BIZCOMMUNITY

Property developers will face cash flow pressure due to VAT on temporary rental of residential units

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The curtains have come down on section 18B of the Value-Added Tax Act, No. 89 of 1991 (VAT Act) and the resultant impact may catch a few residential property developers off-guard.

The VAT relief afforded to such developers in section 18B of the VAT Act was introduced in 2011 and provided that where fixed property consisting of a "dwelling" (essentially a property used predominantly as a place of residence) was developed by a "developer" (as defined in the VAT Act) wholly for the purpose of making taxable supplies or was held or applied for that purpose, and such dwelling (e.g. flat/house) was subsequently temporarily applied by that developer for supplying exempt accommodation in a dwelling under an agreement for the letting and hiring thereof (i.e. in terms of an agreement of lease), such supply of the fixed property was deemed not to be a taxable supply in the course or furtherance of the developer's enterprise.

In other words, while the developer in these circumstances would have been deemed to have made a taxable supply of the property in terms of section 18(1) because of the change in use of the property from a taxable use (for sale) to an exempt use (residential letting), the application of section 18(1) was in effect suspended (i) for a period of 36 months from the date that the property was let, (ii) until the developer applied the property for a taxable purpose (i.e. sale), or (iii) 1 January 2018, whichever was the earlier.

Amendment to sunset clause

The developer would have been able to claim input tax relief on all the goods and services acquired by it to develop the property and need not have clawed back such input tax notwithstanding its wholly exempt temporary use until the happening of one of the events referred to above. The relief measure was subject to a sunset clause in section 139(2) of the Taxation Laws Amendment Act 24, 2011, ending on 1 January 2015. An amendment to the sunset clause was later introduced by section 111(1) of the Taxation Laws Amendment Act 43 of 2014, which extended the application of section 18B for an additional three years up to 1 January 2018.

The relief measure accordingly no longer applies, and in the absence of section 18B, developers who previously relied on

this provision not to have to make a change of use adjustment under section 18(1) will now need to make the requisite adjustment. In essence, the developer will be required to account for output tax on the market value of the property (section 10(7) of the VAT Act that is now being used wholly for an exempt purpose (residential letting). The developer will have to account for output tax on the market value of the properties notwithstanding that the developer has not sold the units and generated the income necessary to meet its VAT liability that arises in consequence of the application of the change in use adjustment in section 18(1) of the VAT Act.

Cash flow pressures

The withdrawal of the relief measure will no doubt cause significant cash flow pressures for developers who may be required to account for a significant amount of VAT in a single tax period. It is apparent that the withdrawal of the relief measure should have been phased out, as has been the case in other instances where a change in legislation has significantly impacted the cash flow position of vendors. Vendors who will experience significant cash flow pressure in consequence of the withdrawal of section 18B may, however, approach SARS under section 167 of the Tax Administration Act, 2011 (the TAA) to request that the relevant VAT liability be paid in instalments. In this regard, SARS must be satisfied that the "collection activity would be harsh in the particular case and the deferral or instalment agreement is unlikely to prejudice tax collection" before SARS may agree to an instalment payment arrangement. Section 168 of the TAA also has a number of other criteria that SARS must consider before allowing a taxpayer to pay its tax liability in instalments.

The issue that arises is: what is the VAT position should the developer subsequently dispose of the dwelling in respect of which it has made a change in use adjustment under section 18(1) of the VAT Act? SARS previously confirmed (VAT News 14, 14 March 2000) that while the developer must account for output tax when the property is disposed of, the developer "can deduct the VAT declared and paid at the time the units were let". A similar approach was adopted in an earlier version of the SARS Guide for Fixed Property and Construction (VAT 409 - 2011). The latest VAT 409 Guide (27 September 2016) does not contain a similar dispensation and instead notes (at 7.6), inter alia, that in these circumstances:

"Any subsequent supply of that property after the adjustment date under section 18(1) will not be a taxable supply for VAT purposes. The transaction will instead be subject to transfer duty, subject to any exemptions or exceptions which may apply" (our emphasis).

Double taxation

It is evident that SARS' view results in double taxation. VAT will have to be accounted for on the market value of the property on 1 January 2018 when the change of use adjustment is required to be made under section 18(1), and transfer duty when subsequently disposed of - on the basis presumably that the subsequent supply of the property does not constitute a taxable "enterprise" supply. The previous dispensation where output VAT was required to be accounted for on disposal of the previously let property, but the VAT paid under the change of use adjustment provisions was deductible, seems to us to be a more equitable approach.

It is arguable that where the developer, a vendor, disposes of property that has been temporarily let, it does so in the

course of its enterprise activity, notwithstanding the temporary exempt use thereof and the requisite change of use adjustment under section 18(1). As the subsequent supply (disposal of the property) is a wholly taxable supply (the developer had always intended to dispose of the properties in the course of its enterprise), there has been a change in use from wholly exempt to wholly taxable and it is arguable that VAT relief is available under section 16(3)(h) of the VAT Act. Thus, while the developer is required to account for output tax on the full consideration received by the developer on disposal of the relevant residential property, in essence, a deduction is available under section 16(3)(h) on the lesser of the original cost or market value of the property at the time the property is disposed of. This approach avoids a double charge of VAT and seems to us to be the most equitable solution going forward.

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