PAC-R-187

Correspondence 4.2
Meeting – 08/12/2011

NOTE FOR PAC FROM THE REVENUE COMMISSIONERS

PAC REQUEST

"The Committee requests a note outlining whether changes to VAT laws in 2002 had any impact on the Dublin Waterworld VAT liability, to include advices provided by the Office of the Revenue Commissioners on Regulation 19".

REVENUE REPLY

A: Revenue's guidelines on Regulation 19 pre the 2010 Supreme Court decision

Prior to the introduction of the new VAT on Property regime in 2008, Irish VAT law treated the creation after development of a first lease of 20 years or more as a supply, that is a sale, of property for VAT purposes. Such leases were liable to VAT on the capital value of the rent created.

The methods for arriving at the capital value of a rent created in connection with the disposal of an interest in property were contained in Regulation 19 of the Value-Added Tax Regulations 1979 and reproduced in Revenue's guidelines *VAT and Property Transactions,* issued in October 2001. The purpose of the methods was to arrive at the capital value that the right to receive unencumbered rent from the property would fetch on the open market. The valuation methods provided for in Regulation 19, as interpreted by the October 2001 Revenue guidelines, were:

1. a valuation by a competent valuer;
2. three-quarters of the annual rent multiplied by the number of complete years in the term of the lease; or
3. the result of applying a multiplier based on the most recent national loan redemption yields to the annual rent,

and the Revenue guidelines at the time stated that "the taxpayer may adopt whichever valuation s/he wishes".

B: The Finance Act 2002 changes:

Section 99 of the Finance Act 2002 made changes to the VAT law with effect from 25 March 2002. The provision established a rule that came to be known as the "economic value test" (EVT). The VAT economic value of a property was the cost for VAT purposes of the acquisition and development of the property, that is, the full amount on which VAT input credit was claimed. A transaction failed the EVT where the consideration on disposal (the capital value of the rent created) was less than the VAT economic value of the property.

With effect from 25 March 2002, a person disposing of a leasehold interest in a property proceeded as before to arrive at the capital value of the rent created and then compared this value with the VAT economic value of the property described above. Where the capital value of the rent created was less than the VAT economic value of the property, the disposal was deemed to be an exempt letting of property. In such circumstances, the person making the disposal was not entitled to deductibility on the acquisition or development of the property. Any deductibility previously claimed was then clawed back.

The provision was an anti-avoidance measure designed to counteract the use of artificial devices to reduce the amount of VAT payable on the development of property by or on behalf of VAT-exempt bodies, including banks and insurance companies.[1] The new provision had its legal basis in a European Court of Justice decision namely, Stichting 'Goed Wonen' (Case C-326/99). The Court held that Article 5(3) of the Sixth Directive did not preclude the adoption of a provision in national law whereby classification of a lease as a supply of goods is made subject to a condition that the consideration must equal the 'economic value' of those goods.

C: Effect of the 2002 Act changes in the current case

The impact of the 2002 Finance Act changes in the current case is set out in the 2010 Supreme Court judgement. For reasons of taxpayer confidentiality, Revenue cannot provide material to the Committee that goes beyond what is contained in that published judgement.

Both sides in the Supreme Court case accepted that the economic value was approximately €62m. In order for the lease of the National Aquatic Centre to be subject to VAT, the capitalised value of the lease, determined in accordance with VAT legislation, would have to equal or exceed the economic value.

In purported reliance of Regulation 19 (as interpreted by the Revenue guidelines at the time) Campus & Stadium Ireland (CSI) applied valuation method 2 in Section A above, which produced a figure of just under €76m. CSI had, however, received an opinion from the Valuation Office that the open market value was €35m. As stated by Mr Justice Hardiman in his judgement: "From CSI's point of view the problem with this was that the open market value (€35 million) was less than the Economic value which exceeded €60 million. Accordingly, the lease 'failed' what is referred to as the EVT (Economic Value Test). Thus the lease would be VAT exempt."

As outlined at B above, if the lease fails the EVT, the person making the disposal is not entitled to deductibility for VAT incurred on the acquisition or development of the property, and any deductibility previously claimed would be clawed back.

D: Supreme Court decision

The Supreme Court decided that Revenue's guidelines on the application of Regulation 19 were incorrect. The Court ruled that Regulation 19 provided that a lessor could choose between the valuation formulae 2 and 3 in Section A above only in circumstances where there was "an absence of other evidence" of the amount of the open market price. The Supreme Court ruled that there was evidence at the time the lease was created that the value of the lease was €35 million. The consequences of the application of this valuation of €35 million is that it was less than the VAT economic value and, if it had been applied at the time the lease was entered into by the parties, then the lease would have been exempt from VAT.

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[1] VAT-exempt persons have no entitlement to recover VAT incurred on goods or services provided to them.