



# RESIDENTIAL PROPERTY AND VAT

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Until recently it was smaller investors who bought and let residential property. But nowadays even listed Real Estate Investment Trusts (REITs) are building, buying and letting large portfolios of residential property. No doubt the investors are looking to satisfy the demand for residential property, and to realise better yields than may be achieved in commercial property.

The value-added tax (VAT) rules on the building, buying, letting and selling of residential properties are not simple. It is worthwhile recapping some of the general principles that apply.

### Lease of Dwelling

The term 'dwelling' is defined in the Value-Added Tax Act, No 89 of 1991 (VAT Act), essentially, as immovable property together with fixtures and fittings which is used, or which is intended to be used mainly as a place of residence of a natural person.

The lease of a 'dwelling' (without related goods or services) is an exempt supply. In other words, the landlord must not raise VAT on rental charged to the tenant. The landlord is also not entitled to claim VAT on amounts it paid to its suppliers, for example, on commission of rental agents. Notably, a landlord is not entitled to claim VAT on the price paid on the purchase of a dwelling.

A person who has let a dwelling must also not charge VAT on the sale of the property. Instead, the buyer must pay transfer duty.

### **Supply of Commercial Accommodation**

The VAT Act distinguishes the concept of 'commercial accommodation' from that of a 'dwelling'.

'Commercial accommodation' means:

- (1) lodging, or board and lodging in a building or other structure;
- (2) together with 'domestic goods and services':
- (3) which is regularly or systematically supplied;
- (4) where the total annual receipts exceed (or are expected to exceed) R60,000 in a 12 month period; and
- (5) which is not a dwelling supplied under a lease.

(The term also includes lodging, and board and lodging in, for example, a house for the aged and a hospice.)

The term 'domestic goods and services' is defined in the VAT Act as goods and services provided in an enterprise that supplies commercial accommodation. The term includes things like cleaning, maintenance, electricity, air conditioning, television, meals and a laundry service.





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## CONTINUED

A person who supplies commercial accommodation may be able to claim VAT charged to it by its suppliers to the extent that it charges VAT on the supply of accommodation, goods and services.

The supply of accommodation, goods and services in a residential property used as a guest house is an example of 'commercial accommodation'. Another example is a person who lets apartments to students, and who also provides the students with meals and a cleaning and laundry service.

A person who supplies commercial accommodation must account for VAT in two ways:

- If the person provides the accommodation, goods and services for a period up to 28 days for an all-inclusive charge, then the person must charge VAT on the charge at the standard rate (14%).
- If the person provides the accommodation, goods and services for a period exceeding 28 days for an all-inclusive charge, then the person must charge VAT at the standard rate (14%) on 60% of the charge only.

Note in particular that, to be 'commercial accommodation', lodging must be supplied together with the goods and services. So, if one person supplies accommodation to, say, a student and another person supplies goods and services to that student, then the first person must charge no VAT on the rental for the supply of the accommodation (it is an exempt supply of a dwelling) while the second person must charge VAT at the standard rate (14%) on the goods and services supplied.

Note further that the special VAT rules on the supply of commercial accommodation only apply if the person making the supply raises an all-inclusive charge for the supply. In other words, if a person raises one invoice for accommodation and another invoice for the goods and services, then the person must (1) raise no VAT on the rental charged for the accommodation (it is an exempt supply of a dwelling), and (2) must raise VAT at the standard rate (14%) on the supply of the goods and services.

A person who supplies commercial accommodation may be able to claim VAT charged to it by its suppliers to the extent that it charges VAT on the supply of accommodation, goods and services. A person who buys property to supply commercial accommodation may also be able to claim VAT on the price paid for the property.

### **Developers**

Developers who build residential units must charge VAT at the standard rate (14%) when selling the units. The developers are entitled to claim VAT on the cost of supplies made to them, for example, building materials.

However, in some cases developers are not able to immediately sell the units which they have built. In those cases the developers often let the property to individuals until they are able to find buyers.

The problem then is that there is a change of use for VAT purposes: the developer who held the units to sell as stock (and raising VAT at the standard rate) now starts using the units to supply a 'dwelling' (and raising no VAT as the supply is exempt from VAT). The effect of that change of use is that the developer must account for VAT

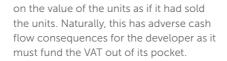




# RESIDENTIAL PROPERTY AND VAT

# **CONTINUED**

It is apparent that the way in which residential property is applied can have a fundamental impact on the incidence of VAT.



Fortunately, under s18B of the VAT Act, a developer in that position may let the unit for a period of 36 months after concluding the lease without triggering the VAT on the change of use. If the developer sells the unit during the 36 month period, the developer must account for VAT on the sale at the standard rate. If, however, the developer is not able to sell the unit within 36 months then, at the end of that period, there will be a change of use and the

developer will have to account for VAT on the value of the unit as if it had sold the unit.

### Conclusion

It is apparent that the way in which residential property is applied can have a fundamental impact on the incidence of

Investors should obtain advice when buying, selling or letting residential property.

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