

Waiver of exemption – Transitional Measures

This document should be read in conjunction with section 96, and section 97(3) of the VAT Consolidation Act 2010 (VATCA) and regulation 35 of the VAT Regulations 2010.

Document last reviewed April 2024



Table of Contents

Introduction	3
1 What was the position prior to 1 July 2008?.....	3
2 What changes occur from 1 July 2008 in the waiver system? Section 96.....	4
3 Are there any further restrictions on existing waivers of exemption? Section 96(8).....	5
4 What will be the position as regards the landlord's other properties (those where the tenant is not connected with the landlord) that are subject to the waiver of exemption?.....	5
5 What is the position if the connected tenant is entitled to deduct at least 90% of the VAT chargeable on the rent?.....	5
6 Are there other exceptions to the cancellation of a waiver where the landlord and tenant are connected?	6
7 What is the permitted minimum rent that must be payable? Section 96(9) and (10).....	7
8 Provisions relating to waivers and VAT groups. Section 96(11)	9
9 How does the Capital Goods Scheme (CGS) operate in relation to properties that are subject to a waiver of exemption? Section 96(7)	9
10 Automatic cancellation of a waiver of exemption. Section 96(12)[2]	9
11 Pre-waiver deductibility	11

Introduction

This guidance deals with the situation of a taxpayer that had waived exemption in respect of short-term letting of property prior to commencement of the new provisions.

1 What was the position prior to 1 July 2008?

Prior to the introduction of the new system for VAT on Property, leases were divided into short leases (those for a period of less than 10 years) and long leases (those for a period of 10 years or more).

Long leases were considered a supply of goods and tax was payable by reference to the capitalised value of the lease. The transitional measures as regards these leases are dealt with in [Transitional Properties](#).

Short leases were exempt from VAT but a landlord could waive this exemption. Where the exemption was waived, the landlord was entitled to deduct the VAT incurred on the acquisition or development of the let property. The landlord was required to charge VAT on all rents payable to her/him under short leases or lettings. The waiver of exemption applied to all properties let by the landlord under short leases or lettings. Where the landlord sold a property that was within a waiver of exemption and in respect of which the landlord was entitled to deduct VAT incurred on its development or acquisition, the supply of the property was subject to VAT.

A landlord could cancel a waiver of exemption. Where this occurred, the landlord had to make what is known as a cancellation adjustment. The cancellation adjustment is the difference between the VAT deducted by the landlord in respect of the acquisition or development of let properties, and in respect of other goods or services consumed in the business of short-term letting and the VAT accounted for by the landlord in respect of rents.

Example 1 - Old rules - waiver of exemption

Ms. "C" acquired a property in November 2002 for €750,000. She was charged VAT of €101,250 (€750,000 @13.5%) on the acquisition. She had waived her exemption before acquiring the property and was entitled to deduct this amount in 2002. The property was let with effect from 1 January 2003. By the end of 2007 she has charged VAT of €44,000 on the rent from the property. She had accounted for this in her VAT returns, but as she was entitled to deduct €5,000 of the further VAT she incurred over the years in respect of the letting, she had paid only €39,000 by the end of 2007. If C wished to cancel the waiver of exemption at the end of 2007 she would have to pay €62,250 to Revenue, i.e. the difference between the VAT deducted in respect of acquisition and the VAT paid by her on rents.

With effect from 2 April 2007, a waiver of exemption could not be exercised in respect of residential lettings and an existing waiver in place at that date did not extend to a letting of a property for residential purposes where that property was either:

- Acquired on or after 2 April 2007 unless a binding written contract had been entered into before that date, or
- Developed on or after 2 April 2007 unless an application for planning permission to develop the property as a house, apartment or similar establishment had been received by a planning authority before that date.

If a person cancels his or her waiver of exemption after 1 July 2008 the normal waiver cancellation rules apply. The cancellation applies in respect of all properties to which the waiver applies and the cancellation sum, if any, must be paid.

2 What changes occur from 1 July 2008 in the waiver system? Section 96

A new waiver of exemption cannot commence on or after 1 July 2008.

An existing waiver of exemption does not extend to a property acquired** or developed on or after 1 July 2008. However, development carried out after that date that completes a development that was underway on 18 February 2008, by or on behalf of the person who exercised a waiver on or before 18 February 2008, does not prevent the extension of that waiver to the property.

Example 2 - Extension of waiver to properties being developed

Mr. "B" has had a waiver of exemption in place for a number of years. He acquired an additional property for letting in 2007. He intended to let the property short-term, and on the basis of his waiver claimed input credit for the VAT incurred on the acquisition of the property. B carried out extensive renovations to the property. These works were on-going on 18 February 2008 and continued until the end of September 2008. The property is let on 31 October 2008. The waiver may be extended to the letting of the property, even though the property was developed on or after 1 July 2008.

Example 3 - Properties developed on or after 18 February 2008

Mr. "B" in Example 2 purchases an additional property in May 2008 that requires further development before it can be let. This development is also completed in September 2008. B's waiver does not extend to this property, as it was not undergoing development on 18 February 2008, by or on behalf of B. This would be the case even if the property were being developed on that date since it would have been undergoing development by or on behalf of someone other than B.

Note:** 'Acquired' includes a situation where a legacy lease in a property is surrendered to a landlord on or after 1 July 2008.

If a person cancels his or her waiver of exemption after 1 July 2008 the normal waiver cancellation rules apply. The cancellation applies in respect of all properties to which the waiver applies and the cancellation sum, if any, must be paid.

3 Are there any further restrictions on existing waivers of exemption? Section 96(8)

Yes. A waiver of exemption, in so far as it applies to a letting between connected persons, is cancelled with effect from 1 July 2008. In such cases, the landlord will have to pay a cancellation adjustment in respect of the property. The cancellation adjustment will apply to that property only. It will be the difference between the VAT deducted in connection with that property and the VAT accounted for and paid in respect of that property. Where certain conditions are satisfied, the waiver in respect of such a letting will not be cancelled on 1 July 2008.

4 What will be the position as regards the landlord's other properties (those where the tenant is not connected with the landlord) that are subject to the waiver of exemption?

The waiver will continue in place as regards these properties. In effect, the landlord will be treated as having had two waivers in place, one in respect of the property that is let to the connected person and one in respect of all the landlord's other properties.

5 What is the position if the connected tenant is entitled to deduct at least 90% of the VAT chargeable on the rent?

Where the tenant is entitled to deduct at least 90% of the VAT charged on the rents, then the waiver will not be cancelled with effect from 1 July 2008, but will continue as long as at least that level of deductibility applies. However, if at any point the tenant's entitlement to deduct the VAT charged on the rent falls below the 90% figure, then the waiver of exemption immediately ceases to apply to that letting. The landlord will be required to make the cancellation adjustment for the taxable period in which this occurs.

6 Are there other exceptions to the cancellation of a waiver where the landlord and tenant are connected?

Yes. Provided the VAT on the rents is at least the permitted minimum amount outlined in paragraph 7 below, the cancellation of a waiver is not required where a waiver was in place on 18 February 2008, where either:

- The letting that is in place on 1 July 2008 was in place since 18 February 2008, or
- The property in question was owned by the landlord and was in the course of development by or on behalf of the landlord on 18 February 2008.

The cancellation is also not required where the waiver relates to a letting of a property held by a person under a legacy lease that was acquired between 18 February 2008 and 30 June 2008 from an unconnected landlord.

Under the rules applying to VAT on property transactions prior to 1 July 2008, a Special Purpose Company ('SPC') was frequently used to spread the payment of the VAT chargeable on the creation of a legacy lease out over a period of time, generally a period of 9 years and 11 months (the maximum length of a lease that was not subject to the capitalised value rules). The ultimate user of the property was usually a company that was not entitled to deduct the full VAT charged on the creation of the legacy lease. Example 4 below illustrates how this operated in practice.

Example 4 - SPC waiver mechanism

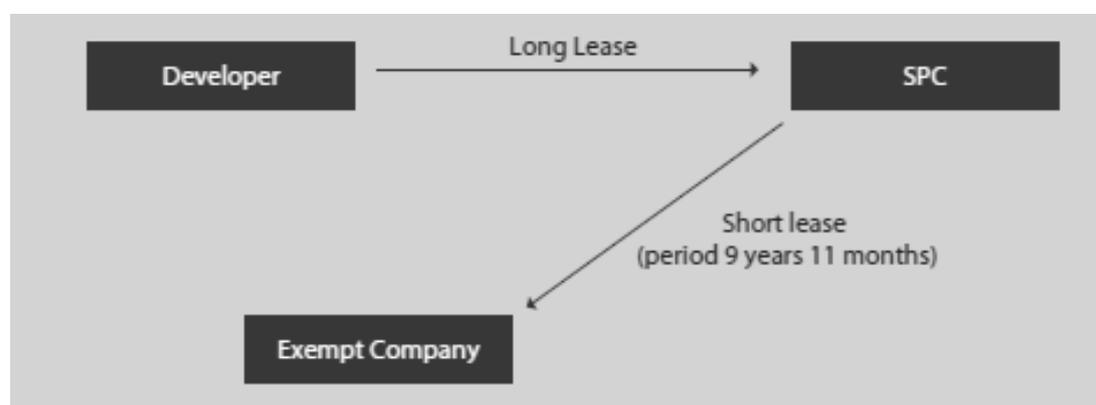


Figure 1: Use of the waiver mechanism by a Special Purpose Company

In this case, the exempt company established an SPC, which acquired a long lease of the property (lease for a period of 10 years or more). The SPC waived its exemption from VAT on a short lease (less than 10 years) of the property to the exempt company, claimed back the VAT on the capitalised value of the lease and charged VAT at the [standard rate](#) on the rents.

In all the above cases, the cancellation can be avoided and the waiver continued where the VAT on the rents charged by the landlord is greater than the permitted minimum outlined in paragraph 7.

Circumstances in which waiver of exemption for letting to connected person may be retained on or after 1 July 2008 (90% deductible tenants excluded) where the VAT on rents is at least the minimum permitted amount.

Nature of landlord's interest in property				
	Waiver in place 18 Feb 2008	Property on hand on 18 Feb 2008	Letting in place on 18 Feb 2008	Waiver in place 1 July 2008
Freehold/Freehold Equivalent	Required	Required	Required	Required
Freehold/Freehold Equivalent under development on behalf of landlord on 18 Feb 2008	Required	Required	Not Required	Required
Legacy lease	Required	Required	Required	Required
Legacy lease acquired from unconnected party 18 Feb 08 to 1 July 2008	Not Required	Not Required	Not Required	Required

7 What is the permitted minimum rent that must be payable? Section 96(9) and (10)

The permitted minimum rent is an amount that will ensure that an amount equivalent to the VAT deducted by the landlord in respect of the acquisition or development of the property will be accounted for within 12 years. It is calculated by the formula below (the 12 year rule):

$$A - B/12 - Y$$

Where:

A = the VAT deducted by the landlord in respect of the acquisition or development of the property.

B = the VAT chargeable and paid on the rents that would be taken into account if the waiver were cancelled at that time.

Y = is the lesser of 11 or the number of full years since the date of the first letting of the property or the date on which the landlord waived exemption, whichever is later.

If the VAT on the rent being charged by the landlord to the connected tenant prior to 1 July 2008 satisfies the minimum test in the 12-year rule, the landlord simply continues to charge VAT on the rents. The landlord must however ensure that the VAT on the rents continues to satisfy the minimum amount.

Example 5 - Calculation of the minimum payment

Assume that Mr. "C" in Example 1, is connected with her tenant. The waiver of exemption can continue to operate from 1 July 2008 if the VAT payable in respect of the rent from the property for the following twelve months is equal to the amount calculated in accordance with the formula below.

$$A - B / 12 - Y$$

Where:

A = VAT deducted by C on acquisition of property = €101,250

B = VAT chargeable and paid by C, which would form part of the cancellation amount on 1 July 2008 if the waiver were cancelled at that date = €48,000 [assuming C paid an additional €4,000 in VAT on rent in the first half of 2008, having already paid €44,000 up to the end of 2007]

Y = number of full years since the date of the first letting or the date on which C waived exemption = 5

$$A - B / 12 - Y = €101,250 - €48,000 / 12 - 5 = €7,607$$

If the current rent is insufficient and C wants to avoid cancelling her waiver (in respect of this property), she will have to increase the rent chargeable to her tenant to ensure that the VAT payable on that rent for the coming twelve months is at least €7,607. Provided that this amount of VAT will be paid, in equal instalments, over the following year and that she keeps her VAT payments in respect of the letting up to date, the property will remain within her waiver of exemption.

The waiver cancellation will not be required while, on the basis of the letting agreement in place, the tax that the landlord is accounting for, in equal amounts in every taxable period, is not less than the minimum rent as calculated using the formula. Whilst the legislation only provides for a bi-monthly basis, it has been agreed that there would be no need to account for the VAT in equal bi-monthly instalments if the letting agreement in place provided that the rent would be paid less frequently e.g. quarterly. However, in such cases the rent payable from 1 July 2008 should, irrespective of the period for which it is payable, be at such a level that when 'annualised' the 12-year rule will be satisfied.

The failure, at any point from 1 July 2008 onwards, to meet these conditions will result in the immediate cancellation of the waiver and the requirement to pay the cancellation amount.

8 Provisions relating to waivers and VAT groups. Section 96(11)

Where a landlord who has a waiver of exemption in place in respect of a letting to a connected tenant becomes a member of a VAT group (of which that tenant is a member) on or after 24 December 2008, then the landlord is obliged to pay the waiver cancellation amount, if any. This rule ensures that connected persons cannot use the grouping provisions to avoid the rules in Section 96 VATCA 2010 for lettings between connected parties where a waiver of exemption has been exercised. This rule will not apply when the underlying use of the property is for other than exempt purposes and the property is used by the group for the purposes of making supplies that entitle that group to deduct at least 90% of the VAT incurred by it in relation to those supplies.

9 How does the Capital Goods Scheme (CGS) operate in relation to properties that are subject to a waiver of exemption? Section 96(7)

The CGS does not apply to sales of properties which have been subject to a waiver of exemption where that waiver has been cancelled. In such cases, the adjustment period for the CGS is deemed to end on the date the waiver is cancelled. This means there are no CGS adjustments required as the sale will occur outside the adjustment period.

If, however the sale occurs before the waiver has been cancelled the normal CGS rules apply. See Examples 6, 7 and 8 below.

10 Automatic cancellation of a waiver of exemption. Section 96(12)[2]

A provision came into effect on 3 June 2009, which automatically cancels a landlord's waiver of exemption in the following circumstances:

- The landlord has a waiver of exemption in place on 3 June 2009
- The landlord owns a property which is subject to the waiver of exemption on 3 June 2009, and
- The landlord at any time on or after this date ceases to own (or have an interest in) any such property.

When this provision applies the landlord's waiver of exemption is deemed to be cancelled on the date that the landlord ceases to own (or have an interest in) property which is subject to his or her waiver of exemption. Example 6 below illustrates how this provision operates in practice.

Note : There are special rules in relation to certain transactions involving waivers and the sale of properties which occurred between 1 July 2008 and 2 June 2009 - please see Chapter 7b VAT Manual, published under Section 16 Freedom of Information Act 1997.

Example 6 – Automatic cancellation of landlord’s waiver of exemption

Mr. “P” purchased a property on 19 September 1995 on which VAT of €75,000 was chargeable. Mr. P waived his exemption from VAT and was entitled to deduct all of the VAT.

Mr. P rented the property out to various tenants between September 1995 and 4 June 2010 at which point, he sold the property. The total VAT paid on the rents during this period was €46,000.

Unless Mr. P and the purchaser exercise the joint option to tax the sale (see [Note](#) below), the sale is exempt from VAT and the normal CGS rules apply (as the waiver has not been cancelled prior to the sale) which results in a claw-back of some of the VAT deducted, as follows;

$$B \times N / T = 75,000 \times 6 / 20 = \text{€}22,500 \text{ VAT payable by Mr. P.}$$

Where:

B = total reviewed deductible amount

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

T = total number of intervals in the adjustment periods

Waiver Cancellation Section 96(12)

As Mr. P has no more properties which are subject to the waiver, the waiver is automatically deemed to be cancelled and the cancellation sum must be paid. This is the difference between the VAT deducted and the VAT paid on the rents.

$$\text{€}75,000 - \text{€}46,000 = \text{€}29,000$$

The VAT payable on the CGS claw-back may be offset against this liability - €29,000 - €22,500 = €6,500.

Total VAT payable for the taxable period where sale occurs (May/June 2010) is
 $\text{€}22,500 + \text{€}6,500 = \text{€}29,000$

Timeline of events

The sequence of events is that the property is first sold. When this happens the following is triggered:

- A CGS claw-back, as it is an exempt sale of a property.
- The waiver is automatically cancelled.

Although both the sale and the waiver cancellation occur on the same day, the sequence of events is very clear – it is the sale (on which the CGS claw-back arises) that triggers the waiver cancellation. The offset of the CGS amount against the waiver cancellation ensures there is no double taxation.

Note: If Mr. P and the purchaser did jointly opt to tax the sale, VAT would be chargeable. When the property is sold, the provisions of Section 96(12) would apply to Mr. P, as he no longer owns any property that is subject to his waiver of exemption. As a result, his waiver would be automatically deemed to be cancelled and Mr. P would be obliged to pay the cancellation sum (if any). The amount of VAT chargeable on the sale would be taken into account when calculating the cancellation amount. For example, if the VAT chargeable on the sale were €300,000, then the cancellation amount would be nil, since there is no excess in the VAT deducted (€75,000) over the VAT paid on the rents plus the VAT chargeable on the sale (€46,000 + €300,000 = €346,000).

11 Pre-waiver deductibility

The treatment of pre-waiver deductibility is outlined in the following examples. Essentially, where a person has taken a deduction in respect of some other activity (other than because of the waiver) before the waiver is exercised then this amount of deductibility is not included for the purposes of the waiver cancellation amount.

Example 7 – Deduction taken in relation to the waiver

In November 2005 Mr. “H” constructs a commercial property on an undeveloped site that he owns. Mr. H registers for VAT before the construction and waives his exemption from VAT. The VAT cost of this development is €100,000 and he deducts this VAT on the basis that he has a waiver in place.

Scenario 1 – Mr. H sells property prior to cancellation

In Sept 2009 Mr. H sells the property. The total VAT paid over on the rents to that date is €20,000. The sale is subject to VAT because it has been less than five years since the property was completed. VAT of €50,000 is charged on the sale. As Mr. H no longer owns any properties which are subject to the waiver, his waiver is automatically cancelled.

The cancellation sum is:

$€100,000 - (€20,000 + €50,000) = €30,000$ VAT payable by Mr. H.

Scenario 2 – Mr. H cancels waiver then sells property

In Sept 2009 Mr. H cancels his waiver of exemption. The total VAT paid over on the rents to that date is €20,000. The cancellation sum is;

$€100,000 - €20,000 = €80,000$ payable by Mr. H.

As Mr. H is then treated as a person who had never waived his exemption, this means that he never had an entitlement to deduct VAT. The sale therefore is not subject to VAT by virtue of Section 95(3) which exempts the sale of transitional properties where the vendor had no entitlement to deduct VAT.

Example 8 – Deduction taken in relation to other taxable supplies

Ms. "M" purchased a freehold property in Jan 1995 on which VAT of €500,000 was chargeable. She deducted this VAT on the basis that she intended to use the property for the purpose of her 'widget' manufacturing business (fully taxable).

In 2007 she moved her widget making business to a new location and granted a 4 year 11 month lease in the property. She waived her exemption from VAT and accounted for VAT on the rents.

Scenario 1 – Ms. M sells the property prior to cancelling

In Jan 2010 she sold the property. The sale is exempt from VAT and there is a CGS claw-back of €125,000 ($€500,000 \times 5/20$).** VAT charged on the rents at that date was €20,000. As Ms. M has no other properties that are subject to the waiver, the waiver is automatically cancelled. The cancellation amount is: $0 - €20,000$, which means there is no cancellation amount since the amount of VAT deducted (assuming no VAT costs in relation to the letting – fees, etc.) is less than the amount of VAT payable in relation to the waiver. This is because the deductibility taken in relation to the acquisition of the property is not related to the waiver itself, but to Ms. M's widget making business. This is why the figure is "0" in the above calculation.

Scenario 2 – Ms. M cancels waiver then sells property

In Jan 2010 Ms. M cancels her waiver of exemption. The cancellation is nil since (assuming no VAT costs in relation to the letting – fees, etc.) the VAT deductible in relation to the acquisition costs is not included in the cancellation sum since it does not relate to the waiver. Ms. M is then treated as if she had never waived her exemption. This has no effect on the original deduction taken since this related to her widget business. The sale of the property is exempt and there is a CGS claw-back of €125,000.

Note:** This claw-back could have been avoided if Ms. M and the purchaser jointly opted to tax the sale. The waiver would still have been automatically cancelled and no cancellation amount would have been due since the figure for the amount of VAT deducted in relation to the waiver would still be "0".