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Value Added Tax on Home Purchases by Individuals

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Abstract

Starting from next year, the current system regarding value added tax for home purchases made by individuals will change. The change is made on the value ceilings of the transactions as well as on the number of transactions that can be carried out with the reduced VAT rate. The work aims to highlight the changes brought by the Government Emergency Ordinance no. 16 from 2022.

Keywords: purchasing houses, value added tax, reduced VAT rate.

1. Introduction

Ever since 2008, when the VAT rate of 5% was introduced for the first time for homes delivered as part of the social policy, VAT was one of the instruments used to encourage the real estate sector. The impact of investments in real estate developments is generally recognized as having a positive effect on the economy (and implicitly on budget revenues), but also on living conditions.

As shown by the data published by Eurostat at the end of last year, although an overwhelming number of Romanians own privately owned homes, things do not look as good when we talk about the quality of living conditions, Romania being the leader in the statistics on housing congestion and in last place in the EU when it comes to the size of the home. Although the reduced VAT rate for social housing has already been implemented for more than 14 years, the application criteria are in a continuous dynamic.

The price ceiling of homes that can benefit from the 5% VAT rate, as well as the number of purchases that can be made by one person have changed over time, currently there are even two such ceilings and the possibility of purchasing one or more houses depending on their price.

2. Current provisions of the Fiscal Code

In 2022, according to art. 291 para. 3 letter c) point 3 of the Fiscal Code as amended by GEO no. 13/2021, the reduced VAT rate of 5% is applied to the tax base for the following supplies of goods and services:

- the delivery of homes that have a useful surface of a maximum of 120 sqm., excluding household annexes, the value of which, including the land on which they are built, does not exceed the amount of 450,000 lei, excluding VAT, purchased by individuals. The usable area of the house is defined by Law no. 114/1996, republished, with subsequent amendments and additions. Household annexes are those defined by Law no. 50/1991 regarding the authorization of the execution of construction works, republished, with subsequent amendments and additions. The reduced rate applies only to homes that, at the time of sale, can be lived in as such;

- the delivery of homes that have a useful surface of a maximum of 120 sqm., excluding household annexes, the value of which, including the land on which they are built, exceeds the amount of 450,000 lei, but does not exceed the amount of 700,000 lei, excluding VAT, purchased by persons individually or jointly with another person/s. The usable area of the house is defined by Law no. 114/1996, republished, with subsequent amendments and additions.

Household annexes are those defined by Law no. 50/1991, republished, with subsequent amendments and additions. The reduced rate applies only to homes that, at the time of delivery, can be lived in as such. Any individual can purchase, starting from January 1., 2022, individually or jointly with another person/other persons, a single house whose value exceeds the amount of 450,000 lei, but does not exceed the amount of 700,000 lei, exclusively VAT, with a reduced rate of 5%.

The legislator's intention is to narrow the scope of the reduced rate of 5% to VAT, lowering the upper price limit and imposing, generically, the purchase of a single house at a reduced price. Taking into account the constant concern of the tax authorities, to maintain the social character of the reduced rate of 5% to VAT, we can think that the existence of a higher ceiling, of 700,000 lei, for the purchase of a single house, as well as the possibility of purchasing more homes below 450,000 lei, are criteria that could favor investments in some cases and were not necessarily characteristic of the social policy in certain cases, on which the introduction of the reduced quota is based.

The qualification of homes for the reduced rate of VAT has been a topic of interest for both property developers and people interested in a new home over the years.

Thus, on the one hand, there is the signal of an increase in credit prices sent by the National Bank of Romania, by increasing the monetary policy interest rate above expectations, which could have the effect of tempering demand, and widening the scope of the reduced VAT rate for the purchase of housing, which should lead to lower prices, at least in the segment targeted by this measure.

On the other hand, inflationary pressures, tensions in the labor market, but also high demand call into question the direction of prices on this market in the coming period.

Returning to the increase in the ceiling for the application of the 5% VAT rate, from 450,000 lei to 700,000 lei, it should be noted that the measure is applicable for a single purchase.

In other words, any person, individually or in co-ownership with another person, can buy a single home with a 5% VAT rate, if the purchase price is between 450,000 lei and 700,000 lei, excluding VAT.

It is not relevant if the mentioned person also bought housing with a reduced share in previous years, when the maximum ceiling was 450,000 lei.

In order to keep track of these transactions, the authors of the law provided for the establishment of the register of housing purchases with a 5% VAT rate, and its model was officially published at the beginning of February 2022.

The register is completed and verified by public notaries on the date of authentication of sales-purchase contracts that have as their object the transfer of property rights for homes with a reduced VAT rate.

It is completed both for homes with a value of less than 450,000 lei, without VAT (in which case the number of purchases made is not relevant), and for those with a value between 450,000 lei and 700,000 lei, without VAT (where the limitation applies on a single purchase).

The tax relief offered in this price segment has the potential to boost purchases, both as a personal home and for investment purposes. Here, however, the effect of the increase in the price of loans comes into play, which could affect demand, given that, in this price segment, mortgage financing is more present.

But Romania's case is not unique, similar situations can be found in most of the world's economies, in the real estate sector. On the other hand, in Romania, the demand for housing has been on an upward trend for several years, and the supply is undersized, so it remains to be seen how the market will evolve in the next period.

Not infrequently in practice, buyers as well as sellers of residential real estate find themselves in the situation of having to obtain clarifications regarding the obligation to pay VAT when purchasing or selling a home.

The situation can become quite complicated, especially in the case of future real estate transactions, when, as a rule, a preliminary contract is concluded between the parties, with the payment of the sale price in installments, in a foreign currency. Although at the time of making the agreement of will regarding the bilateral promise of sale and purchase, the parties have in mind the legal provisions in fiscal matters regarding VAT in force at the time of signing, often the numerous legislative changes that have occurred at short intervals in this field, the fluctuation of the currency exchange rate as well as the superficially drafted contractual clauses, create at the time of the actual sale, significant legal problems that can lead to the cancellation of commitments with the consequence of significant financial losses on both sides.

Therefore, it is good to know what risks we are subject to when we express our intention to buy or sell under conditions of VAT taxation.

A first condition that emerges from the fiscal regulation in question is that the person who buys a property that meets all the other conditions for the application of the reduced VAT rate must be an individual.

A second condition is for a buyer to purchase a single house at a price of more than 450,000 lei but less than 700,000 lei, and any price below 450,000 lei.

The buyers will declare in front of the notaries that they meet the condition for buying the house with the 5% VAT rate, and the declarations thus given will be kept by the sellers.

The purchased home can be bought in exclusive ownership or in co-ownership.

According to the legal provisions, sales of residential real estate are subject to taxation in the form of VAT at a reduced rate.

The notion of home is defined by art. 2 of Law no. 114/1996 and consists of that construction made up of one or more living rooms, with the necessary dependencies, facilities and utilities, which satisfy the living requirements of a person or family.

Therefore, the sale of land without construction is not subject to the 5% VAT rate. However, under the conditions provided by the Fiscal Code, these transactions may generate the obligation to pay the standard 19% VAT rate. Also, neither the sales of buildings with a destination other than housing, as defined in Law no. 114/1996, does not benefit from the reduced VAT rate.

Pursuant to art. 269 of the Fiscal Code, VAT will be applied at the rate of 5%, to the sale of homes that have a useful surface of a maximum of 120 sqm., excluding household annexes. The law establishes that household annexes are those defined by Law no. 50/1991 regarding the authorization of the execution of construction works, republished, with subsequent amendments and additions.

The usable area referred to by the Fiscal Code is determined according to the Housing Law which establishes that it is represented by the sum of all the places (in a home) that can be used, furnished and arranged, regardless of whether it is a single plan or several. Concretely, this includes: rooms (living room and bedrooms), bathrooms (with or without bathtub or shower), kitchen, all closed or open storage spaces and all transit areas – respectively hallways. The calculation of the useful surface does not include: the surface of loggias and/or balconies, door thresholds, niches where radiators are located, nor the surfaces occupied by stoves and bathroom boilers, if they are in the home. In the case of homes that have an internal staircase, this is not included in the calculation of the total usable area. The total useful area is not defined in any legal text, but it is frequently used by real estate developers, being considered the sum of the useful area, as described by law, to which is added the area of loggias and balconies related to the building or apartment in question.

Concerning the condition regarding the surface limit, problems of legal interpretation may arise for the inclusion of the legal operation of the transfer of ownership in the reduced rate or in the standard rate of VAT, in the situation where the parties agree to sell and respectively buy a

future immovable property , regarding which a sale-purchase promise is concluded from the project phase of the future construction that will be purchased.

First of all, for the establishment of the VAT rate, it is important to analyze, according to the documentation attached to the preliminary sale-purchase contract (project, construction permit, plans, cadastral sketches) or the sales contract (cadastral documentation), the usable area and not of the built one. Especially in the situation of the intention to purchase a future building, it is important to check according to the clauses of the pre-contract, the margin of difference between the areas of the building resulting from the cadastral sketches and those specified in the pre-contract because if, according to the estimates of the construction project, the usable area is close to size limit of 120 sqm., it is possible that the useful surface resulting after the completion of the construction will exceed the legal limit, the price of the property will increase significantly by changing the VAT rate from 5% to 19%.

On the other hand, the tax legislation establishes that when measuring the total usable area of the building, the area of the household annexes will not be taken into account. Law no. 50/1991 classifies the notion of household annexes as the constructions of a definitive or temporary nature, intended to house specific activities, complementary to the housing function, which, by being located in the vicinity of the home, make up together with it a distinct functional unit. In the category of household annexes, as a rule in the countryside, are included: summer kitchens, stables for large animals, barns, warehouses, warehouses and the like. Similarly, garages, conservatories, swimming pools and the like are assimilated to the notion of outbuildings.

However, the household annexes as well as the land on which the constructions are located will be taken into account when meeting the value threshold condition of the transaction, under certain conditions.

According to the relevant legal provisions in this area, for the applicability of the reduced VAT rate, the transfer of ownership must concern a building that, at the time of sale, can be lived in as such.

The phrase used by the legislator, "habited as such" does not benefit from a definition of the term, leaving room for interpretations that can generate problems regarding the classification of the transaction in one or another VAT rate.

Thus, in a generalized interpretation, the fiscal body considers that a building can be inhabited as such by reference to the provisions of art. 2 lit. b) from Law no. 114/1996 of housing, which defines the phrase "convenient housing", namely a "housing that, by the degree of satisfaction of the relationship between the user's requirement and the characteristics of the housing, at a given moment, covers the essential needs of rest, food preparation, education and hygiene, ensuring the minimum requirements presented in Annex no. 1 to Law no. 114/1996".

Appendix no. 1 to Law 114/1996 includes a list of minimum requirements for convenient housing, such as free individual access to the living space, without disturbing the possession and exclusive use of the space owned by another person or family, space for rest, space for food preparation , sanitary group, access to electricity and drinking water, controlled disposal of waste water and household waste, etc.

3. Provisions of the Fiscal Code starting January 1, 2023

But let's see concretely what are the news. Thus, from January 1, 2023, the Fiscal Code underwent changes by O.U.G. 16 /2022, thus the 5% VAT rate will be applied to the purchase of a single house with a price of no more than 600,000 lei, exclusive of VAT. Compared to the current rules (two existing caps, one with an unlimited number of purchases and another applicable for only one possible purchase), the new rules seem simpler: only one price ceiling and only one possible purchase.

If we take into account the recent changes made to the taxation of rental income for individuals, namely the elimination of the flat rate, which attracts a higher rent tax, as well as the limitation of access to a single dwelling subject to the reduced VAT rate and within the limit of a reduced ceiling, a tendency can be observed that can discourage such investments among natural persons. It remains to be seen whether this will have the effect of a migration of this type of investment to companies, in which case they can apply reverse taxation to VAT as well as certain expense deductions.

On the other hand, the previous increase in the ceiling had the purpose of aligning this limit with the current price of housing, given the evolution of the real estate market. Here is that, despite the maintenance of high prices on the market, the maximum ceiling under which you can buy a property with reduced VAT will decrease by 100,000 lei, which will, however, limit the population's access to properties with a 5% VAT rate. In addition to uncertainties in the planning of the development activity, due to frequent changes regarding VAT in the current context of challenges related to inflation, price increases for construction materials, increases in labor costs, real estate developers will find themselves between the need to ensure an offer adequate to the new ceiling and to maintain the profit margin.

Good news would be, however, maintaining the 5% VAT rate for buildings delivered in 2023, but which fall within the conditions applicable in 2022 and for which advances were paid in 2022. Thus, from the transitional provisions, it is possible to understand that real estate with a value below 700,000 lei will still be able to be purchased with reduced VAT, if advances have been paid for them in 2022. A contrary interpretation would directly affect individuals who contract such real estate in 2022, for which the percentage increase might not be financially sustainable, from own sources or from lending. Moreover, in such a situation we could see a blockage on the real estate market, which is not desirable under the current conditions.

According to the same transitional provisions, deliveries made starting from 2023 for buildings with a price below 450,000 lei, for which preliminary contracts were concluded and advances received in 2022, would not be taken into account when calculating the limit of a building subject to the 5% quota to VAT, for each individual.

Thus, the buildings purchased starting from 2023, according to the new rules, will be registered in a new register ("Register of housing purchases with a reduced VAT rate of 5%, starting from January 1, 2023"). This seems to indicate that, from January 1, 2023, a new chapter begins in terms of VAT in the real estate market, and transactions contracted prior to this date remain on the rules of 2022.

Regarding the acquisition of real estate by individuals individually or jointly with another individual or individuals, a series of implications may arise in practice. Thus, a first question would be related to the meaning of this phrase - if it refers to persons with degrees of kinship or any form of co-ownership. In addition, there is the question of what happens if the purchase is made by two spouses who later decide to divorce. Can they still purchase another property for which they can benefit from the reduced VAT rate? Basically, no. Also, what happens if the two spouses purchased a property with a 5% VAT rate during the marriage under the property separation regime? Will the other spouse still be able to purchase a property with a 5% VAT rate? Certainly, a series of questions remain, which should be clarified in the coming period, as real estate developers have the task of applying the correct VAT rate for the deliveries made.

4. Conclusions

In the case of the VAT rate for the purchase of housing, the provisions of the Fiscal Code bring a simplification starting from January 1, 2023. There will be a single value ceiling, namely

600,000 lei and a small number of purchases to which a 5% VAT rate can be applied, namely only one.

The transitional provisions, regarding transactions for which an advance was paid in 2022, bring a clear and fair provision for individuals in this situation.

Changes brought to the taxation of rental income, in the case of individuals, namely the elimination of the flat rate, will attract a higher rent tax, as well as the limitation of access to a single dwelling subject to the reduced rate of VAT and within the limit of a reduced ceiling, show a trend that can discourage such investments among individuals. The future will show us if there is an impact in the migration of this type of investment to companies, a situation in which they can apply reverse taxation to VAT as well as apply certain expense deductions.

It could be considered that one of the reasons for the expected change is the increase in revenues to the state budget and, perhaps, the tempering of the appetite of individuals to invest in more "social" housing with a reduced VAT rate.

REFERENCES

- [1] Law 227/2015 on the Fiscal Code
- [2] Ordinance 13/2021
- [3] Ordinance 16/2022
- [4] Law no. 114/1996, republished, with subsequent amendments and additions
- [5] Law no. 50/1991