

Transitional measures applying to legacy leases

This document should be read in conjunction with section 95 of the VAT Consolidation Act 2010 (VATCA 2010)

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Introduction

This guidance deals with the transitional measures applying to legacy leases. Together with [freehold interests or freehold equivalents held prior to 1 July 2008](#), these leases are referred to as transitional properties.

1 What are legacy leases?

Legacy leases are interests in property that were treated as a supply of goods under the old Value-Added Tax (VAT) on property rules, which is a lease of ten years or longer created prior to 1 July 2008. The term does not include interests that constitute freehold equivalent interests.

The lease must have been held by a taxable person on 1 July 2008, and it must form part of the assets of a business at that date.

Prior to 1 July 2008, the creation of a legacy lease and, in most cases, its subsequent assignment to another tenant, was chargeable to VAT at the [reduced rate](#) as a supply of goods (property).

2 What is the VAT treatment of legacy leases?

This section explains the VAT implications when a tenant assigns or surrenders a lease.

2.1 What is an assignment of a lease?

It is the transfer of the lessee's interest or part thereof to another person other than the person who holds the reversionary interest (see Paragraph 8 [What is the VAT treatment of a legacy lease reversion](#)).

2.2 What is a surrender of a lease?

It is the transfer of the lessee's interest or part thereof to the person who at the time of the surrender retains the reversion of that interest and includes:

- the abandonment of that interest in those goods by the lessee
- the failure of the lessee to exercise any option of the kind in relation to that interest in those goods (but excluding any such failure if such interest were created on or after 1 July 2008)
- the recovery by the lessor of that interest in those goods by ejectment or forfeiture prior to the date that the interest would, but for its surrender, have expired.

2.3 Legacy leases under the new VAT on property provisions

The surrender or assignment of a legacy lease is regarded as a supply of immovable goods if it occurs:

- within a period of 20 years from the creation of the interest (the lease) or
- from its most recent assignment or surrender prior to 1 July 2008.

This 20-year life represents the Capital Goods Scheme (CGS) life of the legacy lease.

The question of whether a liability to VAT arises on the surrender or assignment of a legacy lease depends initially on whether or not the tenant was entitled to reclaim any of the VAT incurred on the acquisition of the legacy lease.

2.3.1 Tenant was entitled to reclaim VAT incurred on the acquisition of the lease

The assignment or surrender of the lease is taxable if:

- the tenant was entitled to reclaim any of the VAT charged on the acquisition of that lease or on the development of the property subject to the lease and
- the surrender or assignment occurs within 20 years of that tenant's acquisition of that leasehold interest.

When a tenant assigns such a lease, the new tenant to whom the lease is assigned, and any further assignees will likewise be taxable on its surrender or assignment. This is in respect of the same 20-year period following that first assignor's acquisition of the interest.

2.3.2 Tenant was not entitled to reclaim any of the VAT incurred on the acquisition of the lease

Where the tenant was not entitled to reclaim any of the tax incurred on the acquisition of the lease, the assignment or surrender of the lease is exempt from VAT.

However, the parties to the assignment or surrender can jointly opt to have the assignment or surrender treated as taxable where both parties are taxable persons carrying on a business in the State.

3 What is the VAT treatment of deeds of variations?

A deed of variation is a deed under which the substance of an existing agreement is varied, normally in a fundamental manner.

Deed of variation effects on a legacy lease agreement

A deed of variation in relation to a lease agreement may have the following effects:

- A variation in the property (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, and so forth.

Examples of deeds of variations in relation to legacy leases

These examples generally, represent situations where a deed of variation would not constitute a surrender (or a full surrender as appropriate) of a lease.

Example 1

Variation in the length of the term of the lease

Mr L granted a lease to Mr T for 20 years on 1 July 1994. VAT was properly accounted for on the creation of the lease. On 1 July 2010, a deed of variation was negotiated and agreed between the parties which extended 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 expired (30 June 2014).

When the new lease came into effect on 1 July 2014, there were no VAT implications for Mr L or Mr T. The letting is exempt from VAT and there are no CGS implications for either party.

In this example, assuming there was no development work carried out, there are no VAT obligations on the execution of the deed of variation. This is because there was no surrender of the original lease and the original lease remained in place.

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

Mr A granted a lease to Ms B for 20 years on 1 January 2004. VAT was properly accounted for on the lease. The lease contained a break clause at year ten.

On 1 March 2010, a deed of variation was negotiated and agreed between the parties which reduced the annual rent by 25% but also removed the break clause at year ten.

In this example, there are no VAT implications in relation to this deed of variation because there was no surrender of the original lease and the original lease remains in place.

Example 3**Partial surrender of a lease**

ABC Ltd granted a lease to XYZ Ltd for 20 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 Ltd and XYZ Ltd agreed to a deed of variation which meant that 25% of the area covered by the lease was surrendered to ABC Ltd.

In this example, the VAT treatment is that there was a part surrender of the legacy lease. This part surrender is treated as a supply of goods on which VAT is chargeable.

The amount of VAT chargeable is calculated as follows:

$$(T \times N) / Y$$

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

$$(100,000 \times 16) / 20 = \text{€}80,000$$

$$\text{€}80,000 \times 25\% \text{ (area being surrendered)} = \text{€}20,000$$

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

Example 4

Additional area added

D Ltd granted a lease on a warehouse to E Ltd for 20 years on 1 July 2005. VAT was properly accounted for on the creation of the lease.

During 2017 and 2018, D Ltd constructs a new warehouse adjacent to the one occupied by E Ltd. The development is completed on 1 May 2018. D Ltd reclaims the VAT incurred on this development on the basis that it intended to opt to tax the letting.¹

On 1 July 2018, 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 2025. An additional €250,000 rent per year is payable under the deed of variation.

In this example, 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, is treated as a new lease for VAT purposes.

In order to avoid a claw-back of the VAT reclaimed on the development cost, D Ltd must exercise the landlord's option to tax and charge VAT at the [standard rate](#) on the €250,000.²

4 How to account for VAT on legacy leases

This section sets out the responsibilities, obligations and the tax payable on the assignment or surrender of a legacy lease.

4.1 Who is responsible for the VAT chargeable on the assignment or surrender of a legacy lease?

In general terms, a [reverse charge](#) mechanism operates where VAT is payable on an assignment or a surrender of an interest in a property. This means that where an assignment or surrender is subject to tax, the person acquiring the interest accounts for the tax in their [VAT return](#) (reverse charge). Generally, the tenant in possession of the lease being assigned or surrendered does not charge the tax.

¹ Lettings are exempt from VAT. However the landlord can choose to charge VAT on the rents by exercising the landlord's option to tax.

² When the lease expires on 30 Jun 2025, D Ltd still has CGS obligations in relation to the development of the new warehouse, as the adjustment period for the new warehouse is 20 intervals beginning on 1 May 2018.

More specifically, the reverse charge arises where the person taking the assignment or surrender demonstrates to the reasonable satisfaction of the person making the assignment or surrender that the assignee / landlord is a person of a kind specified below:

- an [accountable person](#)
- the State or a local authority
- a person who acquires the interest in the lease for the purposes of making any of the following exempt supplies in the course or furtherance of business:
 - an exempt supply of property or an exempt letting
 - financial services and agency services in relation to same
 - insurance and reinsurance transactions
 - public postal services
 - national broadcasting services
 - passenger transport.

Where the assignee / landlord is not registered for VAT, they must [register](#) and [account](#) for VAT in respect of that transaction.

If the assignee / landlord cannot demonstrate that they are a person of a kind specified above, the assignor will need to charge and account for the VAT in relation to the assignment or surrender.

If the assignment or surrender is of a lease in respect of which the joint option to tax has been exercised, the assignee / landlord accounts for VAT arising on the assignment or surrender on a reverse charge basis. This is provided that the assignee / landlord is a person described above.

4.2 VAT obligations for the person making the assignment or surrender

The person making the assignment or surrender must issue a document to the person to whom the lease is assigned or surrendered (assignee / landlord).

The document must contain:

- the amount of tax due on the assignment or surrender
- the number of intervals remaining in the adjustment period at the time of the assignment or surrender.

This enables the assignee / landlord to calculate:

- the taxable amount for the transaction
- any tax payable on any future assignments or surrenders made by him or her.

Where a legacy lease is surrendered and the landlord grants a new lease, that lease is regarded as a new letting. The letting will be exempt unless the landlord's [option to tax](#) is exercised (the new letting is not a legacy lease).

The amount of VAT chargeable on the surrender of the legacy lease will be the basis for the landlord's calculation of CGS liability. This occurs when the landlord does not exercise the landlord's option to tax the new letting, or on the exempt sale of the property (see the example in Paragraph 7 [Sale of a property following the surrender of a legacy lease](#)).

4.3 What is the tax payable where the assignment or surrender of a legacy lease is taxable?

There is a formula to calculate the tax payable. The formula is:

$$(T \times N) / Y$$

T = the total tax incurred on the acquisition of the lease. Exclude tenant refurbishment as tenant is CGS owner of same.

N = the number of full intervals, plus one, that remain in the adjustment period for the person making the assignment or surrender at the time of making the assignment or surrender.

Y = the total number of intervals in the adjustment period for the person making the assignment or surrender.

The taxable amount is the tax payable amount re-grossed @ 13.5%.

Where an assignee, for example, will use the property for the purpose of 100% Vatable supplies, he/she will include the VAT in both the output and input sections of the VAT return.

Any premium / reverse premium payable by a landlord to a tenant, or a tenant to a landlord in respect of the assignment or surrender of a legacy lease, is considered outside the scope of VAT. The VAT chargeable on such an assignment or surrender is restricted to the amount calculated using the formula as outlined above.

Example 5

Business X grants Business Y a 35-year lease on 1 July 2000. VAT of €1 million was charged on the capitalised value of the lease, all or part of which VAT was deducted by Business Y.

Business Y is still the tenant (and so has the interest in the property) on 1 July 2008. The adjustment period for the legacy lease is 20 years from 1 July 2000.

On the 15 April 2012, Business Y assigns the lease to Business J, a retailer. The assignment is taxable on the reverse charge basis, as it occurs within the 20-year adjustment period.

When the assignment is made by Y to J on 15 April 2012, the tax payable on the assignment or surrender of a legacy lease is calculated as follows:

$$(T \times N) / Y$$

$$T = \text{€}1,000,000$$

$$N = 9 \text{ (8 full intervals remaining + 1)}$$

$$Y = 20$$

$$\text{€}1,000,000 \times 9/20 = \text{€}450,000$$

$$\text{Tax payable} = \text{€}450,000$$

The taxable amount is €3,333,333 (450,000 re-grossed @ 13.5%)

Obligations for J (the assignee)

The assignment is [reverse charged](#), which means that J is liable to account for VAT of €450,000 on the supply in its March/April 2012 VAT return.

Where J uses the property for the purpose of 100% Vatable supplies, he/she includes the €450,000 VAT figure in both the input and output sections of the VAT return.

The adjustment period for the capital good for J is nine intervals. The total tax incurred is €450,000.

The initial interval for J begins on 15 April 2012 and ends on 14 April 2013. The second interval for J begins on 15 April 2013 and ends when the accounting year for J ends, for example, the 31 December 2013. Each subsequent interval runs from 1 January to 31 December until the lease has expired.

5 Capital Goods Scheme (CGS) and legacy leases

5.1 What is the CGS adjustment period for legacy leases?

The adjustment period for legacy leases is as follows:

- in the case of the creation of the legacy lease, the period of 20 years from creation of the lease
- in the case where the person holding the interest in the legacy lease on 1 July 2008 acquired it by assignment, the period remaining in the legacy lease at the time of that assignment or 20 years, whichever is the shorter.

The first 12 months of the adjustment period is treated as the CGS initial interval. Each subsequent interval is a period of 12 months. However, you may treat the second interval as the period from the end of the initial interval to the accounting date of the business. Subsequent intervals will then be 12 months from that date.

The legislation states that if the property has been developed since the acquisition, creation of that interest, the adjustment period is 20 years from the date of the most recent development of those goods (section 95(12)(c) VATCA 2010). Revenue accepts that this clause will not apply to legacy leases where the person who owns that legacy lease carries out a development and that development is a refurbishment for VAT purposes.

5.2 Are legacy leases subject to the CGS annual adjustments?

Legacy leases are not subject to the normal CGS annual adjustments (based on 1/20), or the provisions relating to the [landlord's option to tax](#).

Refurbishment (development on a previously completed building) that is completed prior to 1 July 2008, is not subject to the normal CGS annual adjustments.

However, if on or after 23 February 2010, a property which is subject to a legacy lease is used for the first time, or there is a change of use in the property, the big-swing test will apply to such a legacy lease (see [CGS – The Big Swing for Transitional Properties](#)).

6 Legacy leases post-letting expenses

A landlord who had charged VAT on the creation of a long lease or the successor to that landlord (where the landlord sold the reversion) was allowed under the rules that applied prior to 1 July 2008, to reclaim certain VAT incurred after the date of the taxable supply of the leasehold interest.

The VAT in question relates to the following post-letting expenses:

- carrying out services that the landlord is required to provide under the lease, the value of which would be reflected in the rent on which the capitalised value was based
- rent collection
- any rent review
- the exercise of an option to extend the lease or to the exercise of an option to end the lease (break clause) provided for under the lease.

This practice is continued as regards legacy leases. If not already an accountable person, a landlord may register and reclaim VAT in respect of those post-letting expenses.

While post-letting expenses are restricted to services provided by the landlord the definition of services in this context is extended by concession to cover the supply of the following goods:

- electricity
- gas
- power
- heat
- refrigeration
- ventilation.

6.1 How are routine general overheads treated?

As a concession, routine general overheads of the landlord may be ascribed to legacy leases, and a portion of the input VAT incurred in respect of them may therefore be reclaimed.

Such overheads would include:

- office expenses
- audit fees

relating to the carrying out of the landlord's business.

Such overheads do not include:

- costs incurred in relation to the purchase or sale of reversions on legacy leases
- costs relating to other exempt activities.

Where the landlord's business includes both legacy leases and exempt lettings, the VAT may be apportioned on a reasonable basis. The landlord will be entitled to reclaim VAT on such overheads in respect of taxable lettings.

6.2 Shared services and legacy leases

The existing practice as regards shared services is being continued for legacy leases. This arises where the landlord agrees under the terms of a lease to arrange for the receipt of the services on behalf of tenants (for example, cleaning and security) on the basis of reimbursement by the tenants.

The landlord passes on the VAT on such services to the individual tenants, who can reclaim the VAT to the extent that the property is used for their taxable activities.

The landlord should issue to each tenant, once a year, an invoice showing VAT charged to the tenant on these services. The landlord should include the VAT payable and the amount he/she can reclaim in the appropriate VAT return.

6.3 How does the practice as regards shared services apply to section 56B certificate holders?

The purpose of the landlord's concession is to avoid trapped VAT where a lessee could reclaim VAT. The landlord's concession provides that a landlord who is an accountable person and registered for VAT may issue to each VAT registered tenant a VAT invoice that shows:

- the landlord's VAT number
and
- details of the goods and services on which the landlord has incurred VAT on the tenant's behalf.

A landlord who is not an accountable person and therefore not registered for VAT may nevertheless register for VAT solely for the purposes of this concession and the issue of an invoice as described above. These invoices enable the lessee to obtain VAT deductibility for VAT paid on the lessee's behalf by the landlord.

In the case of a VAT registered lessee who is a 56B holder, a copy of the 56B certificate should be provided to the landlord registered under the concession. The landlord will then apply the zero rate of VAT to the annual invoices in respect of goods and services to that registered tenant.

It is acknowledged that the scheme as initiated was based on the premise that a landlord registered under the concession could not be in a VAT repayment position since this might:

- confer a cash-flow advantage on the landlord
and
- counter the purpose of the scheme which was to allow the VAT to flow through the landlord to the lessee.

Against this, the purpose of [section 56](#) is to allow holders of a section 56B certificate to:

- receive goods and services at the zero rate
and
- to confer a cash-flow advantage on such certificate holders.

Faced with these two apparently competing circumstances, Revenue's position is that the holder of a section 56B certificate can avail of the zero-rating in relation to invoices issued to the holder by a landlord registered under the concession. This will result in the landlord being in a VAT repayment situation in relation to VAT on goods and services reflected on such invoices.

7 Sale of a property following the surrender of a legacy lease

Any sale of such property, following such surrender during the CGS period will be subject to the normal rules. Any CGS adjustment is based on the VAT charged on the surrender.

Where the sale of such a property is exempt and the parties [jointly opt to tax](#) such a supply, the taxable amount is the consideration for the supply.

The adjustment period to be used in relation to that transaction is the number of CGS intervals indicated in the document that the tenant gives to the landlord on surrender of the lease.

Example 6

Assume the transaction mentioned in the example under [How to account for VAT on legacy leases](#) (see paragraph 4 above) was a surrender of the lease to Mr X (the landlord) and that Mr X reclaimed the VAT chargeable as he intended to opt to tax the next letting.

In May 2013, Mr X (the landlord) sold the freehold without having carried out development.

The sale was exempt under the normal rules because the property has not been developed within the five years prior to the sale.

Mr X's liability in respect of the CGS adjustment relating to the exempt sale was as follows:

$$(\text{€}450,000 \times 8) / 9 = \text{€}400,000$$

This reflects that seven full and one partial interval remained of the nine intervals applying at the time of the surrender. Mr X would repay €400,000 as an adjustment of the VAT reclaimed.

The same adjustment would have been required if, instead of selling the property, Mr X had cancelled his landlord's option to tax or created a new letting without exercising the option.

8 What is the VAT treatment of a legacy lease reversion?

Where a taxable long lease (leases of ten years or more) was created before 1 July 2008, the landlord's interest in the property subject to that lease is regarded as the reversion on that legacy lease.

Where a landlord sells a reversion on a legacy lease on or after 1 July 2008, the sale of the reversion is in most cases exempt from VAT. Where the sale of a reversionary interest is exempt from VAT there is no CGS adjustment required.

However, if the property was developed by, on behalf of, to the benefit of, the landlord subsequent to the creation of the long lease, the supply of the reversion would be taxable if it occurs while the property is considered [new](#).