Capital Goods Scheme – The Big Swing for Transitional Properties

This document should be read in conjunction with section 64(4) of the VAT Consolidation Act 2010

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Revenue
Cáin agus Custaim na hÉireann
Irish Tax and Customs

1. When does the big-swing "test" apply to transitional properties?

Where on or after 23 February 2010 a transitional property is used for the first time, or there is a change of use in the property, the big-swing test (Section 64(4)) will apply to such properties. This means that the owner of such a property will be obliged to make a big-swing adjustment if the first use or the changed use of that property results in a "swing" of more than fifty percentage points.

2. What does "first use" mean?

First use means any use of a transitional property by a taxable person on any date on or after 23 February 2010 where the property has not been used prior to 23 February 2010. First use does not however including a letting of the property by the taxable person.

3. What does "changed use" mean?

Changed use means any situation where on any date on or after 23 February 2010 the property is used by a taxable person for a purpose that is different to its use by the taxable person prior to that date. Changed use does not however include a letting of the property by the taxable person.

In order to qualify as a "changed use", it is not necessary that the changed use be an exempt use. For example, if a person uses a property from January 2006 for the purposes of making widgets (taxable) and changes this use to selling stationery (also taxable) in January 2011, this would constitute a changed use and the big-swing test would apply to that property. If part of a property is used for a "changed use" the big-swing rule will apply.

4. What happens if the big-swing test applies but there is a change of less than fifty percentage points in the taxable use of the property?

In such cases even though the big-swing test applies, no adjustment of deductibility will be required. This is because there has not been a "swing" of more than fifty percentage points in the taxable use of the property. (See Example 3 below). In addition, as the annual CGS adjustments under Section 64(3)[1] VATCA 2010 continue to be disapplied on or after 23 February 2010 in relation to transitional properties, there will be no obligation on the owner of the property to make a "normal" CGS adjustment in such cases.

5. What happens if the property is for the purposes of a letting on or after 23 February 2010 having previously not been used or used for a different purpose?

As stated above, the big-swing test does not apply in such cases. In addition, the special rules in the CGS which deal with the exercising and termination of the landlord's option to tax continue to be disapplied. The claw-back rules in Section 95(4)(a) VAT CA 2010 in relation to exempt lettings of transitional properties continue to apply.

Example 1

Mr H purchases a property on 1 January 2008 for €5 million + VAT €675,000. He deducts all this VAT on the basis that he is going to use the property for the purposes of his fully taxable business. Mr H does not secure the funding he needs to get the business off the ground and the property remains vacant.

On 1 January 2011 Mr H commences operating a creche from the facility. As this is the "first use" of the property and this "first use" occurs on or after 23 February 2010 the big swing test applies to Mr H in relation to the property. At the end of the CGS interval [2] in which the first use occurs (31/12/2011), Mr H will be obliged to calculate whether or not a big-swing adjustment is required.

As he took a full deduction in respect of the acquisition of the property, the benchmark figure is 100% taxable. The use during the interval in which the first use occurs is 0% taxable. As this is a change of more than 50 percentage points an adjustment is required. The formula to be used is-

(C - D) x N

C = reference deduction amount, D = interval deduction amount, N = number of full intervals remaining in the adjustment period for the property + 1. [3]

(33,750 [4] – 0) x 17= €573,750

This amount represents VAT payable by Mr H in the taxable period following the end of the interval in which the use took place. (The VAT is payable in Jan/Feb 2012). This amount corresponds to a claw-back of 17/20 of the VAT initially deducted.

The benchmark figure for the CGS for Mr H in respect of this property after this adjustment is made is 0% taxable. The big-swing test will continue to apply until the end of the adjustment period and if there is any further change of more than fifty percentage points (by reference to the new benchmark figure of 0% taxable), a further adjustment will be required.

Note: if the initial deduction was zero and the first use was taxable, a VAT credit would have been given to Mr H.

[1] This is the “normal” CGS annual adjustment which is based on 1/20.

[2] Interval in this case means the 12 month period beginning on 1/1/2011 that ends 31/12/2011.

[3] For more information on these definitions see Capital Goods Scheme.

[4] 33,750 represents the VAT deducted (€675,000) divided by 20 (number of intervals in the CGS adjustment period).

Example 2

Mr D develops a property that is completed on 1 January 2005. He does not deduct any of the VAT (€500,000) charged to him on the basis that he is going to use the property for the purposes of a fully exempt business – vocational training of hairdressers.

In 2010 Mr D spots an opening in the market and decides to use a significant amount of the space in the building for the purposes of running a hairdressing salon. The salon opens on 3 January 2012. As this is a "changed use" on or after 23 February 2010, the big-swing test applies to this property. During the year a fair apportionment of the use to which the property is put is 70% for the salon, 30% for continuing the training business.

At the end of the interval in which the salon opens (31/12/2012) Mr D is obliged to calculate if a big-swing adjustment is a required. As there is a change of more than fifty percentage points in the taxable use an adjustment is required. The formula to be used is –

(C - D) x N

C = reference deduction amount, D = interval deduction amount, N = number of full intervals remaining in the adjustment period for the property + 1

(0 - 17,500) x 13 = - €227,500.

This amount is given as a VAT credit to Mr D in the taxable period following the end of the interval in which the changed use took place. (The VAT credit is due in Jan/Feb 2013 taxable period). This amount corresponds to a credit of 13/20 of 70% of the non-deductible VAT (€500,000).

The benchmark taxable figure for the CGS for Mr D in respect of this property following this adjustment is 70%. The big-swing test will continue to apply until the end of the adjustment period and if there is a subsequent change of more than fifty percentage points (by reference to the new benchmark figure of 70% taxable), a further adjustment will be required.

Note: if the initial deduction was fully taxable and the changed use was exempt, a VAT claw-back would have arisen.

6. Interaction of Section 95(11) with section 95(4)(a)

Where a person has carried out a big-swing adjustment and paid over VAT to Revenue by virtue of a diversion of a transitional property from fully taxable to fully exempt use (other than letting) and that person subsequently creates an exempt letting of the property, there will be no deductibility adjustment in accordance with Section 95(4)(a). If an adjustment is based on a diversion of less than a 100% change then the figure to be used for "T" in the formula referred to in Section 95(4)(a) shall be reduced by the amount of the tax paid over under the big-swing adjustment for the purposes of calculating the VAT due when the exempt letting is created.

Example 3 – changed use, less than fifty percentage points “swing”.

Ms C develops a property, which is completed on 1 January 2005. She deducts all the VAT incurred in relation to the development on the basis that she will use the property for a fully taxable business, manufacturing furniture for sale.

In January 2013 Ms C begins providing insurance brokerage services as well as the existing furniture business. This represents a "changed use" and Ms C is therefore subject to the big-swing test in relation to that property.

At the end of the interval in which the brokerage business begins (31/12/2013) Ms C is obliged to calculate if a big-swing adjustment is required. The property is used for 30% exempt use (insurance business) during 2013. As there is not a change of more than fifty percentage points in the taxable use, no adjustment is required. [5]

The big-swing test will continue to apply until the end of the adjustment period and if there is any change of more than fifty percentage points (by reference to the benchmark figure of 100% taxable), an adjustment will be required.

[5] There is no obligation to make the "normal" CGS annual adjustment based on 1/20 because section 64(3) continues to be disapplied in respect of transitional properties.

Example 4 – Changed use where there was exempt use before 23 Feb 2010.

DevCo constructed a creche and incurred €2m VAT on the development. The development was completed on 1 January 2008. It deducted all the VAT on the basis it was going to sell the creche. DevCo was unable to sell the creche and instead opened the creche for operation on 1 April 2009. There was no CGS adjustment required as per Section 95(11) as it applied on that date.

On 1 January 2013 DevCo closed the creche and began operating a nursing home. As this represents a "changed use", the “big-swing” test applies to the property. At the end of the interval in which the nursing home is opened (31/12/2013), DevCo is obliged to calculate if a big-swing adjustment is required. The benchmark figure is 100% taxable (as DevCo deducted 100% of the VAT on the development of the property). The use during 2013 is 0% taxable. As there is a change of more than fifty percentage points in the taxable use an adjustment is required. The formula to be used is –

(C – D) x N

C = reference deduction amount, D = interval deduction amount, N = number of full intervals remaining in the adjustment period for the property + 1

(100,000 – 0) x 15 = €1,500,000

VAT payable by DevCo in the taxable period following the end of the interval (year) in which the changed use took place. (The VAT is payable in Jan/Feb 2014). This amount corresponds to a claw-back of 15/20 of the VAT initially deducted.

The benchmark taxable figure for the CGS for DevCo in respect of this property after this adjustment is made is 0% taxable. The big-swing test will continue to apply until the end of the adjustment period and if there is any further change of more than fifty percentage points (by reference to the new benchmark figure of 0% taxable), a further adjustment will be required.