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SUMMARY OF THE JUDGMENT

TEMPORARY LETTING OF RESIDENTIAL DWELLINGS BY DWELLER: IF THE LETTING PERIOD ENDS AFTER 1 JANUARY 2018, HOW MUST VAT BE ACCOUNTED FOR?

SARS Binding General Ruling (VAT) 48 - 25 July 2018

In a Binding General Ruling issued on 25 July this year, SARS clarifies how developers should calculate their VAT liability where they used the section 18B relief after letting property that was intended to be sold on the open market. The window period in which the relief was available terminated on 1 January 2018. How the VAT calculation works if the letting period ends after 1 January 2018 is addressed in the Ruling.

The Ruling can be viewed here.

SUMMARY

Section 18B was inserted into the VAT Act with effect from 10 January 2012. The section addressed the following concern:

> *Developer A constructed residential dwellings for resale. He deducts the VAT incurred in the development cost (an input VAT deduction) and in turn, levies VAT on the purchase price when the residential dwelling is sold. But as a result of the ongoing downturn in the property market, he struggles to reach sale estimations, and cannot recoup his investment or anticipated profits. He decides to let the dwellings – temporarily – in order to assist cash flow. This is only partly successful, as SARS regards the temporary letting as a change of use. (The development and sale of residential properties generally form part of a vendor's VAT enterprise and are subject to VAT at 15% (14% prior to 1 April 2018); letting a residential property or sectional title unit is, on the other hand, an exempt supply. For VAT purposes, where an asset that was acquired for taxable purposes is applied, albeit temporarily, for exempt or other non-taxable purposes, the vendor must make an adjustment for the change in use, by accounting for output tax on the open market value of that asset on the date the change in use occurred. The output adjustment is intended to offset the input tax deductions the vendor was entitled to claim on the development costs while the property was developed or held for taxable purposes.)*
>
> *He must therefore make an output tax adjustment calculated by applying the tax fraction of the open market value of the property when the change of use occurs.*

The section 18B insertion in the VAT Act, effective since middle January 2012, was introduced to allow a developer in such instances to temporarily let dwellings for a period up to 36 months, without incurring the negative VAT consequence as explained above. In terms of this provision, the developer was deemed not to have made a taxable supply when the property was temporarily let, and the output tax adjustment was suspended during this period. The developer was only deemed to have made a taxable supply at open market value on the earlier date of the expiry of a 36-month period after concluding the lease, or the date when the developer permanently applied the property for a non-

taxable purpose.

Initially, the window period would operate only until 1 January 2015 but it was later extended for a further three years (to 1 January 2018).

When does the 36-month period end for VAT purposes?

In order to provide clarity on the determination of the *end* of the period for which the section 18B relief existed, SARS released this Binding General Ruling in July 2018.

- The ruling states that the 36-month period must be calculated from the date that an agreement for temporary letting was entered into for the first time in the relevant period - 10 January 2012 to 31 December 2017.
- Should the 36-month period expire after 31 December 2017, and the property was not permanently applied for non-taxable purposes (i.e. residential letting), the developer must account for the output tax in the tax period when the 36-month period expired. In other words, if a developer entered into a lease for the temporary letting of a dwelling for the first time on 31 December 2017, then the developer must account for the output tax adjustment in the tax period within which 31 December 2020 falls.
- Should any such dwellings be applied permanently for non-taxable purposes during the relief period, the developer is required to account for the output tax adjustment in the tax period in which the specific dwelling is applied permanently for non-taxable purposes.
- As section 18B expired on 31 December 2017, any such dwelling that is temporarily let from 1 January 2018 no longer qualifies for the relief previously provided under that provision.

Many have commented that the ruling is ill-timed. Developers who accounted for the change in use VAT liability when section 18B expired - on 1 January 2018 - may now have lost the opportunity to benefit from the implications of the ruling, which may last until 31 December 2020.

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