

## Imposing VAT on sale of land in Cyprus – A one-way street

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Currently the Eighth Schedule of the Cyprus VAT Law<sup>1</sup> exempts the supply of land from VAT. Thus, currently when any plot of land is sold it is not subject to VAT.

For quite some time now there have been ongoing discussions with regards to the introduction of VAT legislation that will remove the exemption on transactions of land and will make such transactions subject to VAT going forward.

The fact of the matter is that this is a one-way street. Why?

Firstly, we need to understand that keeping the exemption in our VAT legislation is not an option. The derogation allowed by Article 383 of the EU VAT Directive<sup>2</sup>, granted during our accession to the EU, allowed us to continue to exempt the supply of building land until 31 December 2007. This derogation has expired for nearly 10 years now but we have to date failed to amend our legislation and introduce provisions that would subject to VAT the supply of (building) land. There is no infringement procedure currently against us by the EU Commission with regards to this non-compliance, but it is only a matter of time before proceedings are initiated.

Furthermore, the sale of land is not one of the transactions listed under Annex III of the EU VAT Directive, therefore a reduced rate cannot be applied to such transactions so subjecting them to VAT means that they will be subject to the full rate, which currently stands at 19%.


The law has been very close to going to the Parliament for voting but there has always been a change of hearts at the last minute and based on numerous excuses it has always been sent back to the relevant parliamentary committee for more discussions and negotiations. Given the impact that imposing VAT on land would have on the economy, it is easy to understand why.

The biggest problem will be faced by the banking institutions that hold land as collateral. Where land that is held as collateral against a loan is say worth €1m, if VAT would be imposed, the market value of this land would not be €1.190.000, but would still remain €1m, but this time inclusive of VAT. The VAT element is approximately €160.000 which means the market value would become €840.000. This in turn would mean that the bank

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<sup>1</sup> Οι περί Φόρου Προστιθέμενης Αξίας Νόμοι Νόμος 95(Ι)/2000 όπως τροποποιήθηκε

<sup>2</sup> Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax



would need €160.000 of further collateral against the loan. Applying this on a national basis, the deficit would run into several hundreds of millions of euro.

It is essential that the legislation is discussed with all relevant parties to make sure that what is finally passed, is a law that works well and does not kill the construction and property development sectors overnight as this would lead to a cool off in the market and quite likely a drop in the country's GDP as these are major industries contributing to the current strong(er) performance of the country's economy.

Some of the things legislators need to consider and make sure they are addressed in the new legislation are:

- What land will be taxed? Do we want to tax all land including farm land and industrial land or do we want to concentrate on building land which has been zoned as such by the Land Registry? Bear in mind that the EU VAT Directive imposes VAT on the supply of building land so we need to be careful as to our interpretation of building land, and to the extent possible, place a very restrictive definition, at least initially, to minimise the macro economic impact, especially to the banking sector.
- Should we be introducing an option to tax leasing/letting of immovable property to reduce the impact of the legislation? Cyprus is among very few Member States who have chosen not to introduce an option for taxation on the above mentioned transactions.
- What happens to occasional supplies made by individuals? If a non-taxable person that does not engage in an economic activity for VAT purposes chooses to sell a plot of land inherited by him will this be subject to VAT or will incidental transactions not constitute an economic activity?
- What happens to transactions where the shares of a land-holding company are sold instead of the land itself? This is another option granted to Member States by Article 15(2) of the VAT Directive. But imposing this option requires very detailed planning as it can become very complicated to determine the taxable basis where the company whose shares are being sold, may also have other income generating assets or subsidiary companies. The question of who is to discharge the VAT obligation in such cases is also difficult to legislate.
- Back in March 2012 we introduced in our VAT legislation article 11B, which imposed the reverse charge mechanism on most construction-related services as a means of combating the high levels of fraud and tax evasion experienced in the sector as well as minimising the financing of VAT by recipients who had the full right of deduction. Should a similar approach be followed with regards to VAT on the supply of land and under the reverse charge mechanism have the buyer discharge the due VAT? If yes, this requires careful consideration as to the circumstances of how it will work.
- We also need to accommodate the cases of foreclosure where the rights over such immovable property might be transferred to a bank or another financial institution.



We always need to remember that VAT is a consumption tax and as such, it is always borne by the end consumer.

The change will undoubtedly cause some numbness in the market but a price correction will accommodate such a change. And if the economy proved resilient enough to rise through the ashes of what happened in 2013, then imposing VAT on the supply of (building) land will not be the end of the world as we know it.

The fact of the matter remains that VAT on building land is not an option but an obligation which we must meet. A one-way street.

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**Panayiotis Panayi** has close to 10 years of experience in indirect tax consulting with a solid track record of formulating, supervising and reviewing strategic VAT advice.

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**Chelco VAT Ltd** is the only VAT-dedicated firm in Cyprus and specialises in strategic VAT planning and compliance.