Rent to buy scheme

This document should be read in conjunction with sections 94 & 97(4), paragraph 11(1) of schedule 1 and paragraph 14 of schedule 3 of the VAT Consolidation Act 2010 (VATCA 2010)

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Introduction

The rent to buy scheme can broadly be described as an attempt by property developers to attract potential purchasers into buying a house.

The developer structures the agreement using an initial period of renting with an option to purchase at the end of the letting period.

There are many variations of this scheme and as such, the exact Value-Added Tax (VAT) treatment can only be established by the facts of each individual case. However, this guidance provides information as to how to treat some of the variations of this scheme from a VAT viewpoint.

1. How the rent to buy scheme operates

The rent to buy scheme usually includes the following:

- There may be an upfront payment.
- The prospective purchaser may rent the house for a defined period of time. At the end of or during this period, the purchaser can exercise an option to purchase the property at an agreed price or simply not exercise the option.
- The final price paid will generally be net of the upfront payment and some or all of the rental payments.

In such cases, a multiple supply occurs for VAT purposes due to:

- the granting of an option to purchase the house at an agreed price and
- the granting of a lease to allow the prospective purchaser to occupy the house.

The consideration for these supplies must therefore be apportioned between both supplies.

2. Option to purchase the property

The VAT treatment of the granting of an option to purchase a property mirrors that of the underlying supply.

For example, if an option is granted to purchase undeveloped land, the grant of the option is exempt from VAT because the sale of the land would be exempt from VAT.

Similarly, if the option relates to the potential supply of a property that would be subject to VAT then the granting of such an option is subject to VAT. This supply is at the rate at which the property would be supplied at, the reduced rate of VAT.

3. Letting of residential property

The period of occupation is a letting of residential property and therefore exempt from VAT.

The landlord's option to tax does not apply to the letting of residential property.

Adjustments of deductibility for exempt lettings

As the property is being used for an exempt purpose during the period when it is rented, the lessor (landlord) may be obliged to make a Capital Goods Scheme (CGS) adjustment. See Capital Goods Scheme (CGS) for further details. The lessor is required to make a CGS adjustment if he or she claimed VAT deductibility in relation to the acquisition or development of the property.

4. VAT treatment of payments under the scheme

Any upfront payment is treated as a payment for the granting of an option to purchase the property unless refundable at the end of the letting period. This option payment is not a deposit for VAT purposes and is subject to the reduced rate of VAT.

The monthly payments made by the prospective purchaser represent consideration for the letting of the property, and in some cases consideration relating to the option to buy the property.

Any amount payable per month up to the market rent of the property is treated as consideration for the exempt letting. The market rent is the rent that a similar house in the area would fetch on the open market. Any amount in excess of this market rent is treated as consideration for the option to purchase the property.

5. VAT on sale where an option to buy is exercised

Assuming the vendor is the person who developed the property, the sale will always be subject to VAT.

When the prospective purchaser exercises the option to buy the property then if a discount is given for the option and or rental payments already made, this amount will not be treated as consideration for the taxable sale.

A discount may be allowed against the sale price for all the rent paid, but a discount may only be allowed for part of the rent paid (see the two examples below).

Example 1

Dev Co Ltd built a housing estate. It is offering houses to prospective buyers under the 'rent to buy' scheme. The cost of building each unit was €160,000 + VAT[1] of €21,600. The sale price of the house under the scheme is €300,000. The offer breaks down as follows:

	€
Initial Payment	6,000
24 x €1000 monthly payments	24,000
Payment on exercise of option	270,000

VAT treatment of initial payment

The initial payment represents consideration for the granting of the option to purchase the property at an agreed price. This €6,000 is subject to VAT at the reduced rate.

Assuming the price is VAT inclusive, this means the VAT chargeable would be €714[2].

Monthly payments

The monthly payments represent consideration for the letting of the property and, in some cases, additional consideration for the option. The way to determine how to apportion the consideration is to compare the monthly amount paid to the rent that a similar house would fetch in the same area.

In this case there are a number of similar houses in the area advertised for rent at €800 per month. This would be accepted as the market rent. This means that consideration relating to the exempt letting is €800 and the consideration relating to the option is €200. There is no VAT chargeable on the €800 as it relates to an exempt letting. The €200 is liable to VAT at the reduced rate. Assuming this is VAT inclusive, this means VAT of €24 is chargeable.

CGS adjustment of Dev Co's deductibility

Dev Co must also adjust its deductibility as the property is being used for an exempt purpose. At the end of the second CGS interval Dev Co must calculate the amount of VAT to be paid in accordance with Section 64(3)(a) of the VAT Consolidation Act 2010 as follows:

C – D (C = reference deduction amount, D = interval deductible amount, see example in CGS – main provisions)

1080[3] – 0 = €1,080 VAT payable by Dev Co at the end of its second CGS interval.

[1] Assume all VAT costs at the reduced rate.

[2] €6,000/ 113.5x 13.5= €714

[3] €1,080 represents 1/20 of the VAT deducted (€21,600) by Dev Co on the development of the house.

Purchaser exercises option to buy

At the end of the 24 months the purchaser exercises the option to buy. A discount on the purchase price of €300,000 is given by reducing the price by the money paid to Dev Co from the option and rental payments which is €30,000 (€6,000+ €24,000).

VAT is chargeable on the final sales price of €270,000 at reduced rate. Assuming the amount is VAT inclusive, this means VAT of €32,115[4] is chargeable on the sale.

Purchaser does not exercise option to buy

If the purchaser does not exercise the option to buy there are no further VAT implications in relation to the transaction between Dev Co and that person.

Dev Co's obligations on onward supplies

If Dev Co sells the property to a third party (following the non-exercise of the option with the previous prospective buyer) it is obliged to charge VAT on the sales price. If Dev Co enters into another rent to buy scheme the same rules apply as above.

Note: As the initial CGS interval will have already elapsed, Dev Co would be obliged to repay 1/20 of the VAT deducted at the end of the CGS interval in which it has rented the property under the scheme and at the end of any subsequent CGS interval during which the property is rented.

Example 2

Dev Co Ltd built a housing estate. It is offering these houses to prospective buyers under the 'rent to buy' scheme. The cost of building each unit was €100,000 + VAT[5] of €13,500. The sales price of the house under the scheme is €200,000. The offer breaks down as follows.

	€
Initial Payment	2,000
36 x €500 monthly payments	18,000
Payment on exercise of option*	183,600

*Under this particular scheme, a discount on the sales price is given for the €2,000 initial payment and for €400 of the €500 paid per month, which is €14,400.

VAT treatment of initial payment

The initial payment represents consideration for the granting of the option to purchase the property at an agreed price. This €2,000 is subject to VAT at the reduced rate. Assuming the price is VAT inclusive, this means the VAT chargeable would be €238[6].

[4] €270,000/ 113.5x 13.5.

[5] Assume all VAT costs at the reduced rate, currently 13.5%

[6] €2,000/ 113.5x 13.5= €238

Monthly payments

The apportionment of the monthly payment is determined in the same way as Example 1. In this case there are a number of similar houses in the area advertised for renting at €500 per month. This would be accepted as the market rent. This means that consideration relating to the exempt letting is €500 and the consideration relating to the option is nil. There is no VAT chargeable on the €500 as it relates to an exempt letting.

CGS adjustment of Dev Co's deductibility

Dev Co must also adjust its deductibility as the property is being used for an exempt purpose. At the end of the second and third CGS intervals Dev Co must calculate the amount of VAT to be paid in accordance with Section 64(3)(a) as follows:

C – D (C = reference deduction amount, D = interval deductible amount (see CGS – main provisions)

675[7] – 0 = €675 VAT payable by Dev Co at the end of its second and third CGS intervals.

Purchaser exercises option to buy

At the end of the 36 months the purchaser exercises the option to buy. A discount on the purchase price of €200,000 is given by reducing the price by the money paid to Dev Co from the option and €400 per month for rental payments which is €16,400 (€2,000+ €14,400[8]).

VAT is chargeable on the final sales price of €183,600 at the reduced rate, currently 13.5%. Assuming the amount is VAT inclusive, this means VAT of €21,838[9] is chargeable on the sale.

Purchaser does not exercise option to buy

The treatment is the same as above in Example 1.

[7] €675 represents 1/20 of the VAT deducted (€13,500) by Dev Co on the development of the house.

[8] €14,400 represents the discount given for €400 of the €500 monthly rental payments over 36 months.

[9] €183,600/ 113.5x 13.5