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VAT Treatment of Deeds of Variation to Leases

A deed of variation is a deed under which the substance of an existing agreement is varied, normally in a fundamental manner. A deed of variation in relation to a lease agreement may have the following effects; - variation in the property (e.g. an increase in the amount of the property that is subject to the letting), a variation in the length of the term of the lease, a variation in the rent payable under the lease, a variation in the parties to the lease, etc. The VAT treatment of the more common examples of these variations is illustrated by way of examples below.

Example 1 – Variation in term/length of the lease:

Mr. L grants a lease to Mr. T for 20 years on 1 July 1994. VAT was properly accounted for on the creation of the lease [\[1\]](#). On 1 July 2010 a deed of variation is negotiated and agreed between the parties, which extends the term of the lease by five years.

The VAT treatment is that the extension of the lease is treated as the creation of a new lease from the date on which the original lease expires (30 June 2014). Assuming there was no development work carried out, there are no VAT obligations on the execution of the deed of variation because there is no surrender of the original lease and the original lease remains in place. In addition, when the new lease comes into effect (on 1 July 2014) there are no VAT implications for Mr. L or Mr. T. The letting is exempt from VAT and there are no CGS [\[2\]](#) implications for either party.

1. Prior to 1 July 2008 a lease of ten years or more was treated as a supply of goods and VAT was chargeable upfront on the capitalised value of the lease. Such leases are referred to as "legacy leases". See Chapter 3 VAT on Property Guide.

2. Capital Goods Scheme – the scheme that adjusts deductibility over the life of a property.

Example 2 – Reduction in the rent in return for removal of break clause

Mr. A grants a lease to Ms. B for 20 years on 1 January 2004. VAT was properly accounted for on the lease. The lease contains a break clause at year 10. On 1 March 2010 a deed of variation is negotiated and agreed between the parties, which reduces the annual rent by 25% but also removes the break clause at year 10. There are no VAT implications in relation to this deed of variation because there is no surrender of the original lease and the original lease remains in place.

Example 3 – Partial surrender of lease

ABC Ltd granted a lease to XYZ Ltd for twenty years on 1 January 2006. VAT was charged on the creation of the lease in the sum of €100,000.

On 1 July 2010 ABC and XYZ agree to a deed of variation, which means that 25% of the area covered by the lease is surrendered to ABC.

The VAT treatment is that there is a part-surrender of the "legacy lease" [3]. This part surrender is treated as a supply of goods on which VAT is chargeable [4]. The amount of VAT chargeable is determined in accordance with the following formula:

$$\frac{T x N}{Y}$$

T = total tax incurred

N = number of full intervals + 1 remaining in the CGS adjustment period

Y = total number of intervals in the CGS adjustment period

$$\frac{100,000 \times 16}{20}$$

= €80,000 x 25% (area being surrendered)

= €20,000 VAT payable by ABC (the surrender is taxed on the basis of a reverse charge).

3. See footnote 1 above.

4. See Section 4C(6) VAT Act 1972 (as amended) and Chapter 3 VAT on Property Guide.

Example 4 – Additional area added

D Ltd grants a lease on a warehouse to E Ltd for twenty years on 1 July 2000. VAT was properly accounted for on the creation of the lease.

During 2009 and 2010 D Ltd constructs a new warehouse adjacent to the one occupied by E Ltd. The development is completed on 1 May 2010. D Ltd deducts the VAT incurred on this development on the basis that it intends to opt to tax the letting [5].

On 1 July 2010 D Ltd agrees a deed of variation with E Ltd to increase the area covered by the lease to include this new warehouse with the existing lease still to expire on 30 June 2020. An additional €250,000 rent per year is payable.

The VAT treatment of this deed of variation is that the original "legacy lease" is unaffected. The new area covered and the additional rent, which is provided for by the deed of variation to the original lease, are treated as a new lease for VAT purposes. In order to avoid a claw-back of the VAT deducted on the development cost, D Ltd must exercise the landlord's option to tax and charge VAT at the standard rate on the €250,000 [6].

5. Lettings are exempt from VAT. However the landlord can choose to charge VAT on the rents by exercising the "landlord's option to tax".

6. Note – when the lease expires on 30 Jun 2020 D still has CGS obligations in relation to the development of the new warehouse, as the adjustment period for the new warehouse is twenty intervals beginning on 1 May 2010. See Section 12E(3)(a) VAT Act 1972 (as amended) and Chapter 6 VAT on Property Guide for further information on CGS intervals.