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VAT Treatment of Immovable Property

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> Housing is one of the most difficult items to handle under a value-added tax.
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> —*Charles E. McLure, Jr.*

I. Introduction

The appropriate treatment of housing and housing services, as part of the wider area of immovable property, is probably one of the more complicated and, it seems, intractable issues in the theory and practice of the value-added tax (VAT). In most industrial countries, housing services, comprising rents and rental values of owner-occupied dwellings, constitute 15 percent or more of total annual consumption expenditures as computed for national accounts purposes. Surely, this is too large a portion to ignore under a broad-based VAT. Yet, conceptual difficulties and, above all, administrative and political problems seem to preclude the taxation of housing services in a satisfactory and evenhanded manner.

To understand the principles and approaches that are found in various countries, a brief review of some of the pertinent characteristics of the VAT provides some clues as to how immovable property should be taxed. Next, the actual VAT treatment of immovable property in the member states of the European Union (EU) and selected other countries that are members of the Organization for Economic Cooperation and Development (OECD) is surveyed. Finally, a concluding section evaluates this chapter's major findings.

II. Nature of the VAT

The VAT is an *in rem* tax on domestic consumption. The tax is of the *in rem* type because personal circumstances are left out of consideration, unlike, for instance, under the income tax (or, for that matter, an expenditure tax). Although the tax is intended to be borne by the consumer, the consumer is not taxed directly. Instead, "taxable persons" are all producers and distributors who manufacture and trade in taxable goods and services. Each taxable person has to remit that part of the total tax, collected by the

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retailer from the final consumer, that equals the tax rate times the value added by that taxable person. To achieve this, the VAT is imposed upon "taxable events," that is, the delivery of taxable goods and services. Each time a commodity changes hands, tax is due and tax on inputs can be credited against tax on outputs. As a result, all commodities can in effect be traded tax free within the "ring" of registered businesses, but the full tax is payable once goods and services leave the ring, because they are sold to unregistered persons, usually consumers.[1]

There is wide agreement on the nature of the VAT collection mechanism. VAT is simply a retail sales tax that is collected piecemeal throughout the entire production-distribution process. The consensus may be smaller, however, on some of the theoretical underpinnings of the tax. Is the VAT a tax on consumption *activities* or, more narrowly, on consumption *expenditures*? Is the VAT a tax on *current* consumption or, more broadly, a tax on all commodities that leave the ring of registered businesses, regardless of whether they are consumed forthwith or embody a stock of services that are consumed over the useful life of the asset? Cars, household appliances, furniture, and, of course, houses are examples of the latter type of asset.

The answers to these questions seem pertinent to obtaining the right focus on the appropriate treatment of immovable property. To a large extent, the answers depend on whether one adopts a theoretical, economic point of view or whether one takes a more practical, legal approach to the VAT.

A. Activities or Expenditures?

From an economic point of view, ideally the VAT should tax all consumption activities because this approach would most closely satisfy commonly accepted equity and neutrality criteria. As a tax on consumption activities, the VAT should in principle include self-produced items of consumption, such as garden vegetables and household meals, in the base at market value. This would ensure equal treatment with other products bought in the marketplace. Proponents of this view draw a parallel with the accretion concept of income that, in theory, also includes in the base the value of self-produced items.[2] Purists stretch the point even further by insisting that the consumption of leisure should be taxed as well.

To be sure, it is readily admitted that it would be impracticable to tax home-produced consumption (not to mention leisure), but, the argument goes, this should not detract from the principle. It is also pointed out that all VAT laws stipulate that goods withdrawn from the stock of a business for personal use are taxable. If a butcher takes meat from the larder for consumption at home, he or she has to pay tax on its market

[1]For a discussion of the nature of the VAT, *see* Sijbren Cnossen, *The VAT and RST: A Comparison*, 35 Canadian Tax Journal 559 (1987). Sales in the ring are in effect tax free because, even though such sales are taxable, the tax paid is offset by a tax credit available to the purchaser. *See, e.g.,* CAN GST § 169. By contrast, under a sales tax with a ring system, such sales are exempt.

[2]*See, e.g.,* Victor Thuronyi, *The Concept of Income*, 46 Tax L. Rev. 45, 79-83 (1990).

value, although the supplier's price is often taken as a close enough proxy (this means that, as an alternative, the tax credit attached to the purchase of the meat can simply be denied). Generally, the meat would also be taxable if it were "produced" by slaughtering a calf that had been fattened on the butcher's premises.

Under the legal approach to VAT, however, it is emphasized that even in principle the VAT is not intended to tax nonmarket consumption activities. If, in the example above, the butcher is taxed, it is because as a taxable person he or she supplies him- or herself with the meat, either directly from the larder or indirectly by raising the calf. In other words, the meat is not produced in a personal capacity, but in a business context. This triggers the taxable event. In contrast, the homegrown vegetables of the butcher would not be subject to the VAT. The definition of "taxable event" in VAT statutes emphasizes that only goods and services bought in the marketplace are taxable. Moreover, the VAT generally becomes due only if the taxable transactions are undertaken for a "consideration." Self-produced items of consumption and, for instance, gifts are not taxable. In short, the tax is on consumption *expenditures* rather than on consumption activities.

B. Flows or Stocks?

Is the VAT a tax on current consumption or simply a tax on consumption items that leave the ring of taxable persons? Most economists would insist that the VAT is a tax on flows, not on stocks.[3] Ideally, under the VAT, durable consumption goods, such as cars, that provide a flow of services over a long period of time (extending, say, beyond the normal tax reporting period) should not be taxed on their value at the time of purchase, but rather on the value of the services that the goods subsequently provide.

Again, it is admitted that it would be impracticable to implement this rule literally. Hence, as a second-best measure, it is assumed that the purchase price of a durable consumption good represents the discounted present value of its future services. By extension, the tax on the purchase price may be considered a close proxy of the discounted present value of the tax that should have been levied on the flow of services. This "prepayment method" is also found in the literature on the personal expenditure tax.[4]

Lawyers and tax administrators point out that the foregoing view is a misrepresentation of the nature of the VAT. The VAT is not a personal tax, but an *in rem* tax on consumption expenditures. For all goods and services, a cutoff point must be established at which the tax becomes final. That point is the retail stage, regardless of the kind of commodity that is sold. The *in rem* nature of the VAT does not support the position that durable consumption goods should be treated differently from nondurable consumption goods. Neither in theory nor in design does the VAT permit imputing a

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[3]This is the view found in Alan Schenk, *Value Added Tax: A Model Statute and Commentary: A Report of the Committee on Value Added Tax of the American Bar Association Section of Taxation* 72-79 (1989). For a strong defense of the VAT as a tax on consumption flows, *see also* Robert F. Conrad, *The VAT and Real Estate*, *in* Value Added Taxation in Developing Countries 95 (Malcolm Gillis et al. eds., 1990).

[4]*See, e.g.,* Michael Graetz, *Implementing a Progressive Consumption Tax,* 92 Harv. L. Rev. 1575, 1597-1623 (1979).

current consumption value to durable goods. Ultimately, the VAT is a tax on consumption expenditures as they are incurred. Although the taxation of transactions may not be a goal in itself (as it would be under, say, a stamp duty), it is sufficiently central to the nature of the VAT that it cannot be ignored.

III. How Immovable Property Should be Taxed

The previous discussion has an important bearing on the way in which immovable property should be treated under the VAT. Land and buildings embody stocks of services that can be used for consumption or production. If immovable property is used for production purposes, like plant and machinery, the services that it generates should not be taxed. Any tax paid at the time of purchase of the property should be creditable immediately against the tax on the sale of other property or the tax on the products made by, say, the factory situated on the property. If there is no tax on sales, simply because there are no sales, a refund would be due forthwith. On balance, no tax should attach to the factory, regardless of whether it was used or not.

A. An Economic Point of View

From an economic point of view, the same treatment should be accorded immovable property that generates housing services. The most attractive solution from a theoretical perspective would be to register for VAT purposes all persons, natural as well as juridical, who own or buy residential real estate. By purchasing a dwelling, these persons would become producers, not consumers, of housing services. In their role as producers, they would subsequently sell the housing services to consumers. These consumers might be either third parties who buy the services against a consideration, that is, a rental charge, or each producer might sell the housing services to him- or herself as the owner-occupier of the dwelling.

The VAT consequences of these events are obvious. The registered taxpayer who buys a bundle of housing services in the form of a dwelling would pay tax on the purchase price, but at the same time the taxpayer would be entitled to a tax credit (and refund, if due) for the same amount. If the taxpayer sells the housing services to a third party, that is, a lessee, he or she would have to charge VAT on the amount of the rental. The lessee, being an unregistered consumer, would not be able to pass the tax on but would be stuck with it just like consumers of other commodities. Similarly, as owner-occupier, the producer of housing services would charge VAT on these services, represented by the rental value of the dwelling, rendered to him- or herself as consumer. And like the lessor, the producer would have to remit that tax (net of any tax on inputs, such as repair and maintenance services) to the tax office.

So far the discussion has been about buildings, but the treatment of land would not be any different. If land generates production services, it should follow the same treatment as the factory above. If it is a producer good that generates consumption services (because it is used for hunting hares or simply to sit on), then the same reasoning holds as given above in respect of housing services. Feasibility considerations may dictate other solutions, but it is simply nonsense to say that land should be left out of the base because it is not a consumption good. The issue is whether land generates consumption services.

B A Legal Point of View

Those who take a legal point of view, as outlined in Section II above, do not subscribe to the characteristics of the VAT as a tax on flows. For them, the VAT is a tax on transactions designed in such a way that, ultimately, only consumption expenditures are taxed. In their opinion, immovable property should be taxed if and when it is transferred from the production or business circuit to the consumption or consumer circuit. Thus, newly constructed buildings, residential as well as other real estate, should be taxed at the time they are completed. If the buildings are subsequently rented out for business use or residential use, the rents should be taxed and the tax on the purchase should be creditable against the tax on rents. If residential property were sold to an owner-occupier, however, the tax on the sale would be considered final. The notion that this tax represents the capitalized value of the tax on the value of all future housing services is a useful, but not essential, rationale for this approach.

Furthermore, it is pointed out that, in practice, the registration of all owner-occupiers, as well as the computation of all rental values, would present formidable administrative problems that a VAT should not take on. Most countries do not tax the rental value of owner-occupied property under their income tax or do so at reduced values. Politically, taxing rental values under the VAT would be even harder to accomplish. It would be difficult to explain to owner-occupiers that taxing the rental value of their dwelling under the income tax as well as under the VAT would not constitute double taxation. Under the income tax, owner-occupiers enjoy the rental value in their role as investors, whereas under the VAT they would enjoy the rental value in their role as consumers. Finally, most nonresidential property is located in the agricultural and industrial sectors or is owned by the government. Taxing such property would not yield any net revenue.

Admittedly, taxing rents but not rental values appears to favor owner-occupiers over lessees who would pay the VAT on rental charges. To achieve approximately equal treatment, moreover, it would be necessary to levy the VAT on the sale of owner-occupied dwellings, because the sale of a dwelling from a (taxable) lessor to an owner-occupier would also be taxable. The tax on the original purchase would then have to be taken into account as well as the tax paid in respect of repair, maintenance, and other costs. Complications would arise if dwellings that were initially occupied by the owner were subsequently rented out or if rental property subsequently became owner-occupied.

In the legal view, therefore, the best alternative is to tax new residential construction and then to forget about it. In other words, lessors would also be treated as exempt persons. They would pay tax on purchases of new housing, but would not be able to charge the VAT on rental charges, take credit for tax on purchases of new fixtures, appliances, maintenance costs, and so on. Levying a final tax on new residential construction might leave some distortions in the consumer market for housing services, but few in the market of producers of housing services. The treatment would not discriminate against other services or against services involving the maintenance or renovation of the existing housing stock, assuming that these services are taxed in full along with building materials, fixtures, and whatever else goes into a house to make it habitable. The tax on new residential construction would favor the owners of the housing stock in existence at the time the VAT is introduced, but this advantage would diminish over time.[5]

If current housing services are to be left out of the base, what about current commercial building services, assuming that new commercial buildings are to be taxed? For the most appropriate VAT solution, the use that may be made of these buildings must be taken into account. Commercial buildings, that is, buildings that are used for production purposes, may comprise factory buildings that are difficult to convert to other uses, but also office buildings that may be used either by a registered manufacturer or trader or by an exempt entity such as a bank or nonprofit organization. Moreover, some office buildings can be converted into apartment complexes without much ado and vice versa.

C. Practical Solutions

Two approaches, largely identical in result, are used to resolve the issue. Under the tax method, found in Canada and New Zealand, the sale and rental of immovable property are taxable in principle, but residential rents (and rental values) are exempt,[6] as is the sale of previously occupied residential property.[7] This implies that the construction, alteration, and maintenance of all buildings are taxable. So is the rental of business accommodations. Also, sales of existing buildings are taxable, unless such buildings constitute residential property. The definition of "previously occupied" should be tailored to the mechanics of the tax in the particular country. For example, in Canada, the exemption applies to the sale of a residential complex by the individual who built the complex and who occupied it as a place of residence, unless the individual claimed an input tax credit in respect of the acquisition of the real property included in the complex. Also exempt is a sale of a residential complex by a person who is not a builder of the complex, unless the person claimed an input tax credit in respect of the acquisition of the complex.

Under the exemption method, prescribed in the Sixth Directive of the EU, in principle the sale and rental of immovable property are exempt,[8] but newly constructed buildings as well as alterations and maintenance of the existing building stock are

[5]The extent of this advantage depends on what tax the VAT replaces. If it replaces a turnover tax that covered construction goods and services, then the existing housing stock may be largely tax paid.

[6]CAN GST sched. V, pt. I § 6; NZL GST § 14(c), (ca).

[7]CAN GST sched. V, pt. I §§ 2, 3; NZL GST § 14(d).

[8]*See* Sixth Council Directive 77/388, art. 13B(b), (g), (h), 1977 O.J. No. L 145/1.

taxable.[9] Unlike the tax method, which requires a definition of residential use, the exemption method needs a definition of specified nonresidential use, such as hotel accommodation, camping facilities, and parking space, which are taxable. Furthermore, because the commercial use and sale of existing immovable property are also exempt, the opportunity of optional registration must be provided to avoid potential discrimination and cumulation of tax.

Both approaches must address the VAT implications of the supply of land. Unimproved land is traded less often than buildings are and is used more often for productive purposes in exempt sectors, such as agriculture. New Zealand exempts all land, improved as well as unimproved. Under the Sixth Directive, however, unimproved land is exempt, but improved land, including land on which buildings are sited, is taxable. Probably, the difference in treatment reflects the difference in the relative scarcity of unimproved land. In New Zealand, the "land element" of the purchase price of a building must be separated out from the total consideration. Under the Sixth Directive, the land element must be separated out from the value of other (unimproved) land that is part of the same parcel.

Under both approaches, sales of existing housing stock are exempt. Thus, the introduction of a VAT that raises housing prices provides a windfall gain for the owners of the existing housing stock. This effect can be mitigated by taxing the initial sale of all dwellings following the introduction of the VAT.[10] Although feasible, no doubt such a novel extension of the VAT base would be strongly resisted. The existing housing stock would have to be valued at that time. Moreover, owners of the existing housing stock would have to retain all invoices of alterations and maintenance expenditures showing VAT that would be creditable against the VAT on first sale at some future date. These invoices would become more difficult to verify with the passage of time. No country has adopted this approach upon the introduction of the VAT.

IV. How Immovable Property Is Taxed

Table 1 shows the treatment of immovable property in the member states of the EU and some other OECD countries with VATs. For expository purposes, it seems useful to distinguish construction activities from the lease and sale of immovable property. In several countries, property transfer taxes, such as registration duties, imposed on gross selling prices interact with the VAT; when the VAT is levied, the transfer tax is not imposed, and vice versa. Hence, these taxes are also shown.[11]

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[9] *See id.* art. 4(3).

[10] *See* Alan A. Tait, Value-Added Tax: International Practice and Problems 83 (1988).

[11] For a summary review, *see also* OECD, Taxing Consumption 183–86 (1988).

A. Construction

The consistent VAT treatment of various construction activities, such as the sale of building materials, the rendering of repair and maintenance services, and the creation of new buildings, is essential if distortions and administrative difficulties are to be avoided. As indicated in Table 1, nearly all countries tax building materials at the standard rate. Exceptionally, Ireland applies the lower rate of 12.5 percent to concrete, and Italy taxes "raw materials and semifinished products for the building industry" at 9 percent. In most countries, the treatment of repair and maintenance services follows that of building materials. Exceptions are found in Belgium, which taxes construction services (and, by extension, building materials) in connection with dwellings that have been occupied for at least 20 years at the lower rate; in Ireland, which taxes repair and maintenance services at 12.5 percent;[12] and in Italy, which favors work on old buildings (of which it has many) by taxing it at 4 percent. These end-use types of exemptions must be difficult to monitor properly.

Logically, building materials and repair and maintenance services (broadly interpreted as construction services) add up to a new building. Most countries realize this; under their VATs, the treatment of newly constructed buildings is the same as that of materials and labor. If the rate on new buildings were different, the effective rate on materials and services embodied in these buildings would, of course, be different from the rate applied to materials and services used for maintaining, repairing, and renovating the existing housing stock. This would create distortions, raise administrative difficulties, and be a breeding ground for tax evasion and avoidance.

However, not all countries see it this way. Thus, the United Kingdom applies the standard rate to all construction other than the sale (or long-term lease) of new residential buildings, which is zero-rated.[13] As a result, complications arise when "mixed work" is supplied, for example, the alteration and renovation of an existing house in combination with the construction of an adjoining new dwelling. Another baffling distinction is made regarding builders' hardware: fitted cupboards in kitchens are zero-rated, but built-in units in bedrooms are taxed at the standard rate.[14]

Presumably, similar problems arise in Spain, which taxes new buildings at a lower-than-standard rate.[15] Spain attempts to limit the damage by stipulating that the standard rate continues to apply to construction work carried out by someone other than the

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[12]How complicated such exceptions to the rule may become is evident from the Irish VAT Act, which prescribes that the lower rate applies to, among others, "services consisting of the development of immovable goods, and the maintenance and repair of immovable goods including the installation of fixtures, where the value of movable goods (if any) provided in pursuance of an agreement in relation to such services does not exceed two-thirds of the total amount on which tax is chargeable in respect of the agreement...." IRL VAT 6th sched. (iii).

[13]GBR VAT sched. 5, Group 8.

[14]*See* Tait *supra* note 8, at 83.

[15]*See* ESP IVA art. 91(3).

building contractor,[16] but, in fact, the legal and practical mess may be largely the same as in the United Kingdom. Sweden used to tax new buildings by applying the standard rate to one-half of the taxable value, but since 1992 it has applied the standard rate on the full value.

Preferential treatment based on the end use of new buildings causes the same problems as it does for materials and services. Italy taxes the repair of historical buildings and the construction of low-cost housing at 4 percent. (In terms of VAT statistics, the country's housing stock probably consists largely of historical buildings and low-income housing.) Social housing programs are also favored in Belgium, Canada, France, and Portugal. Furthermore, Portugal levies the lower rate on public works contracts.[17] This is a needless complication, because raising the rate and increasing the subsidy would be a simple bookkeeping exercise that would deter evasion. Turkey exempts housing units of up to 150 square meters.[18] Presumably, some families are then tempted to buy two units and subsequently connect them.

Germany and Portugal exempt newly constructed buildings from the VAT, but apply instead the property transfer tax (registration duty).[19] The rate of the transfer tax is lower than the standard VAT rate; on the other hand, no credit is available for the tax on inputs. Except by coincidence, the sum of the transfer tax and the VAT on inputs will not be the same amount as the VAT that would have been levied on the total consideration for the new building. This could be a source of distortions and complications. Optional registration and payment of tax for business property, available in most EU countries, mitigate these effects.

B. Lease

No country in the OECD taxes or has ever contemplated taxing the imputed rental value of owner-occupied property under the VAT. Hence, information on this point is not shown in Table 1. If rental values of owner-occupied properties are not taxed, the equal treatment rule requires residential rents to be excluded from the VAT base. With the exception of Austria, all countries surveyed do indeed exempt the lease of residential real estate.[20] This does not necessarily mean that lessees pay less rent, because the VAT will have been paid at the time the dwelling was created. The exemption does, however, mean that lessors, like owner-occupiers, are stuck with an element of the VAT on repairs and alterations. This should not occur in Austria, which taxes residential rents at the lower rate of 10 percent.[21]

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[16] The law states that the reduced rate applies to works resulting from contracts made directly between the developer and the contractor. ESP IVA art. 91(3).

[17] PRT CIVA app. II, no. 3.7.

[18] Such residences were exempt from tax until December 31, 1995. Provisional arts. 8, 9, Law No. 3099, Official Gazette of Dec. 15, 1984, No. 18606.

[19] *See* DEU UStG § 4(9)(a); PRT CIVA art. 9(30), (31).

[20] *E.g.,* CAN GST sched. V, pt. 1(6); IRL VAT 1st sched. (iv).

[21] AUT UStG § 10(2)(5). A tax on residential rents (not rental values) may be preferable if a country's real estate sector is dominated by large apartment complexes and hotels.

In all countries surveyed except Canada, Iceland, Japan, New Zealand, Spain, and Turkey, the lease of other real estate (commercial, agricultural, and government land and buildings) receives the same treatment as the lease of residential real estate. In principle, therefore, the leasing of real estate is exempt from the VAT. However, most countries mitigate or eliminate the potential cumulative effect of this approach by allowing lessors to opt for registration and payment of the VAT (treating them at par with other taxpayers: full credit for input tax and payment of tax on lease payments), provided that lessees are also registered taxpayers (meaning that they can take credit for the tax on their lease payments) or agree to become registered taxpayers. This provision takes the "cascade sting" out of the exemption. In practice, the exemption-cum-optional-taxation approach may closely approximate the effect of the taxation approach in the six countries mentioned above. Given a choice, lessors will opt for the least-tax-expensive option, but they must take into account that the choice is irreversible. In Belgium, France, and Italy, lessors of furnished commercial real estate are always taxable with respect to the lease or sale of such real estate.

Countries that exempt leases of immovable property and hence housing services, however, do tax hotel accommodation and the rental of parking space and camping grounds.[22] An exemption applies if hotel and similar accommodations, such as boarding houses, are used for residential purposes. Usually, a simple period test, say, an uninterrupted stay of 30 days or more, is used to establish eligibility for the exemption. Under the Sixth Directive, permanently installed equipment and machinery are also taxed.[23] Without an explicit charging provision, such equipment and machinery would be exempt, because they are immovable by law. Finally, the directive also taxes the rental of safe-deposit boxes.[24]

C. Sale

As Table 1 indicates, all countries exempt the sale of previously occupied residential real estate, and most countries the sale of other real estate, too. Six countries (Canada, Iceland, Japan, New Zealand, Spain, and Turkey), however, tax the sale of other (nonresidential) real estate under their VATs. The same countries that allow lessors of real estate the choice of being taxed extend that right to sellers of real estate. Exemption means that increases in the value of the stock of housing services are not taxed (nor is a tax credit provided for decreases in the value). Interestingly, in France, the VAT is levied, albeit at the lower rate, on the realized capital gains of traders in real estate; a credit is allowed for the tax on repairs but not for the tax paid at the time of purchase. Not surprisingly, this approach resembles the treatment of secondhand goods bought and sold by registered businesses.

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[22]Sixth Council Directive 77/388 art. 13B(b)(1), (2), 1977 O.J. No. L 145/1.

[23]*Id.* art. 13B(b)(3).

[24]*Id.* art. 13B(b)(4).

The VAT treatment of the sale or lease of immovable property, as described above, should cause little discrimination unless the purpose to which the building or the land is applied changes from exempt to business use or vice versa. In the event, the member countries of the EU provide for an adjustment period of up to ten years from the date of purchase.[25] If, say, after four years, a building changes from exempt to taxable use, a tax credit is permitted of six-tenths of the tax originally denied. Conversely, if the building has been used for taxable purposes for, say, seven years, a change to exempt use implies that a VAT payment of three-tenths of the original tax must be paid. Annual apportionment of the tax, depending on the relationship between exempt and taxable use, is also possible. In Italy, the adjustment period is five years. In New Zealand, there is no time bar to the adjustment period.

V. Conclusion

This chapter has shown that there are two opposing points of view on the nature of the VAT. The economic point of view is that the VAT is a tax on current consumption activities, although feasibility considerations often dictate that the reach of the tax must be confined to market transactions and that stocks instead of flows must sometimes be taxed. The legal point of view, on the other hand, holds that what economists present as the exception to the rule actually is the rule. In other words, the VAT should be confined to transactions in the marketplace, and it is perfectly legitimate to tax stocks of consumption services as they leave the ring of registered businesses. The collection mechanism of the VAT is a quintessential feature of the tax rather than a means of reaching the consumption base.

The economic point of view holds considerable attraction for the theoretically inclined mind. However, no legislator has ever thought of, let alone proposed, taxing nonmarket consumption activities or durable consumption goods on the flow of services they provide. As the legislative history of every VAT indicates, the reach of the tax ends at the retail stage. Concessions to this view are not made on grounds of principle, but only as a means of blocking possible avoidance routes or to mitigate undue distortions. The *in rem* nature of the VAT considerably weakens the view that durable consumption goods should be taxed on the flow of services they generate to the owner.

The second-best solution, applied to housing services (exemptions of rents and rental values, taxation of newly created houses) by nearly all countries with a VAT, broadly satisfies generally accepted criteria of horizontal equity, neutrality, and feasibility. The tax method (tax all immovable property, unless exempted; exempt housing services and the sale of previously occupied dwellings) is, however, superior to the exemption method (exempt all immovable property, except new dwellings). Under the tax method, commercial exploitation of immovable property, other than houses, is fully taxed. Under the exemption method, increases in the value of commercial housing services are not taxed. Moreover, optional taxation causes differential effects. More

[25] *Id.* art. 20(2).

generally, under the philosophy of the VAT, it is better and easier to define selective exemptions than to define selective charges to tax.

As the examples in this chapter show, the consistent and neutral application of the VAT to immovable property requires that all building activities, forms of leasing, and sales be taxed at the standard rate. Preferential rates cause distortions and raise administrative complications. Their effect may be undone if low-taxed activities, for example, repair and maintenance services, are supplied in combination with normally taxed goods, such as building materials or new buildings. Similarly, building materials, subject to the standard rate, may effectively attract a lower rate if supplied in combination with preferentially treated low-cost housing. Furthermore, it is essential that leases and sales be taxed at the same rate. In the immovable sector also, goods (buildings) and services (renting) have become nearly perfect substitutes. Equal treatment should be more fully achieved under the tax method.

In some countries, such as the Netherlands, the limited adjustment period[26] of ten years led to tax avoidance. Local governments, for instance, established legal entities from which they rented their buildings. The legal entity opted for registration; it charged VAT on the rent but was also entitled to a credit for the tax on the purchase of new buildings. After the expiration of the ten-year period, the buildings were sold tax free to the local governments. In the case of a building with a useful life of 40 years, this yields a VAT saving of three-fourths of the tax that should have been paid. To repair this loophole, the Dutch VAT law was changed. Currently, the option of registration and payment is available only if the immovable property is sold or leased to an entity 90 percent or more of the turnover of which consists of taxable transactions. Here, as in many other VAT matters, New Zealand has chosen the best approach: in addition to the tax method, it has an unlimited adjustment period. Moreover, New Zealand taxes local governments.

By any standard, transfer taxes (registration and stamp duties) are an anachronism. These taxes exhibit the same cumulative effects as a cascade turnover tax. In most countries, they yield little revenue. At best, they can be viewed as a proxy for the VAT that should have been levied on the increase in the value of immovable property realized at the time of sale. This increase represents the capitalized value of the increase in the value of the (housing) services of the immovable property that belongs in the VAT base. It would be better to abolish the transfer taxes and subject gains realized upon the sale of immovable property (including dwellings) to the VAT. This would justifiably resemble the treatment of other secondhand goods.

[26] *See supra* sec. IV(C).

Table 1. VAT Treatment of Immovable Property in Selected OECD Countries

Country	Construction			Lease		Sale		Alternative tax	
	Building materials	Repair and maintenance	Newly constructed	Existing residential real estate	Other real estate[a]	Residential real estate	Other real estate[a]	Kind	Rate[b] (percent)
EU Countries									
Austria	S	S	S	L	S	E	E	Property acquisition tax	3.5
Belgium	S[c]	S[c,d]	S[c]	E	E[*,e]	E	E[*,e]	Registration duty	12.5
Denmark	S	S	S	E	E[*]	E	E[*]	No, stamp duty	
Finland	S	E[f]	E	E	E	E	E	No, stamp duty	
France	S	S	S	E	E[e]	E	E[e,g]	Registration duty	6.9- 18.6
Germany	S	S	E[h]	E	E[*]	E	E[*]	Property acquisition tax	2
Greece	S	S	S	E	E	E	E	Registration duty	9
Ireland	S[i]	L[j]	L	E	E[*]	E	E[*]	No, stamp duty	0-6
Italy	L	S[k]	S[k]	E	E[e]	E	E[e]	Registration duty	8
Luxembourg	S	S	S	E	E[*]	E	E[*]	Registration duty	10
Netherlands	S	S	S	E	E[*]	E	E[*]	Transfer tax	6
Portugal	S	S	E[h,l]	E	E[*]	E	E[*]	Registration duty[m]	8-10
Spain	S	S	L[n]	E	S	E	S	Registration duty	6
Sweden	S	S	S	E	E[*]	E	E[*]	No, stamp duty	
United Kingdom	S	S	Z[o]	E[n]	E[*,p]	E	E[*]	No, stamp duty	

Selected Other OECD Countries									
Canada	S	S	L	E	L	E	L	None	
Iceland	S	S	S	E	S	E	S	None	
Japan	S	S	S	E	S	E	S	Transfer tax	4
New Zealand	S	S	S	E	S	E	S	No, stamp duty	
Norway	S	S	S	E	E	E	E	None	
Turkey	S	S	S	E	S	E	S	Transfer tax	4

Key: S = normally liable to the standard rate
L = normally liable to the lower rate
E = normally exempt from tax
Z = normally subject to the zero rate
* = optional registration and taxation are possible if the property is for use in a taxable activity.

Notes:

a In the member states of the EU and some other OECD countries, hotel accommodation, camping sites, and parking space are taxed.
b Special rates that may apply are not shown.
c Belgium applies an intermediate rate of 12 percent to public housing, such as dwellings supplied to regional housing corporations and apartment buildings for the elderly, the handicapped, the homeless, minors, and students. Work on such buildings is also taxed at 12 percent.
d In Belgium, renovation, repair, and maintenance services to dwellings that have been used as such for at least 20 years are taxed at the lower rate of 6 percent.
e Taxed if leased or sold by a commercial lessor.
f Finland taxes installation work relating to water pipes, sewers, heating, gas pipes, and electric wires.
g In France, the supply of building sites for social housing programs is taxed at the lower rate of 5.5 percent; other building sites are taxed at 13 percent. Traders in commercial property are subject to the VAT on gains; no credit is allowed for the tax on purchases, but the tax on repairs is creditable.
h In Germany and Portugal, newly constructed property is subject to the alternative tax.
i In Ireland, concrete is taxed at the lower rate of 12.5 percent.
j In Ireland, repair and maintenance services are taxed at the standard rate if their value is less than one-third of the work contract.
k In Italy, the lower-lower rate of 4 percent applies to work on specified (historical) buildings and the construction of low-cost housing.
l In Portugal, the lower rate of 5 percent applies to public work contracts and to construction work of housing development cooperatives.
m In addition, stamp duty at 0.75 percent is payable on property transfers, while construction work attracts a 0.6 percent stamp duty.
n In Spain, the standard rate applies to construction work carried out by someone other than the building contractor.
o In the United Kingdom, the standard rate applies to the supply of new commercial buildings.
p Leases in excess of 21 years granted by the original builder-developer are zero-rated.