease ("Droit de Bail")**

The tax on lease applies on lettings which are not subject to VAT.

The rate of the tax on lease is 2.50% of the rental fee, including rental expenses.

The lessor and lessee are jointly liable for the payment of the tax.

However, the tax is usually recharged to the lessee by the lessor.

## **PROBLEM AREAS AND DISTORTION OF COMPETITION**

### **Problems areas**

#### Deduction of VAT

Until 1995, private persons were not allowed to ask for a refund of VAT credit. In order to suppress this distortion and because of the realty crisis, the legislator entitled the private persons to ask for such refund.

#### Real estate dealers

Taxable persons whose major activity is the purchase-deal of immovable property on a continuing basis, are subject to a specific VAT regime which allows them to calculate the taxable amount on their commercial margin. A distortion may appear to the extent that the accounting margin calculation differs from the taxable one. Therefore it is possible to be taxable while the person occurs losses.

#### Payment in kind

In case of payment in kind (for example when a part of the purchase price consists in a supply of realty), problems may arise as regards the determination of the taxable basis (e.g. price mentioned in the prior agreement or price of the buildings at the date of their completion).

### Transformation of a building

In case of transformation of a building (such as addition of building height or significant changes in the structure of the building), there may be a problem regarding the tax treatment of such transaction. The VAT regime would indeed not be the same if the operation is treated as a supply of a newly constructed building (in such case, there is a supply of good) or may be deemed as a repair and maintenance transaction (works of construction are deemed as supplies of services).

### Distortions

#### Public bodies

VAT treatment of public bodies differs from the regime applicable to private taxable persons: when performing certain commercial activities (normally subject to VAT), public bodies benefit from a presumption which allows them not to be VAT taxable.

#### Exercising the input VAT deduction

Distortions may appear between taxable persons which are allowed to opt for the regime of VAT on a cash basis, which enable them to deduct VAT as the payment goes along, and the others (i.e. non professionals who cannot offer sufficient guarantee), subject to the normal regime (full deduction at the date of the transaction. Until 1995, private persons were not allowed to ask for a refund of VAT credit. In order to suppress this distortion and because of the realty crisis, the legislator entitled the private persons to ask for such refund.

#### Taxable basis

As regards the taxable basis of a transaction, Tax Authorities tend in practice to take into account the cost price of the immovable property sold, rather than the sale price, because they consider the fair market value cannot be lower than such cost price. This situation may lead to a distortion in case of immovable property crisis where the selling price of realty should be lower than this cost price.

# Germany

## IMMOVABLE PROPERTY

The German tax legislation does not contain a definition of immovable property. For the meaning of the term immovable property one should refer to civil law. Immovable property is described as spatial delimited piece of earth surface including its integral parts. Integral parts are tangible property fix connected to the ground (principally buildings which are not connected temporally) and rights in rem. Further, the leasehold ("Erbbaurecht") and the particular ownership in buildings ("Teileigentum") are considered as immovable property.

## VALUE ADDED TAX ("Mehrwertsteuer")

### Background

VAT was introduced into Germany by the VAT Act of 1967. The VAT Act of 1967 has been in force since 1968. The VAT Act has been amended from time to time, including the major revision of January 1, 1980 in which the Act was brought in line with the EC Directive 77/388 of May 17, 1977.

According to the German VAT Act all transactions subject to real estate transfer tax (principally, the supply of immovable property and the establishment and assignment of leasehold) and the letting and leasing of immovable property including similar transactions (establishment of rights in rem) are tax exempt from VAT. As an exception thereof, the construction of buildings for the landowner or holder of the land is subject to VAT.

Important revisions concerning immovable property were introduced with the Budget Structure Law ("Haushaltsstrukturgesetz") of 22.12.81 the Tax Clearing Law of 14.12.84 ("Steuerbereinigungsgesetz") and the Abusive Structures Prevention Law of 21.12.93 "Mißbrauchs- bekämpfung- und Steuerbereinigungsgesetz").

The revisions refer to the requisites to exercise the option to tax transactions in connection with immovable property. They have been introduced to adjust more fairly the deduction of VAT regarding immovable property. Through the successive adjustments the right to opt has become more and more restricted.

## Main Principles

### General

The taxable person for VAT purposes is the entrepreneur. Any person exploiting immovable property is deemed to be an entrepreneur. Immovable property transactions are in principle subject to the standard rate of 15%. The reduced rate is 7%. However, most transactions are exempt from VAT. The taxable amount is the consideration paid.

From a VAT perspective, a distinction is made between the supply of immovable property and letting and leasing of immovable property. The establishment, assignment, alteration and cession of rights *in rem* to immovable property are treated in some cases as a supply of immovable property in other cases as a supply of services (letting or leasing). The former is the case for the assignment of leasehold and particular ownership. The latter applies for the rest of rights *in rem*, the establishment of leasehold included.

### Supply of immovable property

The main rule is that the supply of immovable property (including the financial leasing under certain conditions) is exempt from VAT. No distinction is made between the supply of constructed and non constructed land. VAT is, however, chargeable on the supply of buildings in the following situations:

#### A. By virtue of law

##### 1. Construction work:

The construction of a building for the landowner or for another person entitled to construct on the land is subject to the standard rate of 15%.

##### 2. Supply of buildings erected on foreign land:

Under certain conditions the supply of a building erected on another person's land during the term of a leasing or similar contract to the landowner constitutes a taxable transaction subject to the standard rate of 15%.

#### B. By virtue of option

The supplier elects to waive the exemption

### *Option for taxable supply*

The option to tax can be exercised by the supplier if the recipient is a taxable person (entrepreneur). The recipient's entitlement to input VAT deduction does not constitute a prerequisite for the exercise of the option.

If afterwards it appears that the recipient did not qualify as an entrepreneur, the supplier is allowed to issue a rectified invoice reverting the transaction in a tax exempt one. As a consequence thereof, the supplier will reduce the taxable amount and VAT due amount reported and will have, in case, to adjust its input-VAT deduction.

### Letting and leasing of immovable property and rights in rem

Letting and leasing of immovable property including rights *in rem* (which are treated as a supply of services) are exempt from VAT. A number of exceptions on this main rule exists. The following transactions are subject to VAT:

#### A. By virtue of law:

1. letting of machinery equipment and business installation;
2. lettings in the furtherance of a hotel, boarding and guesthouse, camping and holiday business to persons staying only for a short period of time (less than 6 months);
3. letting or leasing of parking space for cars;
4. provision of berths and sheds for boats;
5. hire of safes.

#### B. By virtue of option:

Lessor/tenant elects to waive the exemption.

### *Option for taxable letting or leasing*

An election to tax letting and leasing (income) is possible for all immovable property (including rights *in rem* which are treated as a supply of services) under certain conditions.

As a principle, the option is only allowed where the recipient qualifies as entrepreneur, who is wholly entitled to deduct input VAT. Please note, that in Germany the so-called 5% rule is implemented to reduce 'overkill'. If the lessee uses the property only for 5% for transactions without tax credit, the lessor can opt or can keep its option.

The determination could be based on the relation of square meters, time or turnover; i.e. the 5% insignificant part has to be economically assessed.

As an exception concerning the letting and leasing of buildings, the exercise of the option depends on the age of the building in connection with the intended end-use of the building (residence purposes, other than business purposes, business purposes which do not allow an input VAT deduction and such which allow the deduction).

The different conditions under which the option can be exercised stay in connection with the successive restrictions introduced during the years (please refer to background).

The option is allowed in connection with single delimited parts of a building.

### Deduction of VAT

Input VAT incurred on the acquisition and exploitation of immovable property is recoverable if and insofar the property is used for taxable activities. If an immovable property is used for both taxable and exempt activities, VAT can be recovered on the basis of the ratio between taxable and exempt turnover. The adjustment period for immovable property is the period elapsing between the moment of the first use and nine calendar years following this year.

## **OTHER TAXES ON IMMOVABLE PROPERTY**

### **Real Estate Transfer Tax (“Grunderwerbsteuer”)**

#### General

The transfer tax covers inter vivos transfers of German situated immovable property for consideration. Apart from the outright sale and transfer of immovable property, the tax covers contributions of immovable property to the capital of a corporation and the division of immovable property among co-owners, as well as the transfer or sale of all shares (or all shares outstanding which are not yet owned by the purchaser) in a corporation which holds immovable property situated in Germany.

As above mentioned the term “immovable property” comprises immovable property as defined in the Civil Code as well as leasehold, buildings on another person’s land and particular ownership within the meaning of the Condominium Act (“Wohnungseigentumsgesetz”).

The tax is levied at a rate of 3.5%. The tax base normally is the consideration paid, except where the taxable event is the acquisition of unification of all shares in a corporation, in which case the assessed tax value of such real estate forms the tax base.

### Relation to VAT

Basically, transfer tax aims to tax transfers of immovable property which are not subject to VAT.

The VAT exemption avoids double taxation in most cases, but nevertheless it occurs when the supplier exercises the option to tax.

### Exemptions from transfer tax

The Real Estate Transfer Tax Act provides for several exemptions, the most important of which are:

1. transfers of real estate by succession or donation;
2. the division of a deceased’s estate, which includes real estate, among heirs;
3. the acquisitions of real estate by the spouse or the lineal ascendant or descendant of the seller and their spouses;
4. re-acquisition of real estate by the party who had transferred it to a nominee;
5. the transfer of real estate from a partner to a partnership to the extent of the share of the transferring partner in the partnership;
6. if real estate is transferred to a partnership by co-owners, the transaction will not be subject to tax to the extent the share of the individual co-owner in the partnership corresponds to his fraction in the real estate;
7. the transfer of real estate by a partnership to its partner(s) to the extent the fraction transferred to the individual partner corresponds to his share in the partnership.

## Land Tax (“Grundsteuer”)

### General

Land tax, which is similar to rates in England, is a recurring tax levied by the local authorities on all land within their district, whether or not it is developed.

The tax base for land tax purposes, which is the subject of a special assessment, is calculated on the basis of the rateable assessed value ("Einheitswert") of the property pursuant to a separate procedure provided for in the Tax Valuation Act ("Bewertungsgesetz").

The rateable assessed value of property generally comes to only 25 - 50% of its fair market value. The rateable assessed value of real property situated in the eastern part of Germany (former GDR) is assessed on a different basis than in the western part, which generally results in a still lower value.

This amount is multiplied by a factor fixed by the local authority. The annual land tax burden presently varies between 0.5% and 1.4% (in Frankfurt am Main: approx. 1.1%) of the rateable assessed value. Land tax can be deducted in determining the income tax base.

Land tax is payable by the owner of the land. If the land is owned by more than one person, they are jointly liable. Land tax constitutes not only a personal liability of the owner but also a charge on the land.

#### Relation to VAT

Since the tax base value does not coincide with the fair market value, the inclusion or exclusion of VAT does not constitute a relevant matter.

### **PROBLEM AREAS AND DISTORTIONS OF COMPETITIONS**

#### **Problem areas**

Option exercise often leads to abuse practices (e.g. chain letting contracts).

#### *Example*

The wife of a physician (entrepreneur with input VAT exclusion) acquires a building subject to VAT and rents it to the physician exercising the option to tax. This structure has a positive cash flow effect for the physician. The wife will deduct the full VAT suffered on the acquisition and the physician will defer the non deductible VAT over a long term period. In such cases it cannot be demonstrated that there does not exist any economic motive other than tax avoidance to choose this structure, it will not be possible to avoid a distortion. In such cases it constitutes an evidence of the abuse if for example the wife does not have funds enough to purchase the building and pays it with moneys of her husband. There exists innumerable decisions from the tax courts in this regard. A further example is the sale and lease back.

Different option requirements which does not allow a uniform treatment of taxable persons,

The option to tax depends on the end use of the building in connection with its age. If the recipient is an entrepreneur an option to tax can be exercised in the following situations.

<b>Construction</b>			
<b>Start</b>	<b>Start</b>	<b>Completion</b>	<b>End use</b>
< 1.6.84		< 1.4.85	
< 1.6.84		< 1.1.86	other than residence
> 1.6.84	<	< 1.1.98	business purposes
> 1.6.84	<	> 1.1.98	full input VAT
> 11.11.93			full input VAT

*Example:*

A building which construction was finalized before 1.4.85 can be leased subject to tax if the lessee is an entrepreneur; however, a building which construction started after 11.11.93 can only be leased subject to tax if the lessee is fully entitled to deduct input VAT

Co-ownership of property

The constitution of co-ownership as well as transactions of the co-owners often lead to problems.

*Example*

The husband whose immovable property is allocated to its business assets transfers his wife title on the immovable property free of charge and the wife on the other hand grants back usufruct to her husband for consideration.

*Question*

Does the transfer of co-ownership constitute an application for private use?

The Federal Tax Court decided in this case that the transfer did not constitute an application for private use since the husband kept the economic ownership over the immovable property.

A lot of questions exist in this regard, e.g.:  
Does the partition of co-ownership into particular apartment ownership of the co-owners constitute a taxable transaction?

#### Differentiation between integral parts and equipment

##### *Example*

An elevator within a building is generally considered as an integral part of the building. However, if it is only intended for production purposes it would qualify as business equipment, being its rent subject to VAT.

#### Building construction on another person's land

##### *Example*

Depending on different factors (lease payments, whether the building is intended for temporary use or not, etc.) the return of the immovable property to the landowner may constitute a taxable transaction or not.

#### Sports facilities,

##### *Example*

A swimmingpool is considered as business equipment. The rental payment for the exclusive use of the sports facilities for a given time period has to be split up in a rental of immovable property (tax exempt) and a rental of equipment subject to tax.

#### Partly option exercise.

The finance administration has not yet disclosed its opinion to the partly option in connection with the supply of immovable property.

### **Distortions of competitions**

#### The input-VAT adjustment of only 10 years for buildings

The withdrawal of immovable property by a taxable person entitled to fully deduct VAT after ten years as of the first use of the immovable property for private purposes does not lead to any taxation. (Rectification requirement within 10 years). This tax avoidance is not possible for non taxable persons, bodies of public law or entrepreneurs who cannot deduct VAT.

Different option possibilities depending on the building's age,

We refer to problem areas under "different option requirements which do not allow a uniform treatment of taxable persons".

Uncleared situation as concerns the partly option by supplies of buildings.

We refer to problem areas under "partly option exercise".

# Greece

## IMMOVABLE PROPERTY

By immovable property is meant the ground and its consistent parts. The consistent parts are:

1. things firmly attached to the ground especially buildings;
2. the produce of the immovable as long as it is connected with the soil;
3. underground waters and springs;
4. seeds and plants once showed and planted.

## VALUE ADDED TAX

### Background

VAT was introduced in Greece by the law of 1642/1986 and took effect on January 1, 1987.

The provisions regarding VAT on immovable property transactions however, have always been inactive except of construction works on immovable property, which are already taxable.

Initially it was scheduled that they would take effect in 1988 but by virtue of several successive rulings of the Ministry of Finance their effect has been successively suspended. Currently it is scheduled that the provisions will come in effect on January 1, 2000. Until that time immovable property transactions are exempt from VAT and remain subject to transfer tax. Note though, that the sale of land is anyhow exempt from VAT .

### Main principles

#### Taxable transactions

According to the currently suspended provisions taxable transactions on immovable property are the underlisted. Note, as we have already mentioned, that the only transactions, which are currently taxable, are construction works.

### *Commercial and industrial buildings*

1. Construction work on a new building;
2. Demolition services;
3. Repair, maintenance and alteration of existing building;
4. Supply of new or semi-constructed buildings before first use by a contractor;
5. Self supply of new or semi-constructed buildings by a contractor;
6. Lease and use of new or semi-constructed buildings by a contractor.

### *Civil engineering works*

1. New construction work and demolition services;
2. Repair, maintenance and alteration of an existing work.

### *Dwellings and buildings used for residential purposes*

1. Supply of new or semi-constructed buildings before first use by a contractor;
2. Self supply of new or semi-constructed buildings before first use by a contractor;
3. Establishment assignment, and alteration of rights in rem on new or semi-constructed buildings before first use by a contractor;
4. Construction work on a new building;
5. Demolition services;
6. Approved alterations to a listed building;
7. All other repairs, maintenance and alteration of an existing building.

All other leaseholds are exempt from VAT.

### *Land*

Sale of land is exempt from VAT.

## **OTHER TAXES ON IMMOVABLE PROPERTY**

### **Transfer tax on land and property**

The purchase of immovable property as well as any other immovable property transaction is subject to transfer tax, which is due by the purchaser or beneficiary of the right. The taxable base for this tax is the "objective value", which is the value defined in the tables of the Ministry of Finance in accordance with several factors (area, age, type of immovable property).

However, if the price indicated in the contract is higher than the "objective" one, the taxable base is determined as the contract price.

In case the taxable basis is determined to the "fair market value" the tax authorities reserve the right to review the respective transfer tax return and make their own estimation for the fair market value.

Notwithstanding the method of determination of the taxable base, the transfer tax scale is the following:

<u>GRD</u>	<u>Tax Rate</u>
0 - 4 mill	9%
4 mill onwards	11%

For land or premises located in areas with fire brigade (usually urban areas) the tax rates are modified to 11% and 13% respectively.

We would like to point out that the transfer tax is payable before the conclusion of the purchase. The public notary will require the duplicate receipt proving the payment of the transfer tax in order to commence the real estate transfer contract procedure.

### **Stamp duty**

Stamp duty is levied on documents connected with immovable property transactions at fixed rates which are currently GRD 150 per page. Note however that due to the insignificance of stamp duties in comparison to the transfer tax levied, the latter usually absorbs stamp duties due.

Immovable property lease instalments suffer 3.6% stamp duties.

### **Real estate tax**

One other important issue, which should be taken into consideration regarding immovable property, is that from January 1, 1997 all legal entities (and individuals of course) will be called to pay tax for their real estate property of "excessive" objective value. The tax exempt value per legal entity, is determined at the amount of GRD 60,000,000 whereas the -excessive- taxable value is the value exceeding this amount. Thus tax liable companies will be the ones whose property's value exceeds GRD 60,000,000. The taxable base for this tax is the "objective value" of the immovable property as defined by the respective tables of the Ministry of Finance while the tax coefficient is 0.7% for legal entities and scaled rates for individuals.

For individuals the tax exempt value is also GRD 60,000,000 (120,000,000 per spouse) plus GRD 15,000,000 per each dependent child.

## **PROBLEM AREAS AND DISTORTIONS OF COMPETITIONS**

### **Problem areas**

For the time being there are no problem areas, as the respective provisions are suspended until January 1, 2000.

### **Distortions of competition**

If the supply of a building takes place during the adjustment period, the supplier will be obliged to repay VAT to the tax authorities. This leads to cumulation of VAT when the purchaser is entitled to deduct input VAT incurred.

# Ireland

## IMMOVABLE PROPERTY

The term immovable property is defined as land. The term land is defined to include messuages, tenements, and hereditaments, houses and buildings, of any tenure. Broadly, messuage is interpreted as a dwelling house. Tenements means whatever can be the subject of tenure while hereditaments means that which is capable of devolving upon death; these terms are used in a general sense to include such things as houses and land and the rights which arise from them. Tenure denotes the holding of land.

## VALUE ADDED TAX

### Main principles

There are a number of basic principles which must be understood in order to have an overall appreciation of the VAT treatment of property in Ireland. A summary is outlined below.

### Supply of immovable property

There are four basic conditions to be met in determining whether a supply of immovable property is subject to VAT:

1. The property must have been “developed” in whole or in part on or after November 1, 1972. This comprises the developing, cultivation and expanding of an immovable property. If only a part of the immovable property is developed, it is not clear whether or not the complete immovable property is subject to VAT. Furthermore, it is not clear what is to be qualified as maintenance and reparation and what is to be qualified as development.
2. The supplier must hold an “interest” of at least ten years and generally must dispose of an interest of at least ten years. The exclusively holding of a mortgage is not included in this disposal. However, the letting or leasing of an immovable property for a period of 10 years or more is qualified as an interest;
3. The supply must be made “in the course of furtherance of business” of the supplier;
4. The supplier must be “entitled to a deduction” for any VAT on acquisition or development of the property.

As Ireland has a derogation to treat leases as a supply of immovable property, a lease for greater than ten years may be a supply of immovable property if the four tests outlined above are met.

The rate of VAT applicable to a supply of immovable property is

currently 12.5%.

### Letting and leasing of immovable property (< ten years)

Letting of immovable property (< ten years) is a supply of services and exempt from VAT. There are however a number of exceptions to this rule.

A. by virtue of law:

1. The letting of machinery or business installations when let separately from any other immovable property of which they form part (VAT rate = 21%);
2. Letting of hotel and holiday accommodation VAT rate = 12,5% ;
3. The provision by a person other than a non-profit making organisation of facilities for taking part in sporting activities (VAT rate = 21%);
4. Hire of safes (VAT rate : 21%);
5. Vehicle car parking provided by car park operators (VAT rate = 21%)

B. by virtue of option:

The lessor elects to waive the exemption and opts to tax. The rate of VAT applicable to the letting of immovable property (< 10 years) is currently 21%.

C. mixed services/supplies

If one transaction consist of immovable property and a service, for which different VAT rates apply, the highest VAT rate is applicable. In principle, this would mean that the sale of a dwelling house (12,5%) together with its household goods (21%) would be subject to 21% VAT. In practice it appears that the supplier can charge 21% over the market value of the household goods and 12,5% over the remaining amount of the selling price.

### 1997 changes

A number of legislative amendments are currently being introduced to deal with the VAT treatment of broken leases. These new changes deviate from the four basic tests outlined above. As these changes have just been published and are still awaiting formal ratification by the Irish parliament, they have not been incorporated into the questionnaire. Consequently, it is important that the questionnaire is reviewed in conjunction with the summary of changes outlined below.

The 1997 changes in general have effect from March 26, 1997 and can be summarised as follows:

1. It is confirmed that the surrender or assignment of a lease is treated in the same way as the creation of a lease. 'Surrender' would include abandonment or forfeiture of lease;
2. New rules have been introduced for determining the taxable amount in the case of surrender and assignment of leases in certain circumstances;
3. A subsequent supply of the surrendered interest may be treated as a supply for VAT purposes (up to now it was the general view that the original landlord could not make a VATable supply in the absence of further development of the property);
4. An option to tax as a supply of goods is provided where a lease of immovable property of less than ten years is granted following surrender of a lease. This can be done on a lease by lease basis. Alternatively an option to tax the lease as a letting of immovable property is provided i.e. taxed on rental stream.

A reverse charge mechanism has been introduced to provide that in certain circumstances on the surrender or assignment of leases, the new leaseholder is liable to account for the VAT arising on the surrender or assignment. Formal EU approval is awaited for this derogation.

A landlord may also be subject to tax on a reversionary interest on the grant of a taxable lease out of a surrendered or assigned interest. There are new rules introduced for valuing the taxable amount of such reversionary interests.

There has been a change to the definition of "open market price" in Section 10 (10) VATA 1972 in the case of valuing interests in immovable property other than freehold interests. This new definition defines "open market price" as "..... the price, excluding tax, which the right to receive an unencumbered rent in respect of these goods for the period of the interest would fetch on the open market at the time that the interest is disposed of ....."

The above changes have been introduced to combat certain VAT avoidance arrangements which allowed VAT exempt companies to obtain leases of property VAT free. The legislation must be formally adopted by the Irish parliament in May 1997. We are still studying the detailed implications of the legislation which was introduced during the course of our completion of the property questionnaire.

Consequently, our questionnaire does not take into account the changes introduced and should be considered in conjunction with the summary of the changes outlined above.

## **Anti-avoidance**

As outlined earlier, the Revenue has introduced specific anti-avoidance provisions in the 1997 Finance Act to deal with broken leases. These are to combat a number of arrangements which allow that VAT exempt companies to obtain leases of property VAT free.

The following is a summary of how this could have been achieved prior to the introduction of the changes:

1. A group company takes a long term lease of property and recovers VAT charged on the capitalised value;
2. It grants short-term leases to VAT exempt group companies (not a group for VAT purposes) and opts to tax the rental flows;
3. After a period of time it assigns its interest in the head lease to a VAT exempt group company for a nominal amount;
4. The assignment is a taxable supply but the consideration is limited to the nominal amount.

Changes introduced by the Revenue ensure that the taxable amount is calculated as if the assignment was the creation of a lease. Similar provisions apply in relation to surrenders, abandonment, forfeiture of leases etc.

There is an anti-avoidance provision in the legislation to exclude supplies of property from VAT group treatment.

There is also a general anti-avoidance provision which applies to all taxes (Section 86 Finance Act 1989). We are not aware of this provision having been used by the Revenue to-date in the case of VAT.

## **OTHER TAXES ON IMMOVABLE PROPERTY**

### **Stamp duty**

#### **General**

Stamp Duty is payable on instruments which convey property. Stamp Duty is a transaction tax payable by the purchaser. The general rate applicable on sale of property is 6%. However, new residential property is exempt from stamp duty. The rate on second hand residential property can increase to 9%.

The stamp duty charge which applies depends on the nature of the transaction. As outlined above, transfers of property are generally subject to Stamp Duty at 6% of the consideration passing. In the case of leases, there is a separate method for calculating the stamp duty charge on the lease document. (See chapter 12: EA-6).

A typical charge on a lease document would be a once off charge of 6% on the average annual rent, 6% on any premium (>£60,000) and a fixed nominal charge.

The stamp duty rate applicable on transfer of shares in a company is 1%. Due to the 5% differential in the stamp duty rate between transfer of shares and transfer of property, it is preferable where possible to effect a property transaction by the sale of a company rather than the direct sale of the property itself. However, this gives rise to a whole range of commercial issues and in many situations proves impracticable.

### Stamp Duty Reliefs

As stamp duty represents a very significant real cost in property transactions, any steps which can reduce this cost can be very significant. However, the scope for avoidance of stamp duty in property transactions is limited.

There are however, a number of reliefs which are available including the following:

1. reduced rate between connected parties;
2. relief on certain reconstructions and reorganisations involving share transactions;
3. relief on transfer of agricultural land to young farmers.

### Interaction with VAT

Stamp Duty is not payable on any VAT included in the consideration on the conveyance of any property or under a lease.

## **PROBLEM AREAS AND DISTORTIONS OF COMPETITION**

### Key definitions

Key definitions which can give rise to difficulty in determining the VAT treatment of a transaction are as follows:

#### *“Interest”*

The question of what constitutes an “interest” can cause many difficulties of interpretation.

**“Interest”** as defined in Section 4 (1)(b) VATA 1972 means an estate or interest therein which, when it was created, was for a period of at least ten years but does not include a mortgage, and a reference to a disposal of an interest includes a reference to the creation of an interest.

As a disposal of interest includes the creation of an interest, leases created for over ten years can be treated as the disposal of an interest.

The definition of "Interest" has been extended in 1997 legislation (see above) to cover surrenders and assignments (even when less than ten years). Surrenders would include abandonment and forfeiture of leases. However, this does not resolve the difficulties in many situations of determining if an "interest" exists.

There is no specific reference in Irish legislation to *rights in rem* or *shares* as referred to in Article 5 (3) (b), (c) EU Sixth Directive. In addition, there is no definition of right in rem. Consequently, unless a right in rem can be treated as an "interest" it does not within the scope of Irish VAT relating to immovable property.

#### *"Development"*

**"Development"** is defined in Section 1 (1) VATA 1972 and "developed" is construed correspondingly. However, the question of whether a property has been developed can in many instances give rise to difficulties of interpretation e.g. does site work such as laying of foundations on land mean that the land surrounding the foundations is also developed? Repair and maintenance does not constitute development but distinguishing the two can be difficult and is open to interpretation.

Another issue which gives rise to difficulties of interpretation is whether development of part of a building brings the whole building into the VAT net.

#### Reversionary Interests (S.4 (4) VATA 1972)

Another area which can give rise to difficulty is where an interest is disposed of and a reversionary interest retained. The reversionary interest is treated as a self supply at the time of disposal of the interest. For example, where a lease for greater than ten years is granted and is subject to VAT, a self supply will arise on value of the reversionary interest which gives rise to "trapped VAT" which cannot be passed on by the supplier.

#### Second supplies (S.4 VATA 1972, Art. 5 (3)(a))

In general it has been accepted Revenue practice that once there is a taxable supply for VAT purposes, the original supplier will not be subject to VAT on any subsequent supply unless the property has been redeveloped e.g. where a lessor grants a 25 year lease which is treated as a supply for VAT purposes, any subsequent supply of the property would not be subject to VAT where it has not been subsequently developed. This has given rise to many difficulties.

As outlined above, provisions have been introduced in the 1997 Finance Act to deal with second supplies which arise as a result of broken leases.

However, many issues still remain in relation to the question of “second supply” of property which has already been the subject of one taxable supply e.g. a repeat supply by the person who made the first supply. In particular the question of whether development or redevelopment has taken place can give rise to different interpretations. The following examples illustrate the point:

1. X Ltd. grants a 25 year lease to Y Ltd. and charges VAT on the capitalised value of the lease;
2. During the term of the lease Y Ltd. carries out development work on the property and claims an input credit;
3. The property reverts to X Ltd. at the end of the lease;
4. X Ltd. subsequently sells the freehold.

The Revenue view is that the sale of the freehold is subject to VAT as the development work carried out by the tenant was carried out by or on behalf of the landlord. The counter argument is that the development work was carried out by the tenant on his own behalf.

#### Amount on which tax is chargeable (Art.11, S.10 VATA 1972)

On the supply of immovable property, the value of any interest (as defined) in the goods disposed of is included in the consideration. The value of any interest in immovable property shall be the open market price of such interest. Regulations provide for various formula for determining the value of rent to be included in the open market price of the interest disposed of. The Revenue view is that open market price applies to valuing all supplies of property, including self supplies. This is open to interpretation.

It is not clear how using open market price for determining the taxable amount for property transactions ties in with the EU Sixth directive.

In practice, the Revenue normally deal with a self supply by way of clawing back the actual input credit claimed.

#### Trapped VAT on grant of leases trapped for less than ten years (Art.13 C, S.7 Para. (iv) First Schedule VATA 1972)

Businesses can suffer trapped VAT in the case of short term leases. The following example illustrates the problem:

1. A company purchases a freehold property which it uses for its taxable business;
2. It recovers VAT suffered on the purchase;
3. After a year, it lets out part of the building which is surplus to its requirements on a short-term lease;
4. It does not opt to tax the short term rents prior to the lease or

- “surrender of possession”;
5. A self supply arises which is subject to VAT which cannot be passed on;
  6. The Revenue Commissioners do not allow option to tax on a retrospective basis i.e. if the option is not made prior to the letting or before possession is surrendered, trapped VAT arises.

This can give rise to very unfair results.

#### Rates of VAT (Art. 12, S.11 VATA 1972)

The general rate of VAT for property transactions is 12.5% ( the rate applicable to short-term letting of immovable property is 21%). However, where a number of goods and/or services are sold for an all inclusive price, the highest rate of VAT that applies to any of the goods or services package applies to the total consideration. This can give rise to difficulties where for example a house is sold where part of the sale price includes furniture, fittings etc. This would result in the total consideration being liable to VAT at 21%. In practice, the Revenue will allow the vendor to account for VAT on 21% on the open market value of such fittings and at 12.5% on the balance of the consideration.

#### Deemed supplies (Art. 5(3)(a), S.4 VATA 1972)

Where a person disposes of taxable interest in immovable property, a supply of immovable property shall be deemed for the purpose of the VAT Acts to take place. The legislation provides that VAT which forms part of the consideration in a transactions shall be recoverable by the supplier. However, as a supply of property is a deemed supply, there is a question mark as to whether it can be passed on to the recipient in the absence of the recipients agreement.

#### VAT on post letting expenses (Art.17, S. 12 VATA 1972)

A lease of property of greater than ten years can be treated as a supply for VAT purposes. The Revenue view is that the property has gone out of the VAT net for the duration of the lease and therefore VAT on expenses arising during the term of the lease cannot be recovered e.g. ongoing maintenance costs. The case of Erin Executor and Trustee Company Limited v Revenue Commissioners is currently under appeal to the Supreme Court.

A Revenue concession is in place to allow landlords to issue VAT invoice to lessees on an annual basis where the lessees reimburse the company for various ongoing expenses such as provision of insurance, security, cleaning services and light and heat.

#### Relief for bad debts (Art. 11 C (i), S.10 (3)(c) VATA 1972)

No relief is available where VAT arising on the grant of long lease which is treated as supply of immovable property is not recovered from the tenant.

#### Reverse charge mechanism (Art. 27, S.4A VATA 1972)

As a longterm lease may be treated as a supply of immovable property, a VAT charge arises on a notional capitalised value on the grant of the lease. In order to ease cashflow for fully VAT registered businesses, a reverse charge mechanism which makes the leaseholder liable to account for the VAT has been introduced. Formal EU approval for this derogation has not been obtained.

A formal EU derogation has also been requested to permit a reverse charge mechanism in the case of surrenders and assignment of leases in certain circumstances. This has been introduced into national legislation with effect from March 26, 1997.

#### Capital adjustment scheme

A capital adjustment scheme is not in place in Ireland. Therefore, the taxable person recovery rate may not fairly reflect the allocation of goods to taxable/non-taxable use. We understand that the Revenue are considering the introduction of such a scheme.

# Italy

## IMMOVABLE PROPERTY

Italian tax legislation does not contain a definition of immovable property. For the meaning of the term “immovable property” one should refer to civil law. Immovable property are the soil, water sources and water courses, buildings and other constructions, even if joined to the soil for a temporary purpose, and in general everything that is artificially or naturally annexed to the soil. Mills, baths and other floating buildings are also considered immovable when they are securely attached to the bank or the bed and are destined to remain so permanently for their utilization. From the definition in civil law and from the way tax legislation refers to immovable property appears that all rights (*in rem*) follow the applicable tax regime for immovable property transactions.

## VALUE ADDED TAX (“Imposta sul valore aggiunto”)

### Background

VAT was introduced in Italy by the Presidential Decree October 26, 1972, n.633 and took effect on January 1, 1973.

In 1973, the VAT regime of buildings, land and property was the following.

The supply of buildings, including rights *in rem*, was taxable; the letting and leasing (non finance) of immovable property of any kind were exempt while the supply of land of any kind was outside the scope of VAT.

In 1979, the supply of building land was considered as a taxable transaction.

In 1989, the exemption on leasing (non finance) and letting of real property was limited to: residential buildings let by companies other than builders or real estate companies and non building land different from parking areas.

Starting from 1992, no deduction is granted for input VAT on the purchase (also by finance lease) of immovable property in joint estate or in co-ownership with non taxable persons, and on the purchase of immovables instrumental to the practice of crafts and professions or their purchase by means of financial leasing contracts.

Since June, 1996, the leasing and letting of residential buildings carried out by a real estate company, builder or developer becomes taxable; the supply of residential buildings made by taxable persons other than builders, developers, or real estate companies becomes exempt; no deduction is granted for VAT relating to the purchase of buildings, or portions thereof, destined to dwelling use, and the tax relating to the letting of the same, save the businesses which have as exclusive or principal object of the activity carried out the resale of said buildings or of said portions thereof.

The main disputes with the VAT offices, which produced a significant number of case law, revolved around the deduction of Input VAT for Real Estate Management companies.

Although the Italian VAT law does not provide for any specific rule regarding the recoverability of VAT paid by Real Estate Management companies, the Italian Tax authorities took the position that a Real Estate Management company (i.e. a company owning immovable property for the purpose of letting it), even when the letting of the property is taxable, has to be considered as a final consumer from a VAT viewpoint as it does not carry out any real commercial activity. Consequently, they took the view that any VAT paid by it (both on the purchase of immovable property and on any other purchase of goods or services relating to the immovable property activity) is not recoverable, even if the activity carried out by the company is fully VATable. In other words: the Italian VAT authorities would on one side reject any VAT credit refund claim filed by a Real Estate Management company and on the other side disallow any input VAT set off against output tax.

However, with circular letter 8 May 1997, n. 127/E, further to the opinion received from the European Commission according to article 169 of the Treaty of Rome, the Ministry of Finance reverted its position holding that Real Estate Management Companies are carrying out a commercial activity based on Italian VAT legislation and thus input VAT incurred in the acquisition of real estate is deductible.

The 1997 Finance Bill empowers the Government to issue, within September 1997, anti avoidance legislation in order to review:

- a) the definition of taxable persons with respect to activities consisting in the mere enjoyment of goods (whether moveable or immovable) not aimed at the production and supply of goods and services; and
- b) the deduction of VAT and relating adjustment excluding the right of deduction for the purchases of goods and services exclusively destined to non business purposes used for transactions outside the scope of VAT, except from those whose deduction is allowed by the Sixth Council Directive.

Legislative Decree n. 313 was issued by the Government on 2 September 1997. The new provisions took effect starting from January 1, 1998.

## Main principles

### General

The taxable person for VAT purposes is anyone who carries out a business pursuit (or the practice of a craft or profession) as his usual, though not necessarily exclusive, occupation. A person exploiting immovable property is deemed to be a taxable person when he engages, professionally and on a continuing basis, in such activity. Immovable property transactions are in principle subject to the standard rate of 20% (starting from 1 October 1997) , however reduced rates of 10% and 4% may apply. The taxable amount is the consideration paid.

From a VAT perspective, a distinction is made between the supply of immovable property and letting and leasing of immovable property. The establishment, assignment, alteration and cession of rights *in rem* to immovable property are treated as a supply of immovable property. Based on case law, the transfer of ownership subsequent to construction work is to be considered as a supply of goods where the obligation of 'giving' is more relevant with respect to the obligation of 'doing'.

In any case in order to classify the transaction, the specific agreement shall be reviewed in order to ascertain whether it may be considered as a supply of services rather than a sale of a 'future' good.

### Supply of immovable property and rights *in rem*

#### *General*

The main rule is that the supply of immovable property (including rights *in rem* which are treated as a supply of goods while excluding the supply of non building land which is outside the scope of VAT) and financial lease is taxable. However, the supply of building (or parts thereof) destined to dwelling use is exempt from VAT if not carried out by:

1. builder;
2. developer; or
3. property dealer.

### Letting and leasing of immovable property

#### *General*

Letting and (non finance) leasing of immovable property is taxable. However a number of exceptions to this main rule exist.

The following transactions are exempt from VAT:

non financial leasing and hires, related transfer, resolutions and extensions, of

- 1) non building land and areas other than those destined to the parking of motor vehicles; and
- 2) residential buildings, including accessories, effects and in general movable property intended for long-term service and furnishing of the premises leased or let, other than those let by property dealers (i.e. enterprises which built them for sale) which are subject to the reduced VAT rate of 10%.

In particular the following transactions are taxable:

1. Lettings in the furtherance of a hotel, boarding and guesthouse, camping and holiday business;
2. Letting or leasing of parking space for cars;
3. Hire of safes.

#### Deduction of VAT

Input VAT incurred on the acquisition and exploitation of immovable property is recoverable if and insofar the property is used for taxable activities. If an immovable property is purchased by a person engaged in both taxable and exempt activities, VAT can be recovered on the basis of the ratio between exempt and total turnover. An adjustment to said deduction is provided for when the ratio changes by more than 10%. The adjustment period for immovable property is the period elapsing between the moment of the purchase and the fourth following calendar year.

The supply of dwelling houses by a real estate company is subject to VAT. However, if a real estate company also leases the building, the Italian Ministry of Finance is of opinion that the supplier does no longer qualify as real estate company. This means that the supply of the immovable property is VAT exempt and the supplier cannot recover the input VAT on the purchase of the immovable property.

## OTHER TAXES ON IMMOVABLE PROPERTY

### Transfer Tax (“Imposta di registro”)

#### General

The following transactions regarding immovable property located in Italy are subject to transfer tax:

1. the acquisition of legal title to and/or economic ownership of immovable property;
2. the acquisition of rights *in rem*;
3. leasing and letting of immovable property.

The rates of transfer tax are 1%, 4%, 8%, 15% depending on the nature of the property transferred and the kind of transaction.

The taxable base is the market value of the property at the time the transaction is effected or the price if it is higher. Leasing (non finance) contracts are subject to a 2% tax on the amount of the consideration.

#### Relation to VAT

Basically transfer tax aims to tax transfers of immovable property (including rights *in rem*) which are not subject to VAT. In fact, VAT exempt supplies of residential buildings and Vat exempt leasing and letting of immovable property are subject to transfer tax at the above VAT mentioned rates. Conversely, VAT taxable supplies and lettings are subject to transfer tax at the fixed amount of Itl. 250,000. Transfers of immovable property made by way of capital contributions in companies of any kind is subject to transfer tax at the same rates provided for other kind of transfers on the market value of the property unless the immovable property is part of a going concern (or a branch of a going concern) which is contributed.

#### Other exemptions from transfer tax

The acquisition of immovable property by public bodies is exempt from transfer tax while the acquisition as a result of a merger or a demerger is subject to tax at the fixed amount.

## Mortgage and Cadastral Taxes ("Imposte ipotecaria e catastale")

### General

The following transactions regarding immovable property located in Italy are subject to Mortgage and Cadastral Taxes:

1. the acquisition of legal title to and/or economic ownership of immovable property;
2. the acquisition of rights *in rem*.

The compound rate is equal to 3%. The taxable base is the market value of the property at the time the transaction is effected or the price if it is higher.

### Relation to VAT

Basically Mortgage and Cadastral taxes aim to tax transfers of immovable property (including rights *in rem*) which are not subject to VAT. In fact, VAT exempt supplies of residential buildings are subject to transfer tax at the above mentioned rate. Conversely, VAT taxable supplies are subject to tax at the fixed amount of Itl. 500,000.

Transfers of immovable property made by way of capital contributions to companies of any kind is subject to mentioned taxes at full rate provided for other kind of transfers on the market value of the property unless the immovable property is part of a going concern (or a branch of a going concern) which is contributed.

### Other exemptions from transfer tax

The acquisitions of immovable property by public bodies are exempt from these taxes. Mortgage and cadastral taxes are levied at the fixed rate of Itl. 500,000 for the same transactions for which the transfer tax is levied at 4% or 1% with the exception of transfer of archaeological and historical buildings. Transfers of immovable property as gifts to charities are subject to tax at 1/4th of its amount. Transfers made as a result of a merger or a demerger operation are subject to tax at the fixed rate.

### Tax on the increased value of immovable property (INVIM)

The Tax on the increased value of immovable property (INVIM) has been cancelled starting from December 31, 1992. However the tax will be levied for transactions taking place until December 31, 2002 with reference to the increase in value of the property from the date of acquisition and its value as at December 31, 1992.

The tax is levied on gains realized on the disposal of property at progressive rates (between 5% and 30%).

### Real Property Tax ("ICI")

Starting from January 1, 1993 a municipal tax on real estate property (ICI) was introduced. The taxable basis is the cadastral value of the building. The tax rates range from 0.4% to 0.7% as resolved by each Municipality. It is due on a yearly basis for the ownership period in the taxable year. Exemptions are provided for buildings owned by public bodies while a reduction of up to Itl. 200,000 is granted for the main residence. Other reductions on the taxable basis are provided for agricultural land and for historical and artistic buildings.

## **PROBLEM AREAS AND DISTORTIONS OF COMPETITION**

### **Status of supplier**

As mentioned above the VAT treatment of real property transactions depends, among other factors, on the nature of the supplier. In particular a distinction shall be made between builders or developers, real estate companies, real estate management companies.

The difference between the last two companies stays in the fact that the former is a company purchasing real estate for its subsequent sale, while the latter is supposed to be a company owning the real property just for its letting. The problem is that most real estate companies carry out both the sale and the letting activities at the same time.

The Ministry of Finance with CM 182/E of July 11, 1996 held that the nature of a real estate company shall be determined with reference to the actual activity carried out by the company notwithstanding its statutory purpose of the company.- Where the company activity is solely or mainly the letting activity, VAT on the purchase of residential buildings purchased is not deductible while the sale of the same is exempt with a pro-rata deduction effect on all input VAT. In order to overcome such problem, a company carrying out both the sale and letting of real estate, may opt to treat the two activities as two separate businesses for VAT purposes.

### **Cumulation of VAT**

The supply of a commercial building is always VATable. Therefore, the acquisition of a commercial building by an exempt entrepreneur and its subsequent sale to another exempt entrepreneur may lead to cumulation of VAT.

# Luxembourg

## IMMOVABLE PROPERTY

The Luxembourg VAT law does not provide for a definition of “immovable property”. This should therefore be defined under the civil law. Broadly speaking, immovable property consists of land and constructions thereon, and goods permanently fixed to such immovable property, e.g. buildings, roads.

## VALUE ADDED TAX

### Main principles

#### Taxable transactions

Supplies of immovable property are split between supplies of goods (mainly tangible assets) and supplies of services (intangible assets).

Supplies of goods include:

1. the transfer of legal ownership of goods under a sales agreement;
2. the handing over of goods under a hire-purchase agreement;
3. the transfer, by order made by or in the name of a public authority or in pursuance of the law, of the ownership of property against payment of compensation;
4. the handing over of certain works of construction.

Certain interests in immovable property, including rights in rem giving the holder thereof the right as user over immovable property, or shares or interests equivalent to shares giving the holder thereof de jure or de facto rights or ownership or possession over immovable property or part thereof are still qualified in Luxembourg as intangible assets subject to the rules of supply of services. By the issue of a Grand-ducal decree, Luxembourg could however opt for the rules of supply of goods.

#### Exempt and taxable supplies

The supply of immovable property is generally exempt from VAT. This exemption does not apply to:

1. supplies of construction work pursuant to a construction contract;
2. supplies of property to the extent that the construction sold does not exist at the time of signature of the contract; this provision is difficult to apply in practice.

### Letting and leasing of immovable property

The letting and leasing of immovable property is generally exempt from VAT. This exemption does not apply to :

1. the provision of short-term accommodation in the hotel sector;
3. the letting of equipped premises or sites outside public roads, that are used for parking vehicles. As a consequence of Case 173/88, *Morten Henriksen* this exception has been extended from January 1, 1995 to long-term parking but does not apply to the letting of parking that is closely linked to an exempt leasing of immovable property, i.e. where the parking and the building belong to the same site and are leased by the same landlord to the same tenant;
4. the leasing of machinery and business installations of whatever kind;
5. the hire of safes.

### Option for taxation/waiver of exemption

Taxable persons may request a waiver of the exemption and elect to have their transactions subject to VAT, provided the person to whom they are supplying, transferring or leasing the property is also a taxable person (Art. 45 CTVA).

Furthermore, the option requires that the property is used wholly or mainly for the purpose of activities for which the acquirer or lessee is entitled to a credit for input VAT. For example, a lessor may not opt if the lessee is a bank which has a pro-rata of deduction of less than 51%. The lessee or purchaser has to certify that this condition will be met, by signing the option form.

In case of sales, the agreement of the VAT authorities must be obtained before the official registration of the sale. It is important to note that opting for VAT on a sale does not avoid the application of the proportional registration duties.

In the case of leases, the application must be supported by a written leasing contract that has been registered. Only the fixed registration duty will apply where the leasing contract is subject to VAT. VAT may be charged from the first day following the month where the option has been agreed by the VAT authorities.

However, with respect to payments to building contractors, a special rule applies. If, at the moment of issuance of an invoice, it is clear that the immovable property will be used for VAT taxable activities, and the owner will attend that an option is filed, the tax authorities in general approve the recovery of VAT. Thus, it is avoided that VAT should be financed in advance.

The special regimes of farmers and small enterprises do not apply to the supply of immovable property subject to VAT by operation of the option.

### Transfer of a business

The transfer of a business as a whole or a separate division of a business, that would include immovable property, is outside the scope of VAT. The transfer does not alter the option to apply VAT on immovable property as the recipient of the business is treated as the successor to the transferor, provided that the property is used under the same conditions.

### Deductions

The general rules for deducting input VAT apply to supplies in respect of immovable property. The following particularity should be noted: in case of construction of a building, the landlord only recovers input VAT as of the date of the Administration's agreement to the option to apply VAT to the sale or lease of the building. However, the Administration may authorize the deduction on receipt of the invoices where it is clear that the building will be used for qualifying activities and the landlord binds himself to file an option application at the end of the construction.

### *Adjustments*

The initial deduction of VAT must be adjusted where, after the return is filed, a change occurs in the factor used to determine the deductible amount, such as:

1. price reductions or cancellation of purchases (for all goods and services);
2. changes of pro-rata rates over the years or disposals of goods (for capital goods).

Capital goods are defined by a Decree of March 3, 1980 as tangible movable or immovable property which are subject to depreciation under the income tax law. It also includes work which qualifies under the income tax law as investment expenditure (as opposed to maintenance or repair expenses).

The adjustment period for immovable capital goods is 10 years. The adjustment period starts from 1 January of the year in which the construction or investment works end or, in case of acquisition, January 1 of the year in which the building has been used.

Luxembourg did not make use of the option provided for in the Second Directive to extend the period to 20 years.

Where the use of the capital good has been deferred, the adjustment period starts from January 1 of the year in which the goods are first used, either for business or private purposes.

The annual adjustment is made for one tenth of the tax imposed on goods. The adjustment is made on the basis of the variations in the entitlement to deduction in subsequent years in relation to that for the year in which the goods were acquired or manufactured.

*Example 1: In 1996, a bank acquired a building worth LUF 10,000,000 exclusive of 15% VAT. Its 1996 general pro-rata being 10%, it has recovered LUF 150,000. This deduction will have to be adjusted from year 1997 to year 2005. Assuming that the 1997 pro-rata is 30%, the bank will claim in its 1997 annual VAT return an additional deduction of  $(1,500,000 \times 30\% \times 1/10) - (1,500,000 \times 10\% \times 1/10)$  or LUF 30,000.*

In case of supplies or self-supplies of movable capital goods, the capital goods are regarded as if they had still been applied for business use by the taxable person until expiry of the period of adjustment. The adjustment is made only once for the whole period of adjustment still to be covered.

If the supply is made before July 1 of any adjustment year, the remaining period of adjustment starts from January 1 of that year. If the supply or self-supply is made after June 30 of any adjustment year, the remaining period of adjustment starts from January 1 of the following year.

*Example 2: In 1995, a bank acquired a building worth LUF 10,000,000 (exclusive of 15% VAT), for which it benefits from a deduction of LUF 150,000 (assuming a constant 10% deduction pro-rata) and resells it in December 1996.*

*The remaining adjustment period starts from year 1997 to 2004. The bank will claim in its 1996 annual VAT return an additional deduction of  $(150,000 \times 8/10) - (150,000 \times 10\% \times 8/10)$  or LUF 108,000.*

For simplification reasons, no adjustment has to be made if the amount does not exceed LUF 5,000.

## **OTHER TAXES ON IMMOVABLE PROPERTY**

### **Registration duties ("Droits d'Enregistrement")**

Registration duties are levied at:

1. a fixed rate ranging from LUF 100 to LUF 100,000, applicable to deeds which do not contain an obligation of sums or securities, nor relate to the transfer of immovable property usufruct or enjoyment of immovable property or chattels;

2. a proportional rate ranging from 0.24% to 14.4% depending upon the nature and the purpose of the legal procedure involved, in respect of deeds which contain an obligation in cash or securities, and for all transfers inter vivos of property and usufruct or enjoyment of immovable property or chattels.

A transfer of property other than immovable property, or rights subject to VAT, are only subject to fixed rate duty on registration. Transfer of immovable property is normally subject to a 6% duty, which is to be increased by the mortgage duty and local taxes. The global rate for Luxembourg city is 10%.

Capitalisation of reserves is subject to a flat rate of LUF 100 only.

The lease of immovable property is subject to a registration duty of 0.6%.

### **Stamp duties (“Droits de timbre”)**

Legal instruments, whose purpose is to provide evidence of contract, are subject to a stamp duty. The rate ranges from LUF 25 to 160 depending on the size of the contract.

Certain official documents such as passports, licenses, permits, certificates, legislation, authorizations etc. are also subject to a flat-rate duty ranging from LUF 10 to 2,000.

### **Mortgage duties (“Droit d’Hypothèques”)**

Registration or renewal of the registration of a mortgage, is subject to a 0,5 mortgage duty computed on the value of principal of the debt registered.

Transfers of mortgages are in principle subject to 1% of the market value of the underlying property. This rate is reduced to 0.5% in case of certain properties such as rural properties and low-cost housing, and in case of certain deeds, such as exchanges and sale of property in case of bankruptcy.

## PROBLEM AREAS AND DISTORTIONS OF COMPETITIONS

### Affectation of a building for dwelling house purposes

As a result of decisions taken at the ECOFIN Meeting (24/06/91) which allowed Luxembourg to submit certain operation to the reduced VAT rate of 3%, during a transition period, the affectation of a building for dwelling house purposes is regarded as a taxable operation subject to this reduced rate.

Any person - in general individual - who carries out this operation is deemed to be a taxable person till the end of the adjustment period (10 years). The operation considered consists in the fact of using a new building or a renewed building as a dwelling house (at least 75%) for his own purposes, or by renting such an habitation to a third party. The mechanism used by Luxembourg taxes at 3% such an affectation. The tax liability is computed on the value of the construction of the building, including front work, electric and sanitary installations and heating system.

In practice, the individual who acquires a dwelling house will be invoiced with VAT at a rate of 15% on the sale price of the dwelling house (the transaction will be considered as a taxable supply of goods). Then, he will be entitled to a reimbursement of the VAT paid in relation to the construction (including front work, electric & sanitary installations and heating system) at a rate of 12%. On a net basis, those elements have suffered VAT at 3%, according to the Luxembourg legislation.

As already mentioned, this regime which seems to be advantageous in comparison with the rules provided by the Sixth Council Directive has been specifically authorized by the ECOFIN Meeting of 24/06/91.

### Option to tax

The mechanism of option to tax transactions introduced in the Luxembourg legislation by art. 45 CTVA and GDD 7/03/80 leads to the following consequences for taxable persons who only have a partial right to deduct input VAT:

1. According to Luxembourg principles the possibility to opt to tax is only granted where the rights in rem or buildings acquired or rented are mainly (> 50%) used to carry out activities which allow the taxable person to deduct input VAT.

If the pro-rata of the taxable person is less than 50%, the real estate transaction could not be subject to VAT. The purchaser/lessee will consequently lose its partial right of deduction on the immovable property transaction as the supplier/ lessee is supposed to increase the price of the transaction with the VAT cost he has suffered.

2. On the other hand, if the real estate transaction is not subject to VAT,

there will be no VAT on the value added by the supplier/lessor to the purchaser/lessee.

### Adjustment period

Luxembourg did not choose to extend the period of regularisation, up to 20 years, of the input VAT on the acquisition of immovable property. The adjustment period applicable in Luxembourg is 10 years.

As a consequence of the length of this adjustment period, the Luxembourg market for immovable property aging more than 10 years offers an incentive.

### Sale of constructions on plans

In principle, the supply of immovable property or rights in rem is exempt from VAT unless this supply results from a sale of a construction on plans and assuming that the building is not yet existing at the time of the sale.

In principle, where the building is partly constructed, the sale price should be split between the part constructed and the part to be constructed for the application of VAT. In practice however it is difficult to proceed to such splitting.

### Cumulation of VAT & transfer tax

The transfer of immovable property does not benefit from the principle of avoidance of double taxation contained in the paragraph XIII of Article 37 of the Law of 7 August 1920. Accordingly, a transfer of the legal property immovable property is always subject to registration duties, which range from 7 to 10%, whether or not the transfer is subject to VAT.

The principle of avoidance of double taxation only applies to the transfer of movable property or rights. Under civil law, a leasing contract in respect of immovable property qualifies as movable property and therefore does not suffer from double taxation. However, the Luxembourg administration tend to requalify as sales certain financial lease operations. This explains that such operations are not frequent in Luxembourg.

In order to reduce the risks of requalification, new law which entered into force on January 1, 1997 specifically provides that a financial lease transaction will not be subject to registration duties under certain conditions. The qualifying financial lease is an operation where a professional lessor (or a company specifically set up by such professional) leases immovable property provided that:

1. the property is used for business purposes;
2. the contract is signed for a fixed duration based on the depreciation life of the property;
3. at the end of the lease, the lessee can opt for:
  - a. returning the property to the lessor;
  - b. renewing the contract;
  - c. buying the property on the terms provided for in the contract;
4. the lessor has to opt for VAT.

If the lessee buys the property, the registration duties apply on the lease and transfer payments which can not be lower than market price.

In case of immovable property transactions subject to VAT (other than leasing/letting), a cumulation of VAT and transfer tax would be supported by the purchaser: in effect, if the purchaser is not entitled to fully recover input VAT, a double taxation of the transaction occurs.

# The Netherlands

## IMMOVABLE PROPERTY

Netherlands tax legislation does not contain a definition of the word “immovable property”. For the meaning of the word “immovable property” one should refer to civil law. Goods are tangible objects susceptible to human control. Immovable property are land, unextracted minerals, plants and buildings directly or indirectly attached to it.

From the definition in civil law and from the way tax legislation refers to immovable property appears that certain rights (*in rem*) follow the applicable tax regime for immovable property transactions.

## VALUE ADDED TAX (“Omzetbelasting”)

### Background

VAT was introduced in the Netherlands by the “Wet op de omzetbelasting 1968” and took effect on January 1, 1968. In so far as relevant for immovable property one should distinguish between the following periods:

1. between 1968 and January 1, 1979;
2. between January 1, 1979 and March 31, 1995, 18.00 hours;
3. as of March 31, 1995, 18.00 hours.

### 1968 - 1979

#### *Supply of immovable property*

Between 1968 and 1979, the first supply of “newly constructed” immovable property (including the establishment, assignment, alteration and cession of rights *in rem* during a period longer than 10 years) was taxable. The subsequent supplies were exempt from VAT unless input VAT was wholly or partially deductible with respect to the previous supply.

The regular VAT system was not applicable for immovable property transactions as a result of the long-term lifespan of immovable property in connection with the possibility of various sales by both entrepreneurs and private individuals during this period. The application of the regular VAT system would lead to cumulation of VAT.

### *Letting and leasing of immovable property*

The letting and leasing of immovable property (including the establishment, assignment, alteration and cession of rights *in rem* with a duration not longer than 10 years), was exempt from VAT. The following exceptions on this main rule existed.

A. by virtue of law:

1. letting and leasing of machinery equipment and business installations;
2. letting in the furtherance of a hotel, boarding and guesthouse, camping and holiday business to person staying only for a short period of time.

B. by virtue of option:

Lessor/landlord opts to tax, provided that the lessee was an entrepreneur who uses the immovable property in the course of his business. A person who exploited immovable property was not deemed to be an entrepreneur for VAT purposes. To avoid cumulation of VAT, these persons had the possibility to opt to tax.

January 1, 1979 - March 31, 1995, 18.00 hours

### *Supply of immovable property*

The VAT regime with respect to the supply of immovable property completely changed. The main rule the supply of immovable property (including the establishment, assignment, alteration and cession of rights *in rem*) became exempt from VAT. The following exceptions on this main rule existed:

1. When the supply took place before, on or within two years after the day on which “newly constructed” immovable property was first put into use (VAT is due by virtue of law); or
2. By virtue of an option in case the two years period has been expired.

### *Letting and leasing of immovable property*

In principle, the VAT regime with respect to the letting and leasing of immovable property did not change completely. The main rule remained that letting and leasing of immovable property is exempt from VAT with the possibility to opt to tax. The most important changes were as follows.

1. The establishment, assignment, alteration and cession of rights *in rem* with a duration not longer than 10 years were deemed a supply of immovable property.

2. As a result of implementation of the Sixth Council Directive, the following transactions are no longer exempt from VAT:
  - a. letting or leasing of parking space for cars;
  - b. hire of safes;
  - c. the provision of berths and sheds for boats.
3. The right to opt to tax did not any longer contain the restriction that the lessee should use the immovable property in the course of his business. The Netherlands has chosen to extend the possibility to opt to tax in order to avoid that the lessor would charge through the non-deductible VAT to a non-entrepreneur at once or during the adjustment period of 5 years. One felt this very troublesome. However, the right to opt to tax was not possible in case it concerned the letting and leasing of dwelling houses.
4. The right to opt to tax was only possible on joint request of lessor and lessee.
5. The word entrepreneur were extended with the person who exploited immovable property.

March 31, 1995, 18.00 hours - to date

*Supply of immovable property*

As a result of implementation of anti-abuse rules to counter unacceptable VAT planning schemes by persons which were not (wholly) entitled to deduct input VAT incurred, the following changes have been introduced.

1. The possibility to opt to tax has been restricted.
2. The establishment, assignment, alteration or cession of rights *in rem* are only deemed to be a supply of immovable property if the taxable amount, increased with VAT, exceeds the fair market value of the immovable property subject to the right *in rem*.

*Letting and leasing of immovable property*

By means of introduction of anti-abuse rules to counter unacceptable VAT planning schemes by persons which were not entitled to deduct input VAT, the possibility to opt to tax has been restricted.

### Anti-abuse rules

In 1989, The Netherlands have introduced two anti abuse rules. Both rules have been introduced to avoid financial disadvantage for the tax authorities when the supplier **does not pay the VAT due to the tax authorities whereas the customer is entitled to deduct this VAT as input VAT**. The following anti-abuse rules have been introduced.

1. Application of a reverse charge mechanism where transferor and purchaser have opted for a taxable supply of immovable property. Especially in situations as bankruptcy of the transferor, a financial disadvantage is avoided, as the tax authorities are not the most preferential creditor.
2. Application of the reverse charge mechanism in case of subcontracting (or hiring out of employees) on works of construction. Especially in the situation of a dishonest subcontractor, a financial disadvantage for the tax authorities is avoided. As a result of the reverse charge mechanism fraud is more difficult, as the entrepreneur who is entitled to deduct VAT is the same entrepreneur as the one who is liable to VAT.

### Additional anti-abuse rules

In 1993 The Netherlands has requested the Council to extend the adjustment period up to 20 years. As a result of implementation of the Second Simplification Directive, Member States have the possibility to extend the adjustment period regarding immovable property up to 20 years. However, The Netherlands did not make use of this possibility.

In 1995, some additional anti-abuse rules have been introduced to counter unacceptable VAT planning schemes by persons who were not entitled to deduct input VAT.

### Leasing of (new) buildings to exempt entrepreneurs or public bodies

The option to tax leasing was introduced to avoid distortion of competition if the lessee would be entitled to deduct input VAT. A lower VAT burden was possible if an entrepreneur without the right of deduction (e.g. an insurance company) or a non-taxable legal entity (e.g. a public body) leased a (new) building from a connected person (e.g. an affiliated real estate company) for a very low lease price where lessor and lessee opted to tax. To avoid these unjustified VAT savings, anti-abuse rules were introduced. These anti-abuse rules have been implemented on December 29, 1995, but most of the rules entered retroactively into effect on March 31, 1995, 18.00 hours.

The following rules were introduced.

1. Extension of the single taxable person for VAT purposes. A person or entity who is considered as an entrepreneur for VAT purposes as a result of the exploitation of immovable property to generate revenues on a continuing basis can also be member of the fiscal unity since December 29, 1995.
2. Since March 31, 1995, 18.00 hours, an option to tax is only possible in case the lessee (or: purchaser) uses the building for transactions which will entitle him to a deduction of at least 90% of input VAT.

#### Supply of buildings to exempt entrepreneurs or public bodies

With respect to the supply of immovable property, the option to tax has also been restricted to purchasers which are entitled to an input VAT deduction of at least 90% to avoid unjustified VAT savings.

However, in this respect it should be noted that this restriction to opt to tax does not apply in case it concerns the supply of “newly constructed” immovable property within the two years period, since this supply is subject to VAT by virtue of law. Therefore, another anti-abuse rule has been implemented to avoid unjustified VAT savings in such cases. This anti-abuse rule is as follows.

Normally, the supply of “newly constructed” immovable property is subject to VAT but exempt from real estate transfer tax. However, when the taxable amount, increased with VAT, is lower than the fair market value and the purchaser does not comply with the 90%-criterion, the exemption of real estate transfer tax does not apply. Therefore, an unjustified VAT saving would result in the liability to 6% real estate transfer tax. Cumulation of VAT and real estate transfer tax may occur under certain conditions.

#### Establishment of rights *in rem* by social housing associations

The establishment of rights *in rem* (e.g. usufruct, servitude, emphyteusis, right of superficies and apartment right) is considered to be a supply of goods. Before March 31, 1995, 18.00 hours, no specific conditions needed to be met. However, this led to unjustified advantages, especially for social housing associations, as the taxable amount in case of establishment of a right *in rem* is fixed on the discounted value. As a consequence, the taxable amount in case of establishment of a right *in rem* is lower than the taxable amount in case of the supply of immovable property.

Unjustified advantages were created as various social housing associations established a right of usufruct on “newly constructed” dwelling houses to connected companies who actually let the dwelling houses to the private individual for a period of 10 years (adjustment period) for a very low yearly retribution. The dwelling house returned to the social housing association after the 10 years period has been expired by virtue of law. As a result, the social housing association was entitled to wholly deduct VAT on the purchase price where (non-deductible) VAT was only due on the (very low) discounted value of the right of usufruct.

To counter this, the establishment, assignment, alteration or cession of rights *in rem* is only considered as a supply of goods if the taxable amount, increased with VAT, is not lower than the fair market value. This anti-abuse rule was introduced on December 29, 1995 but entered retroactively into effect on March 31, 1995, 18.00 hours.

## **Main principles**

### **General**

The taxable person for VAT purposes is the entrepreneur. Any person exploiting immovable property is deemed to be an entrepreneur. Immovable property transactions are in principle subject to the standard rate of 17.5%. The reduced rate is 6%. For immovable property transactions, the reduced rate is only relevant in the hotel sector. The taxable amount is in principle the consideration.

From a VAT perspective, a distinction is made between the supply of immovable property and letting and leasing of immovable property. The following is amongst others considered as a supply of immovable property:

1. transfer of legal title by agreement;
2. hire-purchase contract;
3. works of construction if this work leads to “newly constructed” immovable property;
4. the expropriation of immovable property;
5. transfer of economic ownership;
6. finance lease;
7. self supplies;
8. the establishment, assignment, alteration and cession of rights *in rem* to immovable property, provided that the taxable amount, increased with VAT, is not lower than the fair market value of the property (which is deemed to be at least the cost price). Rights *in rem* include usufructs (“vruchtgebruik”), servitude (“erfdienstbaarheid”), emphyteusis (“erfpachtsrechten”), right of superficies (“opstalrecht”) and apartment rights (“appartementenrechten”).

Letting and leasing is not defined in the Dutch VAT Act. According to

Civil Law, letting and leasing means that:

1. the lessor supplies the lessee with the right to use a certain good or property or part thereof;
2. during a specified period; and
3. at a certain price.

Letting and leasing includes every other. The following is amongst others considered as the letting and leasing of immovable property:

1. operational lease;
2. the establishment, assignment, alteration and cession of rights *in rem* to immovable property if the taxable amount, increased with VAT, is lower than the fair market value of the property.

### Supply of immovable property

#### General

The main rule is that the supply of immovable property is exempt from VAT. No distinction is made between the supply of a building (including the land on which a building stands) and the supply of land. VAT is, however, chargeable on the supply of immovable property in the following two situations:

1. When the supply takes place before, on or within two years after the day on which “newly constructed” immovable property was first put into use (VAT is due by virtue of law).

#### *“Newly constructed”*

The term “newly constructed” is based on a decision of the EC Court of Justice (Case 139/84). “Newly constructed” means the constitution of a good that did not exist before. The new good has a different function than the materials used (function or use of immovable property changed or (re)construction costs are high in itself and high in comparing to the value of the immovable property). The condition that it must concern “newly constructed” immovable property applies for both buildings and land.

2. If before the supply of the immovable property a joint request by the entrepreneur and the recipient has been filed to the tax authorities to tax the supply (VAT is due by virtue of an option).

### *Option for taxed supplies of immovable property*

To opt to tax a supply of immovable property is only possible if the recipient is entitled to at least 90% deduction of input VAT incurred during the period elapsing between the time of the supply and the end of the calendar year (accounting year) following the year in which the supply took place. For travel agencies, real estate agents (brokers) and employers' organizations the percentage of 90 is reduced to 70.

If the exemption is waived the recipient is liable to pay the VAT due to the Netherlands tax authorities under the self assessment method. A deduction of (almost) the same amount is possible. Hence, no or a VAT liability up to a maximum of 10% (or 30%) remains.

If afterwards it appears that the recipient did not comply with the 90%-criterion during aforementioned period, the taxable supply is reverted into an exempt supply. If so, the recipient is liable to VAT due by the supplier as a result of an adjustment of input VAT, if any. The supplier may also be held liable, unless he acted in good faith.

### Self supply of immovable property

To avoid distortion of competition, a self supply occurs when an entrepreneur puts into use manufactured or produced goods (i.e. immovable property), resulting in "newly constructed" immovable property, in his own business where the entrepreneur is not wholly entitled to deduct input VAT incurred when he would purchase the immovable property from a third party. This self supply rule also applies in case of immovable property constructed from goods (including land) entrusted by the principal. Under current legislation no distinction is made between the self supply of buildings and land.

### Letting and leasing of immovable property

#### *General*

Letting and (operational) leasing of immovable property is exempt from VAT. A number of exceptions on this main rule exist. The following transactions are subject to VAT:

#### A. by virtue of law:

1. Letting of machinery equipment and business installation;
2. Lettings in the furtherance of a hotel, boarding and guesthouse, camping and holiday business to persons staying only for a short period of time;
3. Letting or leasing of parking space for cars;
4. Provision of berths and sheds for boats;
5. Hire of safes.

B. by virtue of option:

Lessor/landlord and lessee/tenant elect to opt to tax.

#### *Option for taxable letting or leasing*

An election to tax letting and leasing (income) is possible for all immovable property (including rights *in rem* which are treated as a supply of services) unless it concerns the letting and leasing of dwellings. The election must be signed by both the lessor (landlord) and the lessee (tenant). The election may have retroactive effect for a maximum of three months.

As of March 31, 1995, 18.00 hours, the possibility to tax the letting and leasing is only possible if the lessee is entitled to at least 90% deduction of input VAT. The percentage of 90 is for specific tenants reduced to 70 (see above).

A transitional measure exists to minimize the disadvantages for lettings and leases existing on March 31, 1995, 18.00 hours whereby the tenant/lessee is not entitled to a deduction of input VAT for at least 90%. Consequently, these leases can be continued subject to VAT during the remaining adjustment period even if the lessee does not comply with the 90%-criterion.

#### Deduction of VAT

Input VAT incurred on the acquisition and exploitation of immovable property is recoverable if and insofar the property is used for taxable activities. If an immovable property is used for both taxable and exempt activities, VAT can be recovered on the basis of the ratio between taxable and exempt turnover, unless the actual use of the immovable property differs for more than 10% of this ratio. The adjustment period for immovable property is the period elapsing between the moment of the taxable supply and nine calendar years following the year of the supply.

#### Law proposal on supply of land

In current legislation, no distinction is made between the supply of buildings and the supply of land. This means that the supply of “newly” constructed land is subject to VAT by virtue of law.

### Supply of building land

There is no specific definition of building land. However, the Supreme Court has decided that building land means improved land. Land is improved if -with a view to building- one of the following conditions has been fulfilled:

1. work has been carried out on that land; or
2. infrastructures have been installed which exclusively serve that land;

### Supply of land which has not been built on other than building land

The supply of land which has not been built on other than building land might also be subject to VAT by virtue of law if it is “newly constructed” (e.g. agricultural land that has been ploughed to land to be used for the floriculture).

However, the Supreme Court ruled that the supply of land other than building land, as referred to in Article 13B (g) Sixth Council Directive, should always be exempt from VAT (unless the taxable person (entrepreneur) and the recipient waived their right to the exemption), even if it concerns “newly constructed” land. Consequently, the supplier of land, other than building land, has the right to choose for application of the national legislation (17.5% VAT is due; no transfer tax) or the Sixth Council Directive (no VAT and consequently 6% real estate transfer tax is due).

### Law proposal

Law proposals are pending to change the national provisions as such that national legislation is in accordance with the Sixth Council Directive. Thus, the supply of building land is taxable and the supply of land other than building land is than exempt from VAT. To avoid difficulties whether or not land is improved, a definition of the word “building land” will be included in the national legislation. Building land shall mean land which has not been built on whereby -with a view to building- one of the following conditions have been fulfilled.

1. work has been carried out on that land;
2. infrastructures have been installed which exclusively serve that land;
3. infrastructures have been installed in the neighbourhood of that land;
4. a building permit has been granted.

## OTHER TAXES ON IMMOVABLE PROPERTY

### Transfer tax (“Overdrachtsbelasting”)

#### General

The reason why The Netherlands have chosen to implement a tax on the acquisition on immovable property is only for budgetary purposes. The following transactions regarding immovable property located in The Netherlands are subject to transfer tax:

1. the acquisition of legal title to and/or economic ownership of immovable property;
2. the acquisition of rights *in rem* (excluding mortgages and groundrent);
3. the acquisition of a substantial interest in real estate companies (i.e. companies of which the objective and actual activity is owning, letting and/or exploitation of immovable property and 70% or more of the company’s assets consist of Netherlands immovable property);
4. the acquisition of certain certificates which entitle the owner to a pro rate share of immovable property;
5. the acquisition of a membership of an association that entitles its members to make use of immovable property.

Transfer tax amounts to 6% of the greater of the fair market value of the real estate or the consideration and is due by the acquirer (recipient). If shares in a real estate company are acquired, the taxable amount is the value of the immovable property represented by the shares or the consideration allocable to the immovable property if higher.

#### Relation to VAT

Basically transfer tax aims to tax transfers of immovable property (including rights *in rem*) which are not subject to VAT. In practice this means that the supply of immovable property is not subject to transfer tax when:

1. the newly constructed immovable property has not been used as a business asset; or
2. the immovable property has been used as a business asset and the acquirer is not entitled to a wholly or partly deduct the input VAT.

This transfer tax exemption is only applicable if the supply is subject to VAT by virtue of law. The exemption is not applicable if VAT is due by virtue of option. This exemption avoids double taxation in most cases, but nevertheless it may occur.

Due to the differences in approach, VAT rules are both civil law and economically oriented while transfer tax rules are almost merely based on civil law, the application rules of primary legislation e.g. lead to double taxation (e.g. hire-purchase, transfer of business and transfers within a fiscal unity). The tax authorities approve that nonetheless the exemption is applied.

#### Other exemptions from transfer tax

A number of acquisitions of immovable property is exempt from transfer tax. The most important exemptions apply for acquisitions:

1. by public bodies;
2. by social housing associations;
3. as a result of a merger operation;
4. as a result of a (internal) reorganization;
5. as a result of a capital contribution.

To avoid abuse of VAT legislation it is determined that all the exemptions from transfer tax are not applicable if the acquirer (recipient) is not entitled to deduct at least 90% of the VAT incurred in relation to the supply of the immovable property (or right *in rem*) and the consideration for the supply is below the fair market value (increased with VAT) of the immovable property (or right *in rem*). A collision of VAT and transfer tax may occur.

#### Real property tax (“Onroerende-zaakbelasting”)

##### General

If a person - individual or legal entity - owns and/or uses immovable property at January 1 of any year, this person will be liable to real property tax for the whole fiscal year (calendar year). A subsequent sale or a termination of the rental agreement during the fiscal year does not reduce the property tax liability.

The value of immovable property will be determined by the local authorities once every four years. The taxable value is the highest of fair market value of the immovable property or the depreciated replacement value. The latter value is based on the cost approach.

The tax rate depends on the municipality in which the immovable property is located. The average tax rate NLG 12.00 per NLG 5,000 value for ownership and NLG 10.00 per NLG 5,000 value for the use the immovable property.

## Relation to VAT

The taxable value is to be determined including or excluding VAT. The use of VAT or transfer Tax in the valuation goes under basically the same conditions as the rules determined for supply of property or newly constructed real estate. This implies that for newly constructed immovable property during the first two years after the property is put into first use any non recoverable VAT is included in the value of the immovable property.

When the immovable property has been put into use for more than two years ago it depends on the valuation method whether or not non recoverable VAT must be included in the value of the immovable property for real property tax. Due to new legislation on real property tax which became effective on the January 1 1997, the VAT effect on the valuation for real property tax purposes is not clear. Therefore, jurisprudence is expected on this matter.

## **PROBLEM AREAS AND DISTORTIONS OF COMPETITIONS**

### **Problem areas**

There have been various problem areas in interpreting VAT provisions in The Netherlands. A detailed explanation is too lengthy for this brief overview (but further details are mentioned in the chapter "Country by country reports"). Therefore, we have outlined some important problem areas.

1. Going concern regime in case of a transfer of leased buildings.

It is not always clear if the transfer of leased immovable property will lead to a transfer of a business. This can be relevant with respect to the payment to the tax authorities of initial input VAT on purchase price as a result of the adjustment rules.

2. "Newly constructed" immovable property in case of transformed buildings.

It can be relevant whether or not immovable property has been "newly constructed" (for example: application of self supply rule, supply of "newly constructed" immovable property within the two years period, application of adjustment period). In case a complete new building has been constructed it is not difficult to determine if it concerns a "newly constructed" building. However, especially in case of a transformation of a building, it is not always clear whether or not the building has been "newly constructed". As a consequence, there is much case law on this particular subject.

### 3. Supply of (un)improved land.

We refer to “Law proposal on supply of land”.

#### Application of anti-abuse rules

Anti-abuse legislation is relative new. It is therefore not possible to survey the problem areas. However, we expect various problems in application of these anti-abuse rules (e.g. application of 90% criterion, “overkill effects”).

#### **Distortion of competition**

The following may lead to distortion of competition.

1. As a result of anti-abuse rules, current legislation may lead to distortion of competition if the adjustment period has not been expired and it is not possible to opt to tax where the lessee is entitled to deduct part of the input VAT incurred. This is especially the case if the input VAT deduction of the lessee approaches the 90% and the building is relative new. The following may lead to distortion of competition:

To reduce distortion of competition, two measures have been introduced:

- a. For some branches a 70%-criterion has been implemented;
  - b. Option to tax per different floor in a building is possible.
2. In case of exempt leasing it is common practice that the lessor will charge through the whole amount of non-deductible VAT to the lessee during the adjustment period of 10 years, although the economic lifecycle of buildings is much longer.
  3. In order to achieve that the yield is not negatively influenced, the lease is increased with an amount of which the discounted value equals the non-deductible VAT on the investment.
  4. Different VAT treatment between the supply of “new” buildings (e.g. finance lease) and the letting and leasing of “new” buildings (e.g. operational lease) may lead to unjustified differences where the lessee approaches the 90%-criterion and may restrain modern financing forms. Finance leasing of “new” buildings is taxable by virtue of law where operational leasing is exempt from VAT without the possibility to opt to tax if the lessee does not fulfill the 90%-criterion.

# Portugal

## IMMOVABLE PROPERTY

Portuguese VAT legislation does not contain a definition of immovable property. For the meaning of the term “immovable property” one should refer to civil law. Immovable property concept comprises land, building land, buildings or parts thereof, the waters, trees and forestry whilst attached to the soil and any rights directly connected to the above immovable property. From the definition in civil law and from the way tax legislation refers to immovable property it can be concluded that rights (*in rem*) follow the applicable tax regime for immovable property transactions.

## VALUE ADDED TAX (“Imposto sobre o Valor Acrescentado”)

### Main principles

#### General

The Portuguese definition of taxable person for VAT purposes is very similar to the one laid down in the Sixth Council Directive, being so considered any person or corporate entity that independently carries out any economic activity, namely all activities of producers, traders and persons supplying services and activities of the professions. Any person exploiting immovable property is deemed to be a taxable person. Immovable property transactions are subject to the standard rate of 17%. The reduced and intermediate rates are 5% and 12%, respectively. Madeira and Azores Autonomous Regions benefit from a special reduction, the rates being 12% (standard rate), 8% (intermediate rate) and 4% (reduced rate). The taxable amount is the consideration which has been or is to be obtained by the supplier.

From a VAT perspective, a distinction is made between the supply of immovable property and letting and leasing of immovable property. It is unclear whether the establishment, assignment, and cession of rights *in rem* to immovable property may be treated as a supply of immovable property or, alternatively, as a supply of services. It has to be noted that VAT was recently introduced in Portugal (1986) and that, for simplicity reasons the Portuguese VAT Code only mentions that operations which are subject to the local property transfer tax (SISA) are VAT exempt, not clarifying whether in respect of rights *in rem* such operations should be qualified as supplies of goods or services.

Additionally, there are no Administrative or Court rulings in this respect. However, there are good grounds to argue that the establishment or transfer of certain rights *in rem*, such as the right of apartment or the right of superficial, may be qualified as supplies of immovable property.

The letting or leasing of immovable property is regarded as supplies of services. For Portuguese tax purposes, apart from the full and bare ownership right, rights *in rem* include the partial ownership right (“compropriedade”), usufruct (“usufruto”), easement or servitude (“servidão predial”), apartment right (“propriedade horizontal”), the right of use and the right of habitation (“uso e habitação”) and the right of superficies (“direito de superfície”).

### Supply of immovable property and rights *in rem*

#### *Main rule*

The main rule is that the supply of immovable property which is subject to local property transfer tax - SISA - (including rights *in rem*) is exempt from VAT. No distinction is made between the supply of a building (including the land on which a building stands) and the supply of land.

The listing of rights *in rem* contemplated in the SISA Law is essential to determine the VAT regime applicable to the supplies of immovable property, given that the VAT exemption will only apply to transactions which fall under the scope of SISA, with the exception of letting and leasing which is specifically treated in the VAT Law.

The transfer of ownership or beneficial ownership (rights *in rem*) of immovable property is submitted to specific notarial and registration formalities with the Property Registry Office. In this way, most of the supplies concerning immovable property are adopted in Civil Law and will constitute the basis for VAT taxable supplies.

The supply of constructions services is not featured as a supply of immovable property, thus, being subject to VAT at the 17% standard rate (or 12% in the case of Madeira and Azores Autonomous Regions).

#### *Option for taxed supplies of immovable property*

Portuguese VAT Law foresees the possibility of the exemption waiver in respect of immovable property transactions. However, from the wording of the Law, the option to tax appears to be limited to certain transactions, namely the transfer of ownership and the letting or leasing of immovable property.

Accordingly, it is unclear if this option for VAT taxation can be exercised with regard to the establishment or cession of other rights *in rem*, although under the logic of the Portuguese VAT system such option should be allowed.

To exercise the option for VAT taxation the following conditions and formalities have to be met:

1. The acquirer is required to have the status of taxable person, entitled to deduct input VAT, wholly or partially, in the course of his business activity;
2. The costs and income related to the property concerned have to be separately recorded in the supplier's accounts, in respect of each building or part thereof;
3. The supplier must obtain a certificate from the District Tax Department, containing the identification of the parties engaged in the transaction, the selling price or rent and any other conditions agreed;
4. The waiver certificate has to be obtained before the notarial deed of transfer is executed.

If the exemption is waived the supplier is required to charge VAT to the acquirer, and will be entitled to recover the VAT incurred with the property, from the moment the notarial deed of sale is executed. However, as advance payments made by the acquirer after the waiver certificate has been issued, but before the notarial deed of transfer, are subject to VAT, the supplier will be allowed to recover the VAT incurred with up to the amount of the VAT levied on the advanced payments.

If at a later stage, any changes occur with respect to the VAT status of the acquirer or the property ceases to be used for the purposes of taxable transactions, the VAT initially recovered may be adjusted, if less than 10 years have elapsed since the date of occupation.

It is not possible to waive the exemption with retroactive effects.

### Letting and leasing of immovable property and rights

#### *Main rule*

Letting and (financial) leasing of immovable property are treated as a supply of services and are exempt from VAT. A number of exceptions on this main rule exist. The following transactions are subject to VAT:

A. by virtue of law:

1. the provision of accommodation in the hotel sector or in sectors with analogous function, including camping sites (except: holiday houses);
2. the letting of premises and sites for parking vehicles;

3. the letting of permanently installed equipment and machinery, as well as any other letting of immovable property which generates a transfer of a business activity;
4. the hire of safes;
5. the letting of premises and sites for exhibitions and advertising.

B. by virtue of option:

lessor/landlord and lessee/tenant elect to waive the exemption.

#### *Option for taxable letting or leasing*

An election to tax letting and leasing of immovable property is possible in similar terms established for the supplies of immovable property. Differently to what occurs with the supply of immovable property, the Portuguese VAT Code does not require that the lessee is a taxable person entitled to deduct VAT in whole. In this way, it can be argued that even if the lessee is a fully exempt taxable person, the option to tax can be exercised, in case of letting or leasing of immovable property.

#### Reduced VAT rate

The reduced VAT rate of 5% (4% for Madeira and the Azores Autonomous Regions) is applicable with respect to the letting of accommodation in the hotel sector. Furthermore, the reduced rate is applicable with respect to activities by building contractors for social housing and for immovable property that is owned by the municipality or fire department.

#### Deduction of VAT

Input VAT incurred on the acquisition and exploitation of immovable property is recoverable if and insofar the property is used for taxable activities. If an immovable property is used for both taxable and exempt activities, VAT can be recovered on the basis of the ratio between taxable and exempt turnover. In principle, input VAT incurred on immovable property transactions can only be recovered from the moment the notarial deed has been made. However, if the tax authorities have already approved that an option for a VAT taxable supply can be filed and the supplier has already received prepayments, the VAT due on the prepayments can be deducted with the VAT that has been charged to the supplier. A refund is however not given before the notarial deed has been made. The adjustment period for immovable property is the period elapsing between the moment of the occupation and nine calendar years following the occupation year.

### **Anti-avoidance**

No specific measures have been introduced into Portuguese legislation to counter perceived VAT avoidance. The areas of fraud and tax evasion in what concerns immovable property transactions are not of great significance. Indeed, the common system of VAT was introduced in Portugal in 1986, and only in the past two or three years the economic operators have started to use the VAT exemption waiver mechanism to recover VAT incurred in construction works.

Additionally, the Portuguese VAT Code foresees a ten year VAT adjustment mechanism which imposes strict rules for the repayment of the VAT initially recovered by the taxable entities to the Portuguese State, whenever the property is not used in taxable transactions or activities, whether by reason of being applied in an exempt sector of activity/transaction or by the mere non-use of property. This mechanism constitutes an effective anti-avoidance rule, provided proper monitoring and supervision is carried out by the Tax Authorities.

## **OTHER TAXES ON IMMOVABLE PROPERTY**

### **Local property transfer tax ("SISA")**

#### **General**

The following transactions regarding immovable property located in Portugal are subject to SISA:

1. the acquisition of legal title to and/or economic ownership of immovable property;
2. the acquisition of rights *in rem*;
3. the acquisition of shares in unlimited liability companies and private limited liability companies which own immovable property, whereby the acquirer obtains a minimum shareholding of 75%;
4. the letting of immovable property for a period exceeding 30 years.

SISA should be paid by the purchaser and amounts to 10% of the greater of the consideration or the tax registered value of the property. If shares in a real estate company are acquired, the taxable amount is the value of the immovable property represented by the shares or the consideration allocable to the immovable property if higher.

## Relation to VAT

Basically SISA aims to tax transfers of immovable property (including rights *in rem*) irrespective of these being subject to VAT. This means that the supply of immovable property will generally bear SISA and, in addition, VAT, whenever the taxable persons exercise the right to opt for taxation. No exemption of SISA has been implemented in connection with VAT taxation.

## Exemptions from transfer tax

A number of acquisitions of immovable property is exempt from transfer tax. The most important exemptions apply for acquisitions:

1. made by real estate companies, when the property is to be resold, without improvements, within 3 years after the acquisition took place;
2. of dwelling houses, up to the amount of Esc. 10,700,000 (from Esc. 10,700,000 to Esc 29,700,000 a progressive rate, that increases to 10% is applicable);
3. by public bodies;
4. by social housing associations;
5. as a result of businesses reorganisations.

## Local property tax (“Contribuição Autárquica”)

### General

Contribuição Autárquica is a municipal tax levied, on an annual basis, on the value of immovable property registered for tax purposes at the District Tax Department. If a person - individual or legal entity - owns immovable property at December 31, of any year, this person will be liable to Contribuição Autárquica for that year, which is payable in one or two instalments during the following calendar year.

The value of immovable property will be determined by the local authorities revised annually.

Regarding buildings and building land, the tax rate varies between 0.7% and 1.3%, depending on the municipality in which the immovable property is located. The applicable rate to land, other than building land, is fixed at 0.8%.

## Relation to VAT

There is no relation between VAT and Contribuição Autárquica. The taxable value of Contribuição Autárquica will be the property's tax registered value which is, in general, based on the value declared by the owner, and annually revised.

## PROBLEM AREAS AND DISTORTIONS OF COMPETITIONS

### For the Tax Authorities

Notwithstanding the above, aggressive VAT planning may be achieved due to the absence of a self-supply rule and in sale and lease-back schemes between “connected parties”. Hence, fully or partly exempt taxable entities may self-construct/develop buildings to avoid VAT on construction services, as well as intercompany arrangements may lead to the deferment over many years of the VAT paid to the Portuguese State and, in certain cases, e.g. low rent arrangements, to an effective VAT saving.

### For the taxable entities

One of the main problems of the property sector lies in the existing double indirect taxation. The acquirers of property, not only have to bear the non-recovered VAT passed to them by the supplier as well as will be required to pay SISA, generally at the 10% standard rate, on top of the purchase price (which already includes non-recovered VAT). To reduce the SISA burden it is common that the value declared by the parties does not correspond to the true transaction’s value, despite the fact that this procedure constitutes a criminal offence.

Where it refers to taxable entities with right of deduction this double taxation effect may be minimised with recourse to the exemption waiver mechanism, whereby the VAT incurred upon the construction/development of the property may be totally or partly recovered. However, SISA will still be levied and the trend to declare a lower transaction value applies likewise. From the suppliers’ standpoint the declaration of a lower transaction value may present tax advantages insofar it generally means less taxable profits.

Another critical issue is connected with the bureaucratic complexity attached to the exemption waiver mechanism and the lapse of time involved to obtain VAT refunds from the Portuguese VAT authorities. Along with the impossibility of requesting the VAT refund prior to the notarial deed of sale/letting has been executed, which may imply a delay of several months/years, the taxable entities are faced with an effective practice of the Portuguese VAT Authorities which usually do not comply with the legal term established for granting refunds.

# Spain

## IMMOVABLE PROPERTY

According to Spanish Civil Code, the following , among others, is considered as immovable property:

1. land, buildings, roads and every construction adherent to the ground is considered as immovable property;
2. any structure fixed to an immovable property in such a way that it cannot be separated from it without breakage of the material or deterioration of the object;
3. function and decorative objects, such as machines, instruments, utensils and other types of immovable property, aimed to contribute to the purpose of the immovable property;
4. mines and quarries;
5. government franchises for public works and every right in rem over immovable property.

VAT Law gives a definitions of the term buildings. For the purposes of VAT “building” shall mean any structure above or below ground level which is fixed permanently to or in the ground or to other immovable property and which is capable of being used autonomously and independently.

The following structures shall in particular be considered as buildings, provided that they are fixed to an immovable property in such a way that they cannot be separated from it without breakage of the material or deterioration of the object:

1. buildings, defined as any permanent separate and independent structure, designed to be used as a dwelling or as a place in which to carry on an economic activity;
2. uninhabitable industrial facilities, such as dikes, tanks or loading bays;
3. platforms for hydrocarbon exploration and exploitation;
4. ports, airports and markets;
5. leisure and sports facilities which are not ancillary to other buildings;
6. tracks, inland waterways, railway lines, roads, motorways and all other forms of communication by land or inland waterway, as well as bridges or viaducts and tunnels related thereto;
7. fixed cable transport facilities.

The following shall not be considered as buildings:

1. land development work and, in particular, water supply and drainage works, electricity supply facilities, gas distribution networks, telephone installations, access roads, streets and pavements;
2. structures accessory to agricultural holdings and connected with the nature and use of the farm, irrespective of whether the owner of the holding, the members of his family or the persons working with him have their dwellings in their structures;
3. functional and decorative objects, such as machines, instruments, utensils and other types of immovable property for use as described in Articles 334.4 and 334.5 of the Spanish Civil Code;
4. mines, quarries, dumps, oil and gas fields or other places of extraction of natural products.

## **VALUE ADDED TAX (“Impuesto sobre el Valor Anadido”)**

### **Background**

VAT was introduced in Spain in 1986 when Spain joined the European Union. A major reform occurred in 1993 as a result of the creation of the Single Market. However, the main principles remained unchanged in general terms. It is nonetheless worth to note that the option to waive the exemption on certain supplies of buildings was introduced at that moment.

Therefore, VAT has not been in place in Spain for a long period specially in comparison with some other EU countries.

Currently, three different VAT rates apply in Spain. The standard rate is 16%. There are two reduced rates: 7% which applies, among others, to supplies of housing for dwelling in general terms and a 4% rate which applies to basic supplies and, among others, to specially protected housing for dwelling.

Except for the above, the standard rate applies to most immovable property transactions when they are not exempt from VAT.

### **Main principles**

#### **General**

The key factor in connection with the VAT regime in Spain for the immovable property industry is the scope of exemptions for certain transactions. In fact, most of the specialities of the sector derive from this main issue and, particularly, the following:

1. regime for input VAT deduction (pro-rata);
2. obligation to regularise input VAT on capital goods during the

- adjustment period (ten years for immovable property);
3. obligation to regularise input VAT on supply of capital goods during the adjustment period (again ten years for immovable property);
  4. limited scope of the option to tax, which is restricted to supplies of goods (it does not apply to services on immovable property which are exempt from VAT). Otherwise, transfer tax would apply;
  5. interconnection between VAT and other indirect taxes which may be levied on immovable property transactions, especially transfer tax. VAT and transfer tax may in some cases have an impact in a single transaction which leads to an excess of indirect taxation heavily influencing prices. In the most common cases, a VAT-exempt supply of immovable property always leads to the application of transfer tax.

The above considerations cannot be looked at in isolation since they are intrinsically interrelated. It is intended to provide a clear picture of the Spanish scenario in the next sections taking into account all these factors and how they interact.

### Supply of immovable property

#### *VAT exemption*

In very broad terms, under Spanish VAT law, the following transactions are VAT-exempt:

1. supplies of rural land and other land, that are not qualified as available for building (land is qualified as available for building if one of the following conditions is fulfilled: (1) the land has been destined by the city development plans (or similar plans) to be available for building, (2) a building permit has been granted and (3) the ground has been prepared for building (except when it concerns public greenery or public infrastructure) ;
2. supplies of land made as initial contribution to land owner's consortiums;
3. second and subsequent supplies of buildings, including the land on which they stand when made after completion;
4. "first" supply of a building after the building has been used uninterruptedly for a period equal to or greater than two years by its owner or by holders of rights in *rem* thereto or under lease agreements with no purchase option, unless it is the acquirer who has used the building during the period in question.

The first comment must be referred to the existence of exemptions themselves. Given the mechanism of VAT and its main principles, these exemptions are categorised as exemptions that do not generate input VAT deduction. Therefore, an entrepreneur affected by them will most likely suffer the impact of the restriction to recover VAT borne in pure commercial transactions (this restriction does not occur in case of occasional supplies). The negative influence this may have could be extraordinarily limited if the scope of the option to tax were properly

defined.

Construction work can be treated as the supply of the (renewed) building if the costs of the construction work amount to at least 25% of the purchasing price or of the market value of the building.

Furthermore, the following supplies are subject to VAT by virtue of law:

- the supply of the legal ownership of a building by a finance company based on the buying option of a financial lease contract.
- the supply of a building just before the construction work commences, if the construction work can be treated as the supply of a (renewed) building (see above).
- the supply of a building that is destined to be demolished and rebuilt.

#### *Option to tax*

The scope of the option to tax is limited to the fulfilment of the following conditions:

- a) that the acquirer is a taxable person acting in the course of his business who is entitled to full deduction of input tax; and
- b) that the waiver is duly notified to the acquirer in an authenticated manner prior to, or at the same time as, the delivery takes place (on a case by case basis). Evidently, the option alleviates the most burdensome case, i.e., the case of an entrepreneur who fulfils all the requirements (it is worth noting that, under VAT legislation in force until 1992 -inclusive-, no option existed whatsoever). However, there are still many cases where the option, if extended, would mitigate cumulation of taxes significantly. Currently, cumulation of taxes is not avoided regarding these other situations.

#### Letting and leasing of immovable property

##### *VAT exemption*

Spanish VAT Law provides an exemption for leases legally defined as services (and rights in rem) of buildings or parts thereof used exclusively as dwellings, including garages and annexes thereto, and the movable property leased with the building.

The exemption does, however, not apply to the following transactions which are always treated as a taxable supply of services:

1. leases of land for the deposit or storage of goods, merchandise or products, or for the installation thereon of the elements of a business activity;
2. leases of land for exhibitions or advertising;
4. leases subject to purchase options of land or dwellings whose supply is subject to VAT and not exempt;

5. leases of buildings or parts thereof to be subleased;
6. leases of buildings or parts thereof classified as dwellings under the Urban Lease Law;
7. the arrangements or transfer of rights in rem of use or enjoyment over the assets referred to in 1 -5 above;
8. the arrangement or transfer of surface rights;
9. the letting of hotel and holiday accommodation when the lessor supplies complementary services characteristic of the hotel industry;
10. the letting of premises and sites for parking vehicles.

#### *Option to tax*

It is impossible under Spanish VAT law to opt to tax regarding supplies of services which are exempt from VAT.

### **OTHER TAXES ON IMMOVABLE PROPERTY**

#### **Transfer Tax (“Impuesto sobre Transmisiones patrimoniales onerosas”)**

##### General

Transfer tax shall be payable on onerous transfers for consideration of assets and rights, whatever their nature, which are situated, exercisable or to be complied with in Spanish or foreign territory, where, in the latter case, the person required to pay the tax resides in Spain. The tax shall not be payable on transfers of assets and rights *in rem* situated in foreign territory, nor on transfers of assets and rights, whatever their nature, which, having been made in foreign territory, are to have effect outside Spanish territory.

##### Taxable transactions

The main taxable transactions are the following:

1. *Inter vivos* transfers for consideration of all kinds of assets and rights comprising the net worth of natural or legal persons.
2. The creation of rights *in rem*, loans, security, leases, pensions and administrative concessions, unless the purpose of the last-mentioned is to assign the right to use buildings or facilities in ports and airports.
3. Any subsequent increase in the content thereof which for the owner of same discloses a capital gain shall be assessed as a creation of rights, which shall form the basis for the chargeability of the tax.
4. Transfers of shares of Spanish companies are generally exempt from any indirect taxation, except when more than 50% of the capital stock of a company is transferred and at least 50% of the assets of such company consist of real estate located in Spain: in this case, the

transaction will be considered for indirect taxation purposes to be a transfer of real estate subject to transfer tax at 6%.

Transfer tax generally amounts to 6% of the actual value of the immovable property transferred or of the right arranged or assigned. Only charges which reduce the actual value of the assets or rights shall be deductible, but not debts, even if secured by pledge or mortgage (the law provides a detailed series of special rules relating to the valuation of certain rights, such as usufruct, use and habitation, mortgages, pledges, antichresis, and consolidation of ownerships).

In determining the actual value, what the parties declare may not be the definitive valuation. In fact, the Tax Administration may verify the actual value of the property and rights transferred.

Finally, transfer tax is a cost to the acquirer.

### Relation to VAT

The transactions set forth above shall not be subject to Transfer Tax where they are performed by traders or professionals in the exercise of their business or profession and, in any event, where they are supplies of goods or services subject to Value Added Tax.

However, supplies or leases of immovable property, as well as the creation and transfer of rights *in rem* pertaining to the use and enjoyment thereover shall be subject to Transfer Tax where they are exempt from Value Added Tax, unless the taxable person expressly waives entitlement to exemption in the circumstances and subject to the conditions laid down in VAT Law (the acquirer is a taxable person acting in the course of his business who is entitled to a full deduction of input VAT, and the waiver is duly notified to the acquirer prior or at the same time as the delivery takes place).

### Exemptions

A number of acquisitions of immovable property is exempt from Transfer tax. The most important exemptions apply for:

1. Acquisitions by public bodies;
2. Acquisitions of land by land owners consortiums;
3. Transfer of shares, except when more than 50% of the capital stock of a company is transferred and at least 50% of the assets of such company consist of real estate located in Spain;
4. Acquisition of sites and assignment of right of superficies for the building of officially protected housing;
5. Acquisitions of buildings by companies which habitually conduct finance leasing operations referred to in the seventh additional provision of Law 26/1988 on Discipline and Control of Credit Entities, to be leased with a purchase option to a person different from the supplier, when such transactions are exempt from VAT;

6. Acquisitions of the totality of a taxable person's business assets, or of the assets used for one or more branches of the transferor's business activity, by virtue of any of the operations defined in Article 97 of Law 45/1995 of December 27, that is, Spanish Corporate Income Tax Law (merger, spin off...), provided that such operations qualify for the tax regime regulated in Title One of that Law.

### **Stamp Duty Tax ("Impuesto sobre actos jurídicos documentados")**

Transactions subject to Stamp Duty Tax are those involving notarial documents, mercantile documents, and administrative documents where the transaction is formalised in Spain, or where formalised outside of Spain but having legal or economic effects in Spain.

The contribution is paid through minor fixed quotas, depending basically upon the number of pages the document has.

Additionally, and under certain requirements, first copies of public deeds executed before a notary public are taxed at a rate of 0.5%, when the refer to a valuable thing, they contains acts or registration susceptible of being registered at the Mercantile or Industrial Property Register, and the act or contract is out the scope of Transfer Tax. The taxable base will be the value declared by the parties although, similar to transfer tax, this valuation may be verified by the Tax Administration.

Finally stamp duty is compatible with VAT.

### **Tax on real property ("Impuesto sobre bienes inmuebles")**

This tax is levied annually on the owners of real property or of certain title to real property, on the so-called cadastral value established by the municipality, which cannot exceed market value, at different rates up to a maximum of 1.17% for urban property and 1.11% for rural property.

This tax is deductible for Personal/Corporate Income Tax purposes, and it is compulsory for municipalities to levy.

### **Tax on erection and installation projects and construction work ("Impuesto sobre construcciones, instalaciones y obras")**

This tax is levied on the actual cost of any work or construction activity that requires prior municipal permission. The tax rates vary from 2% to 4% on the actual cost of construction. The top rate can be applied in cities of more than 100,000 inhabitants.

This tax is optional. Each municipality may decide whether or not to establish and levy this tax.

### **Tax on increase in urban land value (“Impuesto sobre el incremento del valor de los terrenos de naturaleza urbana”)**

This tax is levied on the increase disclosed in the value of urban land whenever land is transferred. The person liable for payment is the seller of the land (in the case of onerous transfers).

The tax base is calculated as an annual percentage of the cadastral value at the time of the transfer. The tax rate applicable, which depends on the size of the municipality, is between 16% and 30% on the increase in land value. This tax gives rise to a tax credit against personal income tax for 75% of the tax paid. Besides, this tax is deductible for Corporate Income Tax purposes.

This tax is optional. Each municipality may decide whether or not to establish and levy this tax.

## **PROBLEM AREAS AND DISTORTIONS OF COMPETITIONS**

### **Cumulation of VAT and indirect taxes**

Cumulation of indirect taxes may occur due to several reasons. Nevertheless, we will focus on the most common cases. Although cumulation of taxes may occur within the scope of VAT itself, it is even clearer in its relationship with the other major Spanish indirect tax, which is transfer tax. Additionally, they are more harmful when entrepreneurs are involved in the transaction, as transferor and acquirer where it is evident that the neutrality of VAT is broken.

### **VAT exempt supplies of immovable property**

The clearest situation happens where a sale of immovable property (e.g. second transfer of a commercial building by an entrepreneur to another entrepreneur) takes place and the option to tax is not applicable for any of the reasons explained above.

Two different effects will occur at the same time and regarding the same transaction:

- a) the seller will be obliged to adjust input VAT on acquisition of the building if the transfer takes place within the adjustment period (this would obviously influence the sales price by including a hidden VAT cost); and
- b) the acquirer will be required to pay transfer tax on the transaction value (transfer tax being a cost to the acquirer).

Depending on the nature of successive transactions, cumulation of

indirect taxation may continue. Additionally, if the acquirer rents the building to other entrepreneurs, the amounts charged will always be taxable, regardless of the ability of the lessee to fully recover input VAT.

In other words, immovable property whose transfer is VAT-exempt may abandon the VAT traffic but it may also re-enter it at a later stage.

### Immovable property shares

Transactions over immovable property shares merit a separate mention. It is noteworthy the fact that, under Spanish legislation, it is not possible to opt to tax these transfers and that they are always (provided the objective criteria required by the relevant provisions are met) taxable under transfer tax and cannot be submitted to VAT, even though the parties to the transaction are entrepreneurs qualifying for full input VAT deduction. Therefore, a transaction which leads to a similar economic result (the direct or indirect ownership of real estate property) may be structured in, basically, two different manners. The impact of both may derive in opposite effects from a pure tax perspective.

In fact, the acquisition of, for example, a used commercial building, would be taxed differently if it is planned through the acquisition of the building itself or by acquiring the shares of a company owning the building. If the first alternative is followed (direct acquisition of the building), the parties to the contract may (if all requirements are met) waive the VAT exemption and submit the taxation of the transaction to VAT. This implies that the seller must not adjust downwards input VAT deduction regarding the initial acquisition of the building and the acquirer will recover input VAT suffered upon acquisition of the building. However, if the second alternative is pursued (sale of shares), the effects vary significantly. In other words, the purchaser would be obliged to pay transfer tax as though he had acquired the building itself. At this point, it is important to remember that the aim of the transfer tax provision that submitted to taxation sales of shares in real estate companies was to introduce an anti-avoidance measure.

However, as far as this avoidance of taxes does not occur any longer, at least regarding transactions whose exemption can be waived for VAT purposes, it is improper to maintain a provision that clearly distorts potential alternatives of traffic of immovable property.

It is obvious from the above that the parties intervening in one of these transactions carefully plan how the transaction is structured so that unnecessary tax costs are not incurred.

### Transfers of the totality or a part of the business of a taxable person

A third area where transfer tax negatively affects transactions between entrepreneurs for VAT purposes is the transfer of the taxable person's business.

As a first subsection, we refer to the transfer of the totality of the business. In this case, under Spanish VAT law, it is also required that the acquirer continues to carry on the same business or professional activity, and is the successor to the seller, especially with regard to the VAT situation of adjustment of input VAT on capital goods.

This transaction, although taking place between two entrepreneurs by definition, is outside of the scope of VAT, in accordance with the Sixth Council Directive. The distortion appears since this transaction falls within the scope of transfer tax, regarding any immovable property which may be included in the assets of the transferor. Therefore, the transfer of immovable property is fully taxable under transfer tax. Additionally, if, after a period of time, the acquirer sells immovable property under a VAT-exempt transaction, adjustment of input VAT will also be required.

The second subsection refers to the transfer of a part of the business assets. In this case, the transaction does not fall outside the scope of VAT of itself. Therefore, if immovable property is included within the assets transferred, their sale may be exempt from VAT (e.g. second transfer of a commercial building). This transaction will oblige the seller to regularise input VAT during the adjustment period and the acquirer will be obliged to pay transfer tax on the immovable property acquired.

Finally, it is true that the above transactions may be protected by a special regime for mergers, spin-offs, transfers of branches of activity and similar transactions provided for by the Spanish Corporate Income Tax Law, which would eliminate the negative effect of transfer tax. Nevertheless, it must be kept in mind that in order to qualify for any of these special regimes certain requirements must be met, and they may not necessarily concur in a given transaction.

### Public bodies

To some extent, it is not unusual that public bodies intervene in some manner in the economic process of development of buildings, for commercial or for dwelling purposes, either by selling land or by developing a project by themselves.

Bearing in mind the definition of an entrepreneur for VAT purposes in the Sixth Council Directive and in the Spanish VAT law (they are excluded if a consideration of a tax nature is received), it is extremely difficult in practice to determine whether a given public body is acting in a particular transaction as an entrepreneur for VAT purposes or as a private person. This difficulty arises not only for the other party involved but also for the public body itself, who may be unclear as to whether the transaction must be submitted to VAT or not. In short, serious uncertainties arise where a public body is involved.

The distortions that this fact may create are obvious: while, if VAT applies, no tax costs should be incurred at that stage, if transfer tax must be levied an indirect tax burden is triggered from the beginning.

### **Installation or assembly of goods prior to delivery**

Two different areas must be specially highlighted in connection with this type of works:

#### **1. Place of taxation**

The place of taxation of these works will be Spain provided that two main requirements are met:

1. installation or assembly takes place in Spain and it entails that immobilisation of the goods delivered; and
2. the cost of installation or assembly exceeds 15% of the total consideration for the supply of the goods installed.

In these cases, importation of goods to be used in the works is exempt from VAT. However, if the above requirements are not fulfilled, a distortion may occur between Member States regarding the place of taxation and formal and reporting requirements to be complied with. Additionally, there is no provision under which importations of goods to be used for the purposes of these works are exempt from VAT.

#### **2. Installation or assembly undertaken by entrepreneurs not established in Spain**

In a case where a supply consisting of the installation or assembly of goods is made by a foreign entrepreneur not established in Spain for VAT purposes, irrecoverable VAT may be incurred.

This is specially the case of entrepreneurs resident in non-EU countries with which Spain considers that the requirements of the Thirteenth VAT Directive are not met (e.g. the United States of America). If, for example, a US entrepreneur commits to install a plant in Spain for a Spanish company and the foreign company is not established in Spain for VAT purposes, VAT may be incurred by the US company during the installation process (e.g. VAT charged locally, upon import, etc.).

However, upon delivery, the VAT payer will be the Spanish company through the reverse charge mechanism. Thus, as no VAT will be charged by the US company and it does not qualify for Thirteenth Directive entitlement to refund, all VAT incurred by the latter will be lost.

### **VAT incurred prior to commencement of activities**

Under Spanish VAT law, VAT incurred prior to the effective commencement of activities is not refundable until these are effectively carried out. In simple words, this moment is deemed to take place when the entrepreneur begins to habitually charge VAT. From January 1, 1997, a new procedure is in place under which VAT refunds may be anticipated if certain procedural requirements are met (up to December 31, 1996, this procedure was mandatory, at least in the view of the tax authorities; non-compliance with it led to the definitive forfeiture of input VAT incurred prior to commencement).

Apart from a potential deviation from several decisions by the European Court of Justice with regard to input VAT recovery (e.g. *Rompelman*, *INZO*), VAT paid on acquisition of land can only be deducted as from the time the activities actually commence. Therefore, no procedure would allow an earlier refund.

Bearing the above in mind, and taking into account that the building process normally takes a long time to complete, the negative financial impact of late input VAT recovery causes significant economic disadvantages which are necessarily passed on to the acquirer as a higher price.

This is also related to the slow repayment of VAT by the Spanish tax authorities. In general, refund of excess VAT can only be applied for at the end of the calendar year. Additionally, there is a period of up to, approximately, eight months from yearend to effectively obtain the cash back (without payment of interest by the authorities). Therefore, a given entrepreneur may be obliged to finance input VAT he incurred in his business for a significantly lengthy period out of his own economic resources.

### **Capital goods used for mixed purposes (business and private)**

Under Spanish VAT law, input VAT on goods or services which are not used directly and exclusively for a business activity is not deductible whatsoever. Goods used simultaneously or alternatively for business and private needs are not deemed to be directly and exclusively used for business purposes and, therefore, VAT on them is not recoverable.

It is true that where only part of the business assets are used for the business, that part shall be deemed used for the activity (when the related asset is susceptible of being used separately from and independently of the rest).

Nonetheless, pursuant to the VAT law, the so-called “indivisible business assets” are not susceptible of being used separately. In short, this type of business assets will not generate input VAT credit. In very broad terms (we do not expand on this in the Overview as it is referred to in the Questionnaires), the likely classification of immovable property is as an “indivisible asset” under Spanish law.

In this connection, it is a relatively normal case the situation where an entrepreneur or professional acquires a capital good (e.g. a part of a building, as far as immovable property is concerned) to be partly used both for his business needs (e.g. as an office) and for his private needs (e.g. dwelling).

It is clear from the above that in a case as the situation described, no VAT whatsoever can be recovered, regardless of the percentage of private use versus business use.

### **Charging of VAT and amendment of VAT charged**

As a general principle, VAT must be charged by the VAT payer when the taxable event occurs. However, if VAT is not charged at that point for some reason (e.g. the VAT payer interpreted that the transaction fell outside the scope of VAT or was an exempt transaction) and more than one year elapses, VAT cannot be charged whatsoever to the recipient of the supply of goods or of services (under certain circumstances, the period can be five years). This implies that the VAT payer will be fully responsible for the payment of VAT due to the tax authorities without any possibility to recover it. The neutrality of VAT is jeopardised in this case, even though the transaction takes place between entrepreneurs. Penalties and interest for late payment may also be imposed, as discussed below. Furthermore, the Spanish VAT law requires to amend (within a certain period of time) the amount of VAT charged if, after the transaction took place, it is discovered that an error occurred (e.g. a reduced VAT rate was unduly applied).

However, if, prior to voluntary amendment by the entrepreneur, the tax authorities carry out a tax audit at the entrepreneur and detect the incorrect application of the VAT law, it may occur that they consider that the behaviour of the entrepreneur is subject to penalties.

This implies that the entrepreneur must pay to the tax authorities the sum of:

- a) the amount of VAT not properly charged;
- b) interest for late payment and;
- c) penalties (35% as a minimum if the assessment raised is signed in

agreement by the entrepreneur).

Nonetheless, this has an additional consequence: the amount of VAT not properly charged cannot be recovered from the recipient of the supply of goods or services. Thus, the neutrality of VAT among entrepreneurs is again broken.

As a final comment, the levying of penalties by the tax authorities is very frequent in normal tax audits given that the *per se* strict Spanish tax legislation is rigidly interpreted.

### **Problems of the award of real estate by financial institutions**

When a financial institution grants a loan secured by mortgage and the borrower defaults in its payment, the financial institution enforces the guarantee and obtains title to the real estate. Since this normally is a second transfer of the real estate, the transaction comes outside the scope of VAT and the financial institution is liable for the payment of Transfer Tax at 6%, with the cost that this involves.

However, if the borrower is a business concern or professional, the exemption from VAT could be waived (as stated above), the transaction being made liable for VAT. However, as mentioned above, the party that has to waive is the transferor, in this case the borrower.

The problem arising in practice is that the borrower may have disappeared or may not wish to waive the exemption, etc., so that in most of the transactions of this kind that are occurring in Spain, Transfer Tax is being levied.

Some time ago, we discussed this problem with the Spanish tax authorities to seek a solution. The solution we proposed is that in such cases, the VAT taxpayer should be the financial institution itself, which would therefore waive the exemption from VAT.

The tax authorities considered this to be a good solution, but informed us that they were unable to change the Spanish regulations, since this is not one of the cases contemplated in the Directive for an inversion of the taxpayer to take place (for the taxpayer to be the acquirer instead of the transferor).

Therefore, it would be necessary to promote a change in the Directive in the above sense

# Sweden

## IMMOVABLE PROPERTY

According to the Swedish VAT legislation the definition of goods includes real estate. Subsequently, real estate is regarded as goods according to Swedish legislation. Further the VAT Act includes a specific definition of the term "real estate property". According to the main rule the definition is based on the civil law definition of real estate property. From the civil law definition the Swedish VAT Act has some deviations both extending and restricting the term. For example, buildings that are not owned by the owner of the underlying land, are also included in the tax basis. A building or an other construction is qualified as immovable property if the building or construction has been placed on own or others land to be used there on a permanent basis (normally a period of a least 5 years). Further, interior of buildings intended to be used on a permanent basis in the building also qualifies as immovable property. However, industrial equipment does not qualified as immovable property. Machines and installations for industrial purposes, that are attached to the building, are qualified as industrial immovable property.

### Main rule

Immovable property is land, which is divided in pieces of immovable property ("fastigheter"). Immovable property is connected in three categories of fixtures that are part of real estate:

1. real estate fixtures;
2. building fixtures;
3. industrial fixtures.

### *Real estate fixtures*

As immovable property is regarded buildings, wires, lines, pipes, fences or other constructions attached beneath or above the ground for permanent use, growing trees, other vegetation and natural fertilisers.

As immovable property is also regarded buildings or constructions located outside the own property if it is intended for permanent use in an *in rem* right and the building or construction is not part of that other property.

As buildings are also regarded bridges, walls and piers.

Buildings are regarded as part of the immovable property only if the building is placed on the property with the intention of being used on a permanent basis on the property.

Permanent basis normally means that the building is intended to be used

on the property more than five years. It is not a requirement that the building is attached to the ground in order to be regarded as immovable property.

For example an oil-tank held on the property by it's own weight is regarded as a building in this sense.

Examples of other constructions that are regarded as immovable property are transport constructions as for example rail, items attached in the ground intended for permanent use, football goals etc.

### *Building fixtures*

As building fixtures, and subsequently as part of the immovable property is regarded permanent attached interior and other items intended for the permanent use in the building, or part of the building. Examples of such interior are elevators, handrails, water pipes, wires for electricity or light or other similar equipment, boilers, radiators, fireplaces, fire equipment, inner windows, keys etc.

Regarding building fixtures the basic criteria is that the equipment has to be a normal and typical kind of interior in that specific kind of building, which could also typically be of use for a new owner of the building. For example a bath-tub is regarded as building attachment in a building intended for permanent living while a powerful ventilator can be regarded as an building attachment in an industrial building.

### *Industrial fixtures*

See below.

### Extending deviation

As immovable property is also regarded for tax purposes, buildings, wires, lines, pipes, fences or other constructions, which are not owned by the owner of the land. This is an extension of the term immovable property for tax purposes compared with the civil law term.

### Restricting deviations

Industrial fixtures are according to Swedish civil law part of immovable property. For Swedish VAT purposes, however, the Swedish VAT Act includes restrictions from the main rule, which excludes industrial fixtures from immovable property for tax purposes. As industrial fixtures are regarded machines or other equipment attached to a building intended for industrial purposes. Industrial fixtures are, subsequently, for tax purposes not treated as immovable property but instead as other goods.

### Conclusion

The Swedish National Board of taxation has issued recommendations regarding what shall be treated as real estate fixtures and what shall be regarded as other goods part of a business activity. With consideration to the regulations in Swedish VAT legislation and the recommendations from the Swedish National Board of taxation the determination of what is regarded as immovable property for tax purposes is fairly detailed.

## **VALUE ADDED TAX ("Mervärdesskatt")**

### **Background**

VAT was introduced in Swedish legislation on January 1, 1969. The tax rate at this time was 10%.

Between 1940 and 1969 Sweden has had various forms of tax which were related to consumption of goods and services. The tax covered (with certain exemptions) supply of all movable property. Immovable property was not considered as goods and was subsequently not covered by the tax. The tax, however, covered construction material, and property accessories.

The taxation of services was limited to supplies connected to taxable goods and the finalising, letting, mounting, reparation, maintenance, alteration or cleaning of such goods.

### **VAT introduction**

When VAT was introduced on January 1, 1969, building- and construction work on contract and other similar kinds of services provided by installation- and handicraft companies in the real estate business were subject to the new system of VAT.

### **Tax reform 1990**

In connection with the major Swedish tax reform in 1990, the Swedish tax base was made wider and the value added tax became, as a main rule, generally applicable on all goods and services. At this time, the Sixth Council Directive came into force and the Swedish legislator used the Directive as a model for the adjustments of the existing Swedish VAT system. In general, the Swedish tax base was harmonised with the Directive and the exemptions stated in the Directive were also kept outside the Swedish tax base.

The principle of a general and uniform taxation on all purchases of goods on a commercial basis was introduced in Swedish VAT legislation. However, the taxation did not apply to the provisions of housing. Nor did it apply to the provisions of other immovable property for which the receipts constitute income from immovable property and which was not previously taxed.

Most of the previously untaxed services produced for the management of housing became subject to tax, for example sewage purification and waste disposal. Tax also became payable on procured maintenance of immovable property, cleaning, window cleaning, chimney sweeping and administrative services.

In order to achieve maximum neutrality as regards competition between internal and procured work by real estate companies, certain work which these companies undertook on their real estate became subject to tax, such as new construction, extensions and renovations, repairs, maintenance and work involving drawing, planning and construction or comparable services. This, however, only applied on work managed internally done by the company's own work force. For administrative reasons the tax liability was only applicable if the wage cost incurred, including social security charges, during the tax year exceeded SEK 500,000

All forms of immovable property tenure that yielded business income became liable to tax. This meant that tax was incurred on renting of hotel rooms. It also meant that the tax was extended to include also the rental of parking space if this was done as business activities and not in form of income from immovable property. The same became applicable as on the renting of safety deposit boxes, camping sites and the renting of boat moorings.

The generally applicable VAT rate on goods and services was determined to 25% of the price before tax as from July 1, 1991. This is the generally applicable rate that currently is applicable in Sweden.

As from July 1, 1994 immovable property is regarded as goods according to the Swedish VAT Act.

January 1, 1995 Sweden entered the European Union. Since then the Swedish VAT legislation has become more and more harmonised with the Sixth Council Directive.

## Main Principles

### Taxable building- and construction services in a business activity

Any person who in a business activity supplies certain kind of services is considered as performing taxable building- or construction services. The services are taxable as building- and construction services when they concern:

1. land and includes examinations, planning, ground or soil works, improvement of ground or soil, excavation, use of explosives, drilling, filling and surface treatment;
2. buildings, other constructions which according to the Swedish VAT act classify as immovable property, fences or similar constructions and when the services performed concerns building or erection, demolishing, repairs, alterations, maintenance or cleaning.

The definition of building- or construction services is wide and includes in principle all services performed in the building- and construction sector. Services such as cleaning of premises, window cleaning, and other care-taking of property are, however not considered as such taxable building- or construction services.

As persons performing such taxable building- or construction services should, subsequently, normally be regarded building companies, construction companies and companies performing handicraft work within the area of building and construction.

### Building and construction contract work ("entrepreneur work")

Entrepreneur work is defined as building and construction work on another person's immovable property. Entrepreneur work is considered as a taxable service. Usually the entrepreneur work is regulated in a contract between the entrepreneur and the purchaser of the service.

A contracts between two companies within the same group of companies is also regarded as a transaction between two independents. The services can be performed by employees of the entrepreneur or by subcontractors hired by the entrepreneur. However it is important that the contract is a real entrepreneur contract, i.e. the entrepreneur is obliged to be responsible towards the purchaser stated in the contract.

As part of the taxable supply is also regarded building material and similar equipment that is supplied in connection with the service.

The taxable value of an entrepreneur service is, according to the main rule, the contractual price of the service. In certain circumstances the taxable value may, however deviate from the contractual price.

If a building- or construction service is supplied for a price below market

value the service shall be subject to "withdrawal taxation" (see hereinafter).

#### *VAT reporting*

Only companies that are considered as performing taxable building- or construction services are allowed to use specific rules regarding the VAT reporting according to the Swedish VAT Act.

According to the main rule in Swedish VAT legislation, VAT should be reported in the period in which a service is performed and an invoice is issued.

Regarding advance payments (i.e. payment before the service is performed), the main rule is not applicable. If an advance payment is received the VAT should be reported in the period in which the payment is received.

Building- or construction services performed in Sweden, where a "final inspection" is performed before the service is approved, are treated according to special rules in the Swedish VAT legislation.

According to the Swedish VAT Act, a building- or construction service of this sort is not considered to be finalised until the final inspection is performed. The VAT should then be reported within two months after the final inspection is performed, at the latest. However, this is only applicable if no invoices including VAT are issued during the time the service is performed. If an on account invoice including VAT is issued to the customer before the final inspection is performed and a payment is received, the payment will be regarded as an advance payment. In such a case, according to above, the VAT, in respect of this payment, should be reported in the period in which the payment is received.

Subsequently, if an instalment service is performed from January until May and the final inspection is performed in May, the VAT should be reported within the period of July. However if the customer is on account invoiced including VAT in April, for part of the service, and the supplier of the service receives the payment in April, the VAT for this advance payment should be reported in the April period.

#### Self managed building and construction work ("byggnadsverksamhet i egen regi")

As self managed building and construction services are regarded building and construction of buildings on land owned by the builder or on land which the builder have right to use. Both erection of buildings for permanent living and erection of buildings intended to be used for commercial purposes are regarded as self managed building and construction activity.

Also work as reparation, improvements or maintenance on buildings intended for business purposes is regarded as such services.

During self managed building and construction activity there is not, as in entrepreneur work, a contract between two different independent parties. A common situation is that a building and construction activity starts as self managed activity and at a later stage transfers to entrepreneur work due to the fact that the immovable property is sold to another subject.

Regarding such mixed supplies the Swedish National Board of Taxation has given a recommendation stating that the work shall be treated wholly as a self managed activity or entrepreneur work depending on which of the two that is the dominant part of the supply.

#### *Withdrawal taxation*

Withdrawals, i.e. self supplies, are according to Swedish VAT legislation regarded as a supply for tax purposes. All activities, which are taxable in an entrepreneur activity, when performed for another subject, are subject to withdrawal taxation when performed as a self managed activities. Both services performed by the building company itself and services bought by the company can in principle be subject to the withdrawal taxation.

One condition for the withdrawal taxation rules to become applicable is that the services performed are of a kind typically supplied in a business activity performed for third party customers.

When a service is subject to withdrawal taxation the taxable amount for the service is determined by the acquisition- or production cost of the service. Regarding withdrawal taxation of services performed on real estate the taxable amount is determined on the following facts:

1. direct and indirect costs;
2. interest on own capital used in the production;
3. the value of the taxable persons work, i.e. wage costs.

Regarding building and construction activities subject to withdrawal taxation the tax becomes chargeable at the same time as the services are performed. If the services are taxable building- and construction services in a business activity to an extent exceeding 50%, the tax shall be reported within two months after the real estate could be taken into use.

#### Management of immovable property

"Management of immovable property" includes a number of different services connected to immovable property. Examples of such services are maintenance, smaller reparations but also clerical work such as for example administration of rent-income.

Also maintenance services such as for example cleaning of the real estate is regarded as management of real estate. Supply of this kind of management services are treated as taxable services.

Real estate management services can by the real estate owner be purchased from a third party or the real estate owner can defray the services by using own employees. It is not unusual that companies with large real estate portfolios (for example banks, building companies and municipal authorities) have employees performing management services on all real estate within the company (self management).

When an immovable property owner purchases management services from an external supplier the cost for these management services are not deductible for the owner if he is not optionally registered for VAT purposes. Subsequently the input VAT in these situations becomes a cost for the property owner. Regarding immovable property owners letting the immovable property to non taxable subjects without any possibility for optional registration, the input VAT subsequently always becomes a cost for the property owner. If the services instead were self supplied by the property owner there would not be any input VAT cost for the property owner.

In order to receive neutrality between self supplies and procurement of management services, Swedish legislation includes withdrawal taxation rules regarding certain management services performed as self supplies.

The following services are subject to withdrawal taxation when performed as self supplies:

1. building and construction services, including reparation and maintenance;
2. design, projection, construction and similar services;
3. cleaning, window cleaning and other maintenance services of immovable property.

Clerical work, for example administration, is not subject to withdrawal taxation when performed as self supplies.

Withdrawal taxation shall only be applied if payroll expenses (including the employer's contribution for national social security purposes and similar costs) for the services during one year exceed SEK 150,000.

Withdrawal taxation is also only applicable if the services are performed on immovable property that constitutes an asset in a business activity which is a non taxable business activity and which does not give any right to refund of input VAT. Subsequently withdrawal taxation shall not apply on services performed on immovable property subject to optional taxation or on immovable property used in a business activity that is taxable (such as for example office buildings, industrials buildings etc.) due to the fact that input VAT is deductible in such activities.

### Supply of immovable property and rights in rem

Regarding the supply of immovable property and rights in rem, the main rule is that the supply of immovable property (including rights in rem) is exempt from VAT. What shall be regarded as real estate is defined above (subsequently no distinction is made between the supply of building and the supply of land).

VAT is however, chargeable on the supply of real estate in the following cases:

1. supply of machinery equipment and business installations;
2. supply of growing trees, or other vegetation if the supply is not made in connection with the supply of land;
3. supply of right to agricultural leasehold or right to lumber.

With respect to the supply of immovable property it is impossible to opt to tax.

### Letting and leasing of real estate and rights in rem

Letting and leasing of immovable property and rights in rem are also exempt from VAT according to the main rule in the Swedish VAT legislation. The exemption for letting of rights in rem also includes the supply of water, electricity, gas, heating and wires for radio and TV provided that these are part of the supply of rights in rem connected to real estate.

However, a number of exemptions to the main rule exist. The following transactions shall be subject to VAT:

A. by virtue of law:

1. letting of machinery equipment and business installations;
2. letting in a hotel, boarding or a guest house, camping and holiday business to persons staying only for a short period of time (tax rate 12%);
3. letting and leasing of parking space for cars in a parking business activity;
4. letting or leasing of ports or airport for ships or aircraft;
5. hire of safety deposit boxes;
6. hire of space for advertisements on real estate;
7. letting or leasing of buildings or land for the keeping of animals;
8. letting and leasing for traffic on bridges, roads, tunnels and rail for train traffic;
9. letting of right to agricultural leasehold or right to lumber.

B. by virtue of option:

Immovable property owner/first hand tenant /apartment right owner can elect to waive the exemption.

#### *Option for taxable letting of premises*

The tax authorities can decide that an immovable property owner, first hand tenant or apartment right owner shall be registered as a taxable person regarding the letting of premises to be used on a permanent basis in an activity which is taxable or gives the performer of the activity a wholly or partly right to receive repayment of input VAT. One condition in order for this to be applicable is that the real estate owner has applied to become registered for such purposes. The registration for the letting is subsequently optional.

It is also possible for these subjects to become registered for VAT purposes when letting the premises to the local- or regional government- or state authorities for the use in an activity performed by the local- and regional government or the state.

If an application for optional tax liability for letting of premises is approved, the letting will be regarded as a taxable service performed by the person letting the premises. Subsequently the person letting the premises must charge VAT on the rent but he also receives a right to deduct input VAT charged on costs referable to the taxable letting.

As mentioned above the entering into the system of taxation of letting of premises is optional for the owner, first hand tenant or apartment right owner. However, once the owner, first hand tenant or apartment right owner has entered the system there is no possibility to exit the system on an optional basis. It is only possible to exit the system if the conditions for taxation is no longer at hand, i.e. that the tenant is no longer performing taxable activities etc. When real estate is sold, the new owner can take the position of the old owner regarding a registration for tax if the tenants use the premises in a taxable activity in the same proportion as before the real estate was sold.

#### Deduction of input VAT

The general rules regarding deduction of input VAT is applicable regarding the optional taxability for letting. If the owner is only partly taxable for the letting of the immovable property (i.e. mixed activity) the following is applicable:

1. input VAT on costs referable to the taxable activity is fully deductible;
2. regarding input VAT on costs referable to non-taxable activity the input VAT is not at all deductible;

3. regarding costs referable both to the taxable and non taxable activity the deduction can be recovered on the ratio between the taxable and non taxable activity. The ratio shall be determined on reasonable grounds, for example the ratio between taxable and non-taxable turnover.

A person registered for letting becomes liable for payment of tax earliest at the date when the application has reached the tax authorities. However, there is a possibility in certain cases to receive repayment of input VAT up to three years retroactively concerning costs for new, additional or alteration works performed on immovable property.

The Swedish VAT Act also includes rules that stipulates that deducted input VAT shall be reversed, i.e. repaid to the tax authority, if the following situations occur:

1. a taxable tenant moves out from the facilities and a non-taxable tenant moves in to the facilities and performs a non-taxable activity;
2. a taxable tenant terminates the taxable activity performed in the facilities;
3. the immovable property is sold;
4. the building is destroyed or damaged and is not longer possible to use for the taxable activity after the damage or destruction.

If any of these situations occur within three years from the end of the year when the letting was registered as taxable the tax shall be reversed with 100%, if the event occurs between three and six years 50% shall be reversed and after six years have passed no VAT shall be reversed (the adjustment rules may however apply after this period, see hereinafter).

The purchaser of the real estate has a possibility to receive a deduction of input VAT corresponding to the amount of input VAT reversed by the seller of the real estate. In order for the purchaser to receive this deduction of input VAT the purchaser have to claim a certificate from the seller which proves that the seller have reversed his input VAT according to the rules of optional taxation. Furthermore, the purchaser must have taxable tenants in the same proportion as the seller in order to deduct the whole amount.

#### *Adjustment of input VAT*

As part of the harmonisation with the Sixth Council Directive, Sweden has included regulations regarding adjustment of input VAT regarding capital goods. The adjustment of the input VAT shall be applicable if the capital goods are sold or if the use of the capital goods are changed. For example if capital goods are used in a mixed activity (i.e. one part taxable and one part non-taxable activity) both in the taxable and non-taxable part of activity and the use of the goods is changed so that the goods are only used in the non-taxable activity the input VAT shall be adjusted.

Sweden became a member of the European Union on January 1, 1995.

Therefore, it is only capital goods bought on January 1, 1995 or later that are subject of the system of adjustment.

"Capital goods" shall in the Swedish VAT act be defined as:

- machines, inventories and similar assets with an acquisition cost that exceeds SEK 200,000 exclusive of VAT;
- real estate, including new-, additional- or rebuilding with an acquisition cost exceeding SEK 200,000 during one year.

As capital goods is also regarded a tenant's new-, additional- or rebuilding of real estate. This means that the rules regarding adjustment of input VAT can be applicable if a tenant transfers the new-, additional- or rebuilding to the real estate owner.

The period of adjustment is for real estate six years and for other capital goods five years. The year in which the capital goods is acquired is included in the period of adjustment. To illustrate the rules follows an example (in the example is also included the rules regarding optional registration and the reversal of input VAT connected to such optional registration):

A real estate owner becomes optionally VAT registered for letting of the real estate premises year 1. A retroactive deduction of input VAT referable to the building costs is granted. Year 6 is the real estate rebuilt and a deduction of input VAT of SEK 900,000 is granted (referring to costs of the rebuilding). The real estate is sold during year 8. Since six years have passed since the year the real estate owner was optionally VAT registered no input VAT have to be reversed according to the rules regarding reversed input VAT at the optional VAT registration. However, due to the sale of the real estate year 8 a situation where input VAT have to be adjusted is at hand.

The deduction of input VAT and the adjustment amount is determined as follows:

Sale year = year 8

Period of adjustment = 6 years ( year 6 until year 11)

Remaining = 4 years (year 8 until year 11)

Original amount = deducted input VAT = SEK 900,000

Hypothetical deduction = SEK 0

Adjustment amount = (SEK 900,000 - SEK 0) : 6 years = SEK 150,000 per year

Total sum adjustment amount = SEK 150,000 \* 4 years = SEK 600,000

The original deduction of SEK 900,000, subsequently shall be reduced with SEK 600,000, so that the deduction during the period year 6 to year 8 is SEK 300,000.

Note that the above described adjustment of input VAT does not give the purchaser of the real estate any possible to deduct the adjusted amount as

input VAT in such a way that is possibility regarding the reversed input VAT according to the rules of optional VAT registration.

Input VAT that have been reversed according to the rules regarding optional VAT registration shall not be subject of the rules of adjustment of VAT.

## **OTHER TAXES ON IMMOVABLE PROPERTY**

### **Stamp duty ("Stämpelskatt")**

#### General

Sweden applies a real estate transfer tax called "stämpelskatt" (stamp duty). The stamp duty shall be paid to the state in case of purchase of real estate and site leasehold rights. The tax shall also be payable when mortgage deeds on the immovable property are issued.

The tax shall be paid when the immovable property is transferred with reference to the legal title of ownership (i.e. economic plus legal ownership) of the immovable property. Regarding stamp duty on site-leaseholders the tax shall be paid when the right is established or transferred. The transfer of other rights are not subject to stamp duty.

The taxable amount is determined as the highest value of the price paid due to the transfer or the tax assessment value.

Applicable tax rate is normally 1.5% for private persons and 3.0% for legal entities, However, during the period June 12, 1996 - December 31, 1997 the rates are temporarily lowered to 0.5% and 1% respectively.

#### Relation to VAT

According to Swedish legislation the stamp tax have no direct relation to VAT. Subsequently there is in certain cases a possibility that both stamp tax and VAT will be charged on a transaction including immovable property and subsequently a sort of double taxation will arise in these situations.

Sweden have not introduced any special measures to avoid that stamp duties are levied in addition to VAT.

## Real estate tax ("fastighetsskatt")

### General

An individual person, or legal entity, owning certain kind of immovable property is liable to pay real estate tax. The kinds of immovable property that are subject to the real estate tax are:

1. small family houses intended for one or two families;
2. apartments intended for permanent living and other premises in apartments;
3. pieces of land intended for apartments;
4. residences and pieces of land connected to agricultural land;
5. private residences abroad;
6. industrial real estate.

The tax is paid each year by the owner of the immovable property. If the immovable property is sold during a fiscal year the tax will be divided between the seller and the purchaser with respect to the period of time owned by each party during the year.

As from January 1, 1997 the generally applicable tax rate is 1.7%. Regarding other premises in blocks of flats the applicable tax rate is 1.0% and regarding industrial real estate 0.5%.

The taxable value is determined on the "assessed value" (value assessed for tax purposes). The assessed value is normally determined as correspondent to 75% of the market value.

Regarding private residences located abroad the taxable value shall correspond to 75% of the market value.

### Relation to VAT

The taxable value for real estate tax is an assessed value, which is not related to the VAT.

## PROBLEM AREAS AND DISTORTIONS OF COMPETITIONS

### Problem areas

According to our experience a lot of Swedish companies involved in transactions concerning real estate do not apply the Swedish VAT legislation in a correct manner. The main reason for this is that the real estate transactions are subject of a lot of very complex rules regarding VAT. For example the rules regarding optional VAT registration and adjustment of VAT have risen to a lot of questions and problems.

The problems arising in the area are more due to the complexity of the regulations and the ignorance of the companies involved in the transactions than the intention of avoiding tax.

Mistakes that leads to disadvantages for the companies is as frequent as mistakes that leads to an advantage for the companies. It is, however, difficult to regulate the area of real estate transactions with less complex rules.

### **Distortions of competition**

#### **Cumulation of VAT**

In the following situations a cumulation of VAT may occur:

An exempt supply of immovable property after the reverse period of six years but within the adjustment period may lead to cumulation of VAT, as the purchaser is not entitled to deduct the adjustment VAT that the seller has to pay to the tax authorities.

#### **Different treatment of sales and leases**

The possibility to opt to tax has been introduced to avoid distortion of competition. However, this rule only applies on letting or leasing of buildings, not on supplies of buildings. It is therefore of importance if a transaction qualifies as a lease or a sale. Consequently, VAT legislation may restrain modern financing forms.

# United Kingdom

## IMMOVABLE PROPERTY

UK VAT legislation does not use the term 'immovable property'. Instead, provisions have been implemented for the exemption of 'the grant of any interest in or right over land' (subject to certain exceptions).

UK Customs' view is that 'land' includes buildings, walls, trees, plants and other structures and natural objects in, under or over it as long as they remain attached to it. This will include permanent plant and machinery attached to a site.

For land law purposes, the UK is split into two. Scotland has different laws, principles and practices to the rest of the country.

## VALUE ADDED TAX

### Background

VAT was introduced into the UK by the Finance Act 1972 and took effect on April 1, 1973. Between 1973 and 1989 VAT on construction, land and property was relatively simple to understand and operate.

Construction of buildings, both residential and commercial, was taxable but zero-rated, the sale or long lease (over 21 years) of new buildings was zero-rated, the sale of old buildings was exempt, the sale of land was exempt.

The main disputes with Customs and Excise, which produced a significant number of Tribunal cases, revolved around what work was alteration to buildings (zero-rated) rather than repair or maintenance (standard rated). In a classic case which went to the House of Lords it was decided after much argument that underpinning a building was zero-rated as 'the extension of a building in a downward direction' rather than repair work.

In the mid 1980's, alteration work was made standard rated, other than to certain 'listed' or 'protected' buildings.

### The European Commission Challenge

In 1988, after a long running debate between the Commission and the UK, the Commission took infraction proceedings against the UK on the basis that the UK had infringed the Sixth Council Directive by not taxing at the standard rate the construction and sale of new buildings.

The UK defended its position successfully on the construction and sale (or long lease) of residential buildings and certain charitable buildings so that these remained zero-rated.

The UK lost its position on the construction and sale of new commercial buildings.

As a result, because the UK did not want to burden UK businesses with extra VAT, the UK introduced the election to waive exemption from VAT (commonly known as 'the option to tax') from August 1, 1989.

### **Further Complexity**

In 1990, the capital goods scheme was introduced to adjust more fairly the initial deduction of VAT on commercial buildings.

In 1991, the UK increased the standard rate of VAT from 15% to 17.5% and more companies and their advisers devoted more resources to saving or mitigating VAT by prudent VAT planning.

To counter perceived VAT avoidance, a range of anti-avoidance provisions were introduced into UK VAT law, e.g. the self-supply of construction services (to deter exempt and partly exempt persons self constructing buildings to avoid VAT on construction services), the developers' self-supply (to prevent exempt and partly exempt persons avoiding VAT on the land element by using land they owned or purchased VAT free to construct a building).

From January 1, 1992, the developers' self-supply was extended to include the redevelopment of certain existing buildings. Various changes were also made to the option to tax rules.

Following consultation between Customs and Excise and business representatives over the increasing complexity of the provisions and whether each complexity was needed a number of 'simplification' measures have been introduced. The developer's self-supply has been phased out. The option to tax has been made more flexible (can be revoked after 20 years).

### **Further anti-avoidance**

Following concerns about loss of VAT revenue to the Treasury, some further anti-avoidance rules have been introduced to counter so-called unacceptable VAT planning schemes.

Before 1994, a partly exempt person could defer VAT on a new building by leasing it to a connected person (e.g. a subsidiary property company) which then leased the property back.

The first lease was opted so this enabled VAT recovery on the cost of the new building with VAT on the rents of the lease back being paid to Customs over many years.

UK Customs introduced The Land and Buildings Order 1994 to prevent options between connected parties, but this led to companies continuing lease and lease back schemes via 'unconnected persons'. An unintended effect was that certain businesses were able to break an option by structuring a transaction through a connected party.

Following research by UK Customs on anti-avoidance measures in other EU Member States, and some limited consultation with businesses, the UK announced a draconian rule in the 1996 Budget to disapply options where the user of a building could not recover at least 80% of his VAT. This would have caught many innocent transactions where no VAT avoidance was intended and was claimed to be a 'sledgehammer to crack a nut'. There were also disputes over whether the extra compliance costs (estimates ranged between £10m and £80m) as against the revenue at risk (£110m) were justified.

Following fierce lobbying by property companies, representative bodies and advisers, the UK Government has amended the Finance Bill so that an option will only be disapplied in certain circumstances. This will allow a speculative developer to construct a building and let it to a bank (partly exempt) and still opt to tax, provided the anti avoidance rules detailed under "*Disapplication of the option*" below do not apply.

UK Customs has, however, warned business that they will monitor the new provision and if they detect continued avoidance, they may extend the disapplication of the option rules, or at worst, remove the option to tax altogether.

## **Main principles**

### **General**

In the UK, a taxable person is anyone who is, or is required to be, registered for VAT. Subject to registration, this will include someone making supplies of land to the extent that these are taxable.

Taxable property transactions may be subject to VAT at the standard rate of 17.5%, or (in the case of certain supplies of residential or protected buildings) at the zero-rate.

In the UK, the transfer of ownership and the lease of immovable property for a period that exceeds 21 years is treated as the supply of immovable property. The providing of an 'interest' for less than 21 years is treated as the lease of immovable property.

## Supplies of land

### *General*

The grant, assignment or surrender of any interest in or licence over land is exempt for VAT except for *certain* specified transactions relating to:

new dwellings, and other residential or charitable buildings, which are zero-rated;

cases where the supplies are specified as being standard-rated (these are listed below and include the sale of the freehold of a building less than three years old);

certain supplies relating to protected buildings, which may be zero-rated;

buildings where the grantor may 'elect to waive the exemption' and may make the supply standard-rated;

No distinction is made between the supply of a building (including the land on which a building stands) and the supply of land.

### *Standard-rated supplies*

The following supplies are standard-rated:

A. by virtue of law:

The grant of the freehold ('fee simple') in:

1. an incomplete building not designed or intended for use as a dwelling or for a relevant residential or charitable purpose;
2. a new building (see definition below) not designed or intended for use as a dwelling or for a relevant residential or charitable purpose;
3. an incomplete civil engineering work;
4. a new (see definition below) civil engineering work.

The following supplies and services are subject to the VAT rate of 0%:

- the first supply by a building contractor of a dwelling house or a building, intended for usage by a charitable institution;
- work on dwelling houses or building, intended for usage by a charitable institution (inclusive of the supply of building materials);
- certain activities on behalf of housing associations.

B. by virtue of option:

Grants by a vendor who has elected to waive exemption (see below), which is not disapplied by anti-avoidance provisions.

*New buildings and new civil engineering work*

A new building is one which was completed less than three years before the grant. Completion occurs at the earlier of the issue of an architect's certificate of practical completion or full occupation. Similar definitions apply to new civil engineering work.

*Election to waive exemption (option to tax)*

The election to waive exemption (or 'option to tax') was introduced to alleviate the cost of irrecoverable input VAT suffered by businesses making property-related supplies.

As outlined in d. below, a taxable person elects to waive exemption on a building by building basis - a landlord cannot charge VAT to some tenants, and not to others in the same property.

If permission is not required for an election to be made, the tax authorities should be informed within 30 days. Once an option has been made, VAT must be charged the next 20 years on all future supplies (sales, lettings or service charges) relating to that property which otherwise would be exempt. This includes all future receipts in respect of existing leases, new leases, and proceeds received on the sale of the building.

The option is effective even if the property is sold and re-acquired. Similarly, if the supplier ceases to be registered for VAT and in the future it becomes necessary to re-register, the option will continue to have effect.

An election will bind the whole of a VAT group in relation to the supplies of property it makes. If a member leaves the group after an option has been made, it must still charge tax on future supplies relating to that property.

### *Exceptions*

Certain supplies are not affected by an option and will remain exempt even though the option to tax has been exercised:

1. where the building is designed as a dwelling or is intended to be used solely for a residential purpose;
2. where the intended use is solely for a charitable purpose other than as an office unless the office use is merely incidental in which case it can be ignored;
3. the sale of the property which is treated as the transfer of a going concern;
4. the supply of land for mooring a residential houseboat or pitching a residential caravan;
5. a supply to a registered housing association which has given the supplier a certificate stating that the land will be used for the construction of a building for residential purposes.
6. in respect of a grant falling within the Capital Items Scheme, where the grant was made by the developer of the land and it is the intention or expectation of the grantor, or the person financing the grantor's development that the land would become exempt land (as defined) or would continue to be exempt land for a period (see c. below).

If a property is let to an occupant falling within any of the above categories, there is no tax chargeable and the landlord will not be able to recover any input tax incurred in relation to making that supply of the property. If part of the property is exempt under one of these exclusions, the consideration must be apportioned in relation to it and the option to tax will only relate to the rest of the supply. Any apportionment must be made on an objective basis which gives a fair and reasonable result. This may be subject to inspection by Customs but does not require prior approval.

### *Disapplication of the option*

New provisions took effect of March 19, 1997 to counter VAT avoidance schemes involving partly exempt businesses. These disapply the option to tax on a selection of property transactions.

An option to tax may be disapplied on:

1. certain sales of property from March 19, 1997; and
2. certain leases agreed after November 26, 1996, with effect from March 19, 1997.

The option will only be disapplied in relation to a grant where it is expected or intended that land will be occupied at some point by the grantor, someone responsible for financing the grantors development, or a party 'connected' with either of these *and* the occupier will not be wholly or mainly taxable.

#### *Revoking the option*

The option is irrevocable except in the following circumstances:

1. within three months of the date the election takes effect, with the written consent of Customs & Excise. No VAT must have been chargeable and no credit for input tax must have been made. Furthermore, there must not have been a transfer of a business as a going concern involving the grant of an interest in the property;
2. where more than 20 years have elapsed since the date on which the election had effect. Customs & Excise must give written consent to this and they may specify a later date from which this may occur.

#### Letting and leasing of immovable property

##### *General*

Leases are subject to similar rules to sales. Letting and leasing of immovable property is exempt (subject to the option to tax); legislation also requires the grant of certain rights to be a taxable supply.

The following transactions are taxable at the standard rate:

##### A. by virtue of law:

1. A supply made pursuant to a developmental tenancy, developmental lease, or developmental licence;
2. The grant of any interest, right or licence to take game or fish (unless the right / licence is granted jointly with the freehold of the land);
3. The supply of sleeping accommodation or accommodation in respect of a supply of catering in a hotel, inn, boarding house or similar establishment;
4. The grant of any interest in, right over or licence to occupy holiday accommodation;
5. The provision of seasonal pitches for caravans, and the grant of facilities at caravan parks to persons for whom such pitches are provided;
6. The provision of pitches for tents or of camping facilities;
7. The grant of facilities for parking a vehicle;
8. The grant of any right to fell and remove standing timber;
9. The grant of facilities for housing, or storage of, an aircraft or for mooring, or storage of, a ship, boat or other vessel;
10. The grant of any right to occupy a box, seat, or other accommodation

at a sports ground, theatre, concert hall or other place of entertainment;

11. The grant of facilities for playing any sport or participating in any physical recreation;
12. The grant of any right, including:
  - a. an equitable right;
  - b. a right under an option or right of pre-emption; or
  - c. in relation to land in Scotland, a personal right;
  - d. to call for or be granted an interest or right which would fall within any of paragraphs 1 or 3 to 12 above.

B. by virtue of option:

Grants by a landlord who has elected to waive exemption (see below), which are not disapplied by anti-avoidance provisions.

*Election to waive exemption (option to tax)*

The option to tax applies to all supplies of land, whether sales or leases. The operation of the option is described under 'supplies of land', above.

### Deduction of VAT

Input VAT associated with the acquisition and exploitation of immovable property is recoverable to the extent that the property is used for taxable supplies.

Property costing £250,000 or more (and refurbishments to property where certain expenditure relating to the refurbishment cost £250,000 or more) will fall into the Capital Items Scheme. Initial input tax recovery is adjusted over nine subsequent intervals (usually, but not necessarily, of one year each) to reflect the use of the building in each period.

### Case law

A vast array of case law has developed in the UK on land and property which provides useful precedents when looking at particular areas.

Some of the issues which have come before the courts are:

1. Is a concession to operate shops at an airport an exempt licence to occupy land - YES;
2. Is serviced office accommodation (including cleaning and telephone switchboard) exempt from VAT - YES;
3. Is the non-exclusive occupation of an office an exempt licence to occupy - on facts of the case YES;
4. Serviced office accommodation including handling mail, telephone answering service, was held to be part exempt, part taxable;

5. The grant of facilities from a crane to pass through airspace above someone else's premises was held not to be a licence to occupy land and therefore standard rated;
6. Hairdressing salons - numerous cases dealing with whether owner of shop granting exempt licence to occupy a chair to other hairdressers, or a standard rated use of facilities;
7. Hostel for homeless and unemployed held to be providing standard rated accommodation similar to a hotel or boarding house;
8. Short lettings of furnished flats advertised as holiday accommodation were held to be standard rated;
9. 'Time-share' holiday accommodation held to be standard rated;
10. Beach huts operated by a borough council held to be standard rated;
11. Winter storage of caravans held to be standard rated;
12. Numerous other case law decisions on works to different types of building.

### **Other factors**

It should be noted that although many of the major property companies have been able to keep up to date, with the help of tax advisers, with all the complex changes over the last few years, it is of great concern that many other businesses who do not normally deal with property, but then decide to relocate, sell surplus space, buy or lease new premises will fall into many of the numerous pitfalls in this area. At worst, simple ignorance of the complex rules could result in them being liable for VAT they have not charged and cannot collect, interest on the VAT and possible penalties for serious misdeclaration of their VAT liabilities.

## **OTHER TAXES ON IMMOVABLE PROPERTY**

### **Stamp duty**

#### **General**

Stamp duty is payable on the instrument transferring an interest in land e.g., the conveyance or the lease.

If A, by oral agreement, permits B to occupy his land for 10 years at an annual rent of £10,000, no stamp duty is payable.

#### **Registration of title**

Title to a property cannot be registered until the document is property stamped.

#### **Proceedings**

An unstamped or incorrectly stamped document cannot be used as

evidence in proceedings.

### Conveyance or transfer on sale

Stamp duty is payable on the purchase of a freehold, unless the purchase price is below £60,000, in which case no stamp duty is payable. The rate is between 1% and 2%, depending on the value of the immovable property.

### Leases

Stamp duty on leases is calculated by reference to the average annual rent, the length of the lease, and any premium paid by the purchaser.

Stamp duty on a counterpart lease is always 50 pence.

When calculating the average rent, the Inland Revenue takes into account any rent free periods, stepped rent etc. If there is a rent review clause in a lease providing for a review in the 5th year of the term, then stamp duty is calculated on the ascertainable rent i.e., that stated for the first 5 years.

### Other instruments

No duty is payable on mortgages or powers of attorney.

A declaration of trust is stamped 50 pence.

An exchange of land is stamped by reference to the market value of the property given in exchange for the relevant land interest.

If A exchanges with B a freehold worth £5 million for a freehold worth £7 million and pays to B the sum of £2 million, A pays stamp duty of £70,000 and B pays duty of £50,000.

Before 1993 stamp duty was payable only on the difference between the two values. A would have paid £20,000 and B only 50 pence.

### Liability

It is the responsibility of the buyer to pay the stamp duty. It must be paid within 30 days of the date of the instrument otherwise a penalty is payable.

The penalty is on a sliding scale depending on the original amount of duty payable and the lateness of the payment. It is a criminal offence to avoid the payment of stamp duty.

#### Interaction of VAT and stamp duty

VAT may be chargeable on the premium and/or rent of a commercial property. Where it is payable, stamp duty is calculated on the average annual rent including the amount of VAT payable.

### **PROBLEM AREAS AND DISTORTIONS OF COMPETITIONS**

#### **Some problem areas**

There have been numerous problem areas in interpreting UK VAT provisions. Some of these are as follows, but the detailed explanation is too lengthy for this brief overview (further details can be supplied).

1. surrenders and reverse surrenders;
2. variations to leases;
3. lifting of restrictive covenants;
4. co-ownership of property;
5. transfers of going concerns and interaction with capital goods scheme;
6. rent adjustments on disposal of buildings;
7. service charges;
8. mortgages in possession;
9. land held on trust;
10. protected buildings;
11. relevant residential buildings;
12. relevant charitable buildings;
13. substantial reconstruction of a protected building;
14. licences to occupy;
15. sports facilities;
16. beneficial and joint ownership.

#### **Perceived distortions**

UK property companies, whilst wanting to retain the option to tax, have lobbied UK Customs for a more flexible option to tax regime. At present the UK allows the option to tax only on a building by building basis, so that a landlord has to opt to tax all leases in a building or none of them.

Where a building has, say, six floors with tenants being a retail shop on the ground floor, a firm of solicitors on the 2nd and 3rd floors, and a bank on the 4th, 5th and 6th floors, the landlord would ideally prefer to opt to tax the rents on the 1st, 2nd and 3rd floors, but leave the rents to the bank exempt (because the bank cannot recover much VAT). At present, if the landlord does not tax the rents in the whole building, the service charges to the taxable tenants (retailer and solicitors) carry hidden VAT which cannot be recovered. If the landlord opts to tax the building, the bank may object or go elsewhere because it cannot recover such VAT on the rent.

UK Customs has considered but so far rejected such a greater flexibility in the option to tax. It will be interesting to establish whether this facility is available in other EU countries.