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VAT**

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VAT UPDATE

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THE 5% VAT RATE ON CYPRUS NEW PROPERTY



“knowledge”

*Facts, information and skills
acquired through experience or
education; the theoretical or
practical understanding of a
subject.*

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THE 5% VAT RATE ON CYPRUS NEW PROPERTY

1.0 Introduction

When building or buying new immovable property in Cyprus, advertising often refers to only 5% of Value Added Tax (VAT) as opposed to the standard rate of 19%. Indeed there are possibilities when one's next home in Cyprus will be subject to the 5% reduced rate of VAT.

This update explains the principles and conditions which must be met so that the purchase or construction of a new residence is subject to VAT at the reduced rate of 5%.

2.0 Legislation – European Union

VAT legislation across the countries forming the European Union is to a large extent harmonised. However, the use of the reduced rate in a member state is restricted to specific transactions that are provided for, in the EU VAT Directive (*Council Directive 2006/112/EC of 28 November 2006 on the common system of Value Added Tax*). Therein, Article 98 permits the use of a reduced rate but only to supplies of goods and services in the categories set out in Annex III of the Directive.

Paragraph 10 of Annex III details the relevant EU provision that forms the basis of the 5% rate to new residences in Cyprus, and states:

“...provision, construction, renovation and alteration of housing, as part of a social policy.”

Looking at the Cyprus legislation (explained below), there is immediately an issue of conflict with the EU Directive. This has to do with the last part of the paragraph that states:

‘...as part of a social policy’.

Although when the 5% rate was being championed by the political parties to help first time buyers get on the property ladder, there was a clear hidden agenda which was to help the construction industry in general to offer cheaper housing to wealthy buyers. This is why the restrictions to the 5% reduced rate provided for in the Cyprus legislation make reference only to the size of the property and not to its value, with the size being very generous.

Thus, a 200 sq.m. house on the beach in Limassol, which may sell in excess of €2 ml + VAT, will also be within the scope of the 5% reduced rate. Therefore, strictly speaking it is questionable whether the 5% reduced rate provisions on properties form part of a social policy. This of course is more generally the weakness of a reduced rate of VAT i.e. that it has a universal application and does not target the population that needs it most.

3.0 Legislation - Cyprus

The supplies that are subject to the 5% reduced rate of VAT are detailed in Table C of Schedule 5 of the Cyprus VAT Laws (*The VAT Laws, N95(I)/2000 as amended*). Table C first appeared in the legislation on 7

October 2011. However, those who were championing the legislation on behalf of the developers rather than the first time buyers, quickly realised the mistake they had done, given that the initial legislation only applied to EU citizens who were permanently residing in Cyprus. This naturally ruled out most of the prospective and lucrative clientele from non EU countries, notably Russia.

To fix this discrepancy, the House of Representatives amended the legislation so that from 8 June 2012 as per law N.73(I)/2012¹, the condition that eligible persons were only those who were citizens of the Republic of Cyprus or another Member State and where permanently residing in Cyprus was eliminated and going forward any person living anywhere could benefit from the 5% reduced rate.

Today the reduced VAT rate is available to eligible persons, defined as any physical persons who:

- Have completed their 18th year of age on the date of applying for the reduced rate;
- Acquire the property for use as their main and permanent place of residence in Cyprus;
- Do not own any other property in Cyprus which was acquired with the reduced VAT rate.

The property acquired would need to be a new property which will be used for the first time from the date it was delivered or constructed as per the provisions of the Eighth Schedule of the Cyprus VAT Laws. As of 18/11/2016 when N.119(I)/2016² was published there is no limit to the size of the property. Thus, as of 18/11/2016 all new residences are eligible for the reduced 5% VAT rate which applies for the first 200 sq.m. For residences bigger than 200 sq.m. the standard rate of 19% applies on the value of covered areas in excess of 200 sq.m. (This has been confirmed by the Cyprus Courts in Case 549/2013 of 28/03/2016, Achilleas Kyprianou vs Ministry of Finance). Our understanding is that is that this equates to a hybrid VAT rate apportioned over the total covered areas of the residence which applies on the invoices issued by the constructor/seller after the relevant written authorisation is received from the VAT Authorities (see example 1 below).

Following removal of the size limitation we are of the opinion that eligible persons whose application was denied in the past because the residence exceeded the maximum allowable size of 275 sq.m. now have the right to reapply under the revised legislation under the premise that they have not yet taken possession of the residence. We hold a reservation for this position as the Tax Department has not yet published its position with regards to the practice they will follow after the latest revision of the legislation.

The eligible person must submit to the Tax Department their application for the reduced rate before taking possession of the house. The reduced rate may only be applied by the constructor/seller after obtaining the written approval from the Tax Department. Invoices issued prior to obtaining the approval must bear VAT at the standard rate and this VAT will be corrected after obtaining the written approval.

Application of the 5% reduced rate is granted on the presumption that the residence will be used as the primary and permanent residence of the owner for a period of 10 years³. If the owner ceases to use the residence as his primary and permanent residence, he is obliged to notify the VAT Authorities within 30 days from the day he ceases to do so and pay back the difference between the reduced and the standard rate in analogy for the years remaining out of the 10. Paying back the difference for ceasing to use the

¹ Web link for N.73(I)/2012: http://www.cylaw.org/nomoi/arith/2012_1_073.pdf

² Web link for N.119(I)/2016: http://www.cylaw.org/nomoi/arith/2016_1_119.pdf

³ As per the practice of the VAT Authorities the 10 year period counts on a calendar basis from the date on which the residence is first used. For example if an eligible person buys a residence under the reduced rate scheme and moves in on 15/09/2014, then the 10 year period elapses on 14/09/2024.

residence as a primary and permanent residence within 10 years does not apply in the following 2 cases:

- (a) In case of death of the owner;
- (b) In case the owner transfers title of the residence to an adult child of his who is not himself an eligible person at the time of the transfer. We understand this to mean that the exemption does not apply when the adult child in question, or his spouse, already are in possession of a primary and permanent residence even though it may not have been obtained under the reduced rate scheme.

Following the revision of the law introduced with N.119(I)/2016 on 18/11/2016, persons who have obtained a residence under the reduced rate scheme now have the right within the 10 years period to elect to payback the total difference to the standard rate on one residence so that they may claim the reduced rate on another residence to be obtained within the 10 years period. This means that a person who has obtained a residence under the reduced rate scheme has the below options when they intend to acquire another residence within 10 years:

- (a) Pay back the difference between the reduced and standard rate without a time period analogy on the first residence and be allowed to claim the reduced rate on the second residence, or;
- (b) Pay back the difference between the reduced and standard rate with an analogy to the remaining years out of 10 for the first residence without having the right to claim the reduced rate on the second residence, until the 10 year period has elapsed from the date of the first transaction at the reduced rate.

Please consider Examples 2 and 3 below for a better illustration of the above options and the rights allowed under the revised law for the 10 year period.

4.0 Examples

4.1 Example 1

A family with two children purchases a house in Limassol on the beach for €3 ml + VAT in December 2016. The house has a total covered area of 360 363 sq.m.

No limit of total covered area applies as of 18/11/2016 so the buyer has the right to apply for the reduced rate of 5%. The first 20 sq.m. will be subject to the reduced rate of 5% and the remaining 160 sq.m. will be subject to VAT at the standard rate of 19%. Thus, the effective VAT rate will be $(200/360*5\%)+(160/360*19\%) = 11,22\%$.

Total VAT payable: $€3.000.000 * 11,22\% = €336.667$

4.2 Example 2

An eligible person purchases a 2 bedroom apartment in September 2016 of 90sq.m. for a price of €500.000 +5% VAT (€25.000) taking advantage of the reduced rate scheme.

Due to change in family circumstances in September 2017 (exactly one year after the first purchase) the eligible person found a new house of 250sq.m. for a value of €850.000.

The eligible person now has the below 2 choices to choose from with regards to the treatment for the second transaction:

- (a) Pay back the difference between the reduced and standard rate in full, without a time analogy, for the first residence and apply for the reduced rate on the second residence.
- Pay back VAT of €70.000 ($€500.000 \times (19\% - 5\%)$) for the 2 bed apartment (first residence)
 - Apply for the reduced rate on the new residence which means that effectively VAT of €66.300 ($€850.000 \times 200/250 \times 5\% + €850.000 \times 50/250 \times 19\%$) will be paid for the new residence compared to €161.500 if the standard rate was applied. This translates to an effective hybrid VAT rate of 7,8%.
- (b) Pay back the difference between the reduced and standard rate with a time analogy for the first residence and have no right to apply for the reduced rate on the second residence.
- Pay back VAT for the remaining 9 years on the first residence. $(€500.000 \times 19\% \times 9/10) - (€25.000 \times 9/10) = €63.000$
 - Pay VAT at the standard rate for the new residence $(€850.000 \times 19\%) = €161.500$

Under option (a) the total VAT cost for the 2 residences is €161.300 ($€25.000 + €70.000 + €66.300$).

Under option (b) the total VAT cost for the 2 residences is €249.500 ($€25.000 + €63.000 + €161.500$).

Under this scenario it seems logical for the person to take advantage of the right granted under N.119(I)/2016 and transfer the reduced rate on the second residence.

4.3 Example 3

An eligible person purchases a residence in September 2014 of 200 sq.m. for a price of €2.500.000 + 5% VAT of €125.000 and the reduced rate scheme.

Due to changes in family circumstances he decides in September 2022 (exactly 8 years after moving into the first residence) to get another residence of 100sq.m. for a value of €1.000.000 + VAT.

The eligible person now has the below 2 choices to choose from with regards to the treatment for the second transaction:

- (a) Pay back the difference between the reduced and standard rate in full, without a time analogy, for the first residence and apply for the reduced rate on the second residence.
- Pay back VAT of €350.000 ($€2.500.000 \times (19\% - 5\%)$) for the first residence.
 - Apply for the reduced rate on the new residence which means that VAT of € 50.000 ($€1.000.000 \times 5\%$) will be paid for the new residence compared to €190.500 if the standard rate was applied.
- (b) Pay back the difference between the reduced and standard rate with a time analogy for the first residence and have no right to apply for the reduced rate on the second residence.

- Pay back VAT for the remaining 2 years on the first residence.
 $(€2.500.000 * 19% * 2/10) - (125.000 * 2/10) = €70.000$
- Pay VAT at the standard rate for the new residence $(€1.000.000 * 19%) = €190.000$

Under option (a) the total VAT cost for the 2 residences is €525.000 (€125.000+€350.000+€50.000).

Under option (b) the total VAT cost for the 2 residences is €385.000 (€125.000+€70.000+€190.000).

Under this scenario it seems logical for the person to not take advantage of the right granted under N.119(I)/2016 and pay back the analogy of the VAT difference without claiming the reduced rate on the new residence

A third option would be to wait for the 10 year period to expire (since it quite near) and then purchase a new residence. This would mean that there would not be a need to payback any amount on the first purchase under the reduced rate and the reduced rate would also be applicable on the new residence.

Information is accurate as at the time of publication

NOTE

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