

# TAX update

01/18

**NEW LAW AMENDING THE CYPRUS  
VAT LAW ON THE SALE OF LAND AND  
LEASE OF IMMOVABLE PROPERTY**

  
**KINANIS**  
LAW FIRM

## A. INTRODUCTION

On the 13<sup>th</sup> of November 2017, the Cyprus House of Representatives voted a new law amending the Cyprus VAT Law N.95(I)/2000 (hereby referred to as VAT Law), which introduces VAT at the standard rate on the following supplies, harmonising thus the Cyprus VAT Law with the EU VAT Directive:

1. Sale of undeveloped building land by persons exercising economic activities,
2. rental/lease of immovable property for business use (to lessees who will be using the property for business purposes).

It also extends the use of the reverse charge mechanism on the transfer of land and buildings (before the first use) from the borrower to the lender under a loan reorganization or forced transfer procedure.

## B. CURRENT PRACTICE

Both the sale of land (up until the 1<sup>st</sup> of January 2018) and the rental/lease of immovable property (up until the 12<sup>th</sup> of November 2017) were specifically **exempt supplies** according to the eighth schedule of the VAT Law.

The sale of NEW buildings including the land they are erected on, is subject to the standard rate of VAT (currently at 19%) with the exception of contracts concluded after the 1<sup>st</sup> of October 2011 for the acquisition/construction of dwellings by qualified persons for use as their main residence for the next 10 years.

## C. THE NEW PRACTICE

### 1. Building Land - Subject to 19%

As from the 2<sup>nd</sup> of January 2018, any sale of undeveloped building land, intended for the construction of one or more fixed structures is subject to VAT at the standard rate of 19%, if this is done **in the course of the economic activities of the transferor**.

Consequently, in order to be able to determine whether a transaction is subject or not to VAT, we need to examine whether:

- a) The transferor exercises or not economic activities and
- b) the land is considered to be undeveloped building land

#### 1.1 Business - Economic Activities

Article 3 of the VAT Law, specifically states that "business" means the economic activity exercised independently and in any place, **irrespective of the intended purpose or the outcome of such activity**.

It further states that economic activities are all the activities of a producer, merchant or the supplier of services, including also mining and farming activities, and the activities of freelancers or similar to those. The exploitation of a tangible or intangible good for the purpose of generating a continuing income can also be considered as an economic activity.

Therefore, it is obvious that the sale or exploitation of real estate can be considered as economic activity for VAT purposes, although the facts of each case will determine whether a transaction is within the meaning of economic activity or not.

Below we state the position of the Cyprus VAT Authorities in three specific cases:

**a) Isolated Transactions**

Isolated transactions cannot be considered as economic activities (i.e. sale of inherited land by an individual every 7 to 10 years).

**b) Taxation of the relevant profits**

In the determination of whether a transaction falls within the meaning of economic activity for VAT purposes, it is irrelevant whether the profits from such a transaction are subject to Income or Capital Gains Tax.

**c) Undeveloped building land as asset in the books of the transferor**

If the land is reflected in the books of the transferor as an Asset, then by default the sale of it, is always subject to VAT.

## 1.2 Building land

The definition of **building land** is wide and includes a majority of types of land. It is important to clarify though that land located in areas in a livestock zone or areas which are not intended for development such as areas/zones of environmental protection, archaeological or agricultural **are exempted from taxation**, even if such supplies are conducted by a relevant taxable person (being an already VAT registered person or a person who has the obligation for VAT registration).

**The new law referring to undeveloped building land is effective as from the 2<sup>nd</sup> of January 2018**, therefore, the following supplies are not within the scope of this law:

- a) Land transferred to the name of the buyer before the 2<sup>nd</sup> of January 2018 or
- b) Land for which the relevant Sales contract has been filed with the Land Registry or the Tax commissioner before the 2<sup>nd</sup> of January 2018.

## 2. Leasing of commercial property for business purposes subject to Standard VAT Rate of 19%

Under the new provisions, the Cyprus VAT Authorities subject the lease/rental of immovable property **to a relevant taxable person** in the course of its economic activities to 19% VAT unless the building is used as dwelling.

It is also important to mention that this amendment is only applicable to **new contracts** – the ones concluded as of the 13<sup>th</sup> of November onwards.

Contracts concluded before the enactment of this law, in which there is a provision for:

- a) **Automatic renewal or even**
- b) **automatic increase of the rental/lease payments**

are outside the scope of this law, as they are not considered as new contracts.

In order to decide whether a transaction based on new contract is subject to 19% VAT we need to further examine:

- a) **What will the use of the building be (dwelling or business) and**
- b) **whether the activities of the lessee are taxable activities.**

The term taxable activities is not specifically interpreted in the VAT Law but it refers to the transactions that are not specifically exempted according to the Cyprus VAT Law or they are outside the scope of Cyprus VAT Law.

In order for the lessor to impose 19% VAT on a transaction, he needs to make sure that the lessee deals with taxable supplies. The lessee can be considered as dealing with taxable activities only if at least 90% of its activities are taxable ones.

If the lessee, is not already VAT registered or he does not have the obligation for VAT registration (relevant taxable person), then the lessor cannot impose VAT on the relevant rental/lease.

Consequently, **on the signing of the lease/rental contract**, the lessor needs to have evidence verifying the taxable status of the lessee. This obligation is not extended to the periods following the signing date but it is only restricted on the date, of signing of the relevant contract.

## **2.1 Lessor has the option to exempt such transactions**

As mentioned above, the default position is that new leases/rentals are subject to the standard VAT rate. It should be noted though, that the lessor (either relevant taxable person or not) has the option to exempt a **specific property (either the entire property or a functional part of the property)** from taxation and in such a case he needs to notify the VAT commissioner accordingly.

Such an option cannot be revoked unless the ownership of the relevant property changes, whereas the new owner has also the option either to tax or exempt (by notifying the VAT commissioner as above) the relevant property.

## 2.2 Obligation for VAT registration

The Cyprus VAT registration threshold of €15,600 applies in this case as well. In order for the VAT department to be able to process the relevant VAT registration, the lessor should provide the lease/rental agreement giving rise to such registration.

## 2.3 VAT point

As the lease is a continuous provision of service, vat should be paid on the earliest of:

- a) The date of the relevant VAT invoice and
- b) the lease/rental payments.

## 2.4 Property exploited by a person other than the owner

In such a case, the obligation for VAT imposition exists for both:

- a) The owner who grants the right for property exploitation to another person, as well as,
- b) the right-holder to exploit the relevant property.

Each transaction needs to be considered **independently**.

## 2.5 Property owned by more than one persons

In such cases the obligation for VAT registration lies with all co-owners, although the registration is made as informal partnership.

## 2.6 Input VAT - Refundable or not

### Input VAT - Lessee

Lessee is eligible to claim in full the relevant input vat, given that the property is used for the generation of taxable income.

In case of **mixed activities** (i.e. both taxable and exempt), lessee can only claim vat on a pro-rata basis as in the case of any other input vat (i.e. taxable supplies/total supplies).

### Input VAT - Lessor

The relevant regulations provide that VAT on the acquisition/construction of immovable property **is adjustable over a ten year period** from the date the property was placed **for the first time in use** for any purpose (either taxable or exempt) given that less than 10 years have elapsed since its construction/acquisition.

Important prerequisites for the VAT refund are as follows:

- Lessor keeps evidence of the input VAT paid on the relevant property i.e. VAT invoice verifying the connection of the relevant expense with the specific property.
- Less than 10 years have elapsed since its construction/acquisition and the property was placed in use either for taxable or exempt activities.
- New contract has been signed for the rental/lease of the property after the 13<sup>th</sup> of November 2017 (enactment of the relevant amending law).

**Example 1:** In 2005, a Cyprus Company constructed a warehouse with the intention to lease it out. The input VAT it suffered on its construction amounted to €8.000 which it had never claimed back. In 2018, the Cyprus Company applies for VAT registration in Cyprus and leases out the relevant warehouse with VAT. The company is **not eligible** to claim back the input VAT it incurred on the construction of the warehouse despite the fact that the warehouse will be wholly used for the generation of taxable income, as more than 10 years have elapsed since its construction without putting the warehouse in use.

**Example 2:** In 2015, a property leasing company in Cyprus suffered input VAT of €45.000 on the construction of a building which it had never claimed back, as up until the 5<sup>th</sup> of January 2018 the relevant building was not put in use. In 2018, it applies for VAT registration and leases out the building with VAT. In this case, the company is eligible to claim the **whole amount** of input VAT back, as the building was placed for first time in use for the generation of taxable income. In this case, the 10 years' timeframe is not reduced.

**Example 3:** In 2014, a Cyprus company buys a new building which it leased out to an Insurance Agency without imposing VAT, as the leasing was an exempt supply for VAT purposes and suffered input VAT of €40.000. In 2019, it signs a new contract with a new lessee dealing wholly with taxable supplies. By doing so, the obligation for VAT registration arises and its rental income as from 01.01.2019 is subject to VAT. Given that the building was first put into use in 2014, the adjustment period starts from 2014. Therefore, its first 5 years of use do not enable the company to claim back any input VAT  $((40.000/10) \times 5)$ , but the company has the right to claim back input VAT only for the remaining 5 years of the 10 years' adjustment timeframe  $((40.000/10) \times 5)$ , which it will be able to claim in the next 5 years.

### 3. Reverse Charge on loan restructuring arrangement

When a transfer of land/property subject to VAT (i.e. undeveloped building land, property before its first use) is conducted by the borrower to the lender under a loan reorganization or forced transfer procedure, the recipient of the land/property (i.e. bank) is obliged to apply the reverse charge mechanism and discharge the VAT due on the transaction as if it was its own supply.

Therefore, the obligation for imposing and paying the relevant VAT is transferred from the supplier to the recipient of the property.

This provision will come in force as of 2<sup>nd</sup> of January 2018 and will remain in force for a limited period of time, currently being until the 31<sup>st</sup> of December 2019.

## D. CONCLUSION

The new amendments introduced to the VAT Law, are expected to affect a significant number of companies operating in the relevant sector operating in Cyprus, as the cost of land is increased by the VAT charge and as such might affect the investment decisions of potential investors in Cyprus.

As to the imposition of VAT on rentals, due to the fact that it is only imposed to businesses having taxable supplies of at least 90%, such VAT will not be a cost for the lessee as he will be eligible to claim it back, but it is a positive amendment for lessors who will be now eligible to claim VAT on the construction/acquisition of buildings and subsequent expenses directly related to them i.e. renovation.

## E. HOW KINANIS LLC CAN ASSIST

Kinanis LLC is in a position to assist you with the provision of the following services:

- Review of the facts of each case and advise whether a transaction falls within the term of economic activities based on VAT Law.
- Advise as to whether a specific part of land falls within the meaning of undeveloped building land for VAT purposes.
- VAT Registration and subsequent VAT reporting.
- Assistance in claiming back the refundable input VAT.
- Completion and filing of the application notifying the VAT authorities of the option of the lessor not to tax an entire property or part of it.
- Any other advice as to the operation of the relevant legislation.
- VAT deregistration.

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Author:  
DEMETRA CONSTANTINO  
Manager  
Demetra.Constantinou@kinanis.com

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## Our Firm

**Kinanis LLC**, a law and consulting firm, is one of the leading and largest business law firms in Cyprus and advises for over 35 years the international investor and private clients on all aspects of law, tax and accounting.

Kinanis LLC absorbed the business of its shareholders which are in the legal and consulting profession since 1983, with local and international dimensions.

Experience and practice over the years brought forward the need for transformation from a traditional law firm to a more innovative multidisciplinary firm providing a full range of services combining law and accounting with the extensive expertise in corporate and tax advice to ensure that our clients will obtain the best possible spherical advice adopting the principle as to the services offered “All in one place”, so that the client will find a quick, correct and efficient solution to its daily legal, accounting and tax issues in a trustworthy environment.

This combination of legal, accounting and tax services through our well qualified personnel and our involvement and participation in international transactions over the years, have established our firm as one of the key players in the field. Our involvement in international financial transactions has also provided us with the extensive expertise in representing groups, corporations, funds as well as the private client.

The firm is staffed with around 80 young, energetic and ambitious professionals, including lawyers, accountants and administrators who provide prompt, efficient and high quality services and who are capable of meeting the current demanding challenges of the local and international business environment.

We always look to give solutions in a simple and as possible quick way focusing on the needs of each client trying to anticipate the issues before becoming a problem.

## Kinanis LLC

### Lawyers' Limited Company

12 Egypt Street, 1097, Nicosia

P.O. Box 22303, 1520 Nicosia, Cyprus

Tel: + 357 22 55 88 88 | Fax: + 357 22 66 25 00

E-mail: [KinanisLLC@kinanis.com](mailto:KinanisLLC@kinanis.com) | Web site: [www.kinanis.com](http://www.kinanis.com)

### Corporate Division

Christos P. Kinanis

Fax: +357 22 76 28 08

[corporate@kinanis.com](mailto:corporate@kinanis.com)

### Accounting Division

Charalambos Meivatzis

Fax: +357 22 75 14 74

[accounting@kinanis.com](mailto:accounting@kinanis.com)

### Litigation Division

Andrianna Solomonides

Fax: +357 22 45 81 95

[litigation@kinanis.com](mailto:litigation@kinanis.com)

### Banking Department

Myroulla Kyriacou

Fax: +357 22 75 39 15

[banking@kinanis.com](mailto:banking@kinanis.com)

### Tax Department

Marios Palesis

Fax: +357 22 75 14 74

[tax@kinanis.com](mailto:tax@kinanis.com)

### Accounting & VAT Department

Demetra Constantinou

Fax: +357 22 75 14 74

[accounting@kinanis.com](mailto:accounting@kinanis.com)

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