

## VAT on temporary letting of residential property by developers

Property developers develop residential property with the main purpose of selling the completed residential units in the course of making taxable supplies.

Where a property developer who is registered for VAT develops residential properties for sale, the developer is entitled to deduct the VAT incurred on the development costs as input tax and is obliged to levy VAT at the standard rate on the sale of each developed unit.

Notwithstanding a developers' intention to sell the developed property, it often happens that in adverse market conditions the developer is unable to find a buyer at the required selling price. The developer may then opt to let the property unit temporarily to generate some cash flow until such time as market conditions are more favourable and a suitable buyer can be found.

The leasing of residential fixed property is an exempt supply which would generally result in the input VAT incurred being denied. Consequently, the moment the units are let, the developer is regarded as having made a change in use of the unit for VAT purposes from a taxable application to an exempt application. VAT then becomes due and payable by the developer in terms of section 18(1) on the open market value of the unit as at the date on which the property is let.

A property developer could, for example, develop a townhouse at a cost of R1 150 000. The property developer would have been entitled to claim the VAT on the development cost, being R150 000 ( $R1\ 150\ 000 \times 15/115$ ). If the market value of the townhouse is R3 450 000 on the date that it is temporarily rented out, the property developer would have to pay output VAT of R450 000 ( $R3\ 450\ 000 \times 15/115$ ) on the change of use adjustment.

### Section 18B

Section 18B of the VAT Act was introduced with effect from 10 January 2012 which granted temporary relief to developers who were then allowed to temporarily let the residential units for a period of up to 36 months before a change in use adjustment was required. However, the temporary relief provided under section 18B ceased to apply on 1 January 2018.

Consequently, residential property developers who then, for the first time, let their properties from 1 January 2018, were once again required to perform the change in use adjustment in terms of section 18(1) on the open market value of the property when the unit was first let as a dwelling. However, the difficulties created by the section 18(1) adjustment which existed prior to the section 18B temporary relief measures remained and developers were once again faced with cash flow difficulties resulting from the disproportionate adjustment.

## The Commercial Landlord

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## Section 18D

In order to address this cash-flow inequity, a new section, Section 18D, was inserted in the VAT Act and is applicable to rental agreements entered into from 1 April 2022.

Section 18D(1) defines the term “developer” to mean a vendor who continuously or regularly constructs, extends or substantially improves fixed property or part of that fixed property consisting of any dwelling for the purpose of disposing of that fixed property after the construction, extension or improvement.

Section 18D only provides relief for the temporary supply of the letting of residential accommodation for a total period not exceeding 12 months. The proviso to the definition states that ‘temporarily applied’ does not apply to rental agreements which provide for a fixed rental period exceeding 12 months, in which case section 18D will not apply, but rather the provisions of section 18(1) will apply.

The principles contained in Section 18D ease the output tax liability of the developer by making the output tax adjustment on the adjusted cost and not on the open market value.

The term ‘adjusted cost’ is defined in section 1(1) and is essentially the VAT inclusive cost of the goods or services in respect of the development of the property.

For example, if a property developer developed a townhouse at a cost of R1 150 000 (and all the amounts were paid to registered VAT vendors), the property developer would have been entitled to claim the VAT on the development cost, being R150 000 ( $R1\ 150\ 000 \times 15/115$ ). If the market value of the townhouse was R3 450 000 on the date that the townhouse was temporarily rented out, the property developer would have to pay output VAT on the adjusted cost of R1 150 000, being R150 000 ( $R1\ 150\ 000 \times 15/115$ ). The output tax thus effectively reverses the input tax that was claimed by the developer in constructing the fixed property (input tax would have been allowed as the developer incurred expenses in the course of making taxable supplies). The input tax is reversed as the renting of residential accommodation does not entitle the vendor to any input tax deduction.

The time of supply for this change in use adjustment is the tax period in which the agreement for the letting and hiring of the accommodation comes into effect.

The subsequent use of the fixed property temporarily rented out could include that the fixed property is disposed of within the ‘temporarily applied’ 12-month period. The result would be a normal sales transaction where output VAT is levied on the selling price of the property, the normal time of supply rules with the disposal of fixed property applies and the input tax adjustment is calculated by using the adjusted cost of the fixed property. The vendor can again receive the benefit of the input tax, as the property is supplied while making taxable supplies.

Another scenario might be that the fixed property is permanently applied for the letting of residential accommodation. The resultant VAT consequences would be that a further change in use adjustment is required. Output VAT is levied on the open market value of the property on the date on which the agreement is signed that results in the 12-month period to be exceeded, or the

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decision is made to permanently change the use of the property to be applied as residential accommodation. The input tax adjustment is calculated by using the adjusted cost of the fixed property.

As alternative, the fixed property is no longer applied in supplying accommodation in a dwelling immediately after the expiry of the 'temporarily applied' period not exceeding 12 months. Therefore, the intention of the developer is subsequently changed back to disposing of the property, but the property is empty and on the market, waiting to be sold. No output VAT would be levied as there is no change in use adjustment and no actual supply of the property yet. The input tax adjustment is calculated by using the adjusted cost of the fixed property. Input tax adjustment is claimed in the period when the property is no longer temporary rented out. The input tax adjustment ensures that the vendor is again in the same position it was before the temporary renting of the fixed property that is intended to be sold, occurred.

For example, Mr X is a residential property developer who recently completed a residential development in Langenhovenpark, Bloemfontein. Due to the current market conditions, Mr X is unable to sell the residential development. The renting of residential development property is exempt from VAT. Mr X is a registered Category C VAT vendor. On 30 June 2022, Mr X entered into an agreement to temporarily rent out the property as residential accommodation for a fixed period of 12 months (1 July 2022 to 30 June 2023). The fixed property had an open market value of R2 500 000 and an adjusted cost price of R1 840 000 on the date the change in use occurred.

As a change in use of the property occurred, an output tax should be levied. The output tax should be accounted for on the date the letting and hiring of the accommodation in a dwelling comes into effect, therefore 1 July 2022. The output tax is calculated on the adjusted cost of the developer and not the open market value. An output tax of R240 000 ( $R1\,840\,000 \times 15/115$ ) should be accounted for on the VAT return submitted for the July VAT period. No VAT is levied on the rental income received as it is an exempt supply.

On 31 December 2022, therefore within the 12-month period that the fixed property is temporarily applied, Mr X received an offer from somebody to purchase the fixed property. Mr X sold the fixed property to an independent third party on 5 January 2023. The market value of the property on date of disposal was R3 105 000 and the full amount was paid in cash on date of registration of the property. The fixed property was registered in the deed's registry on 28 February 2023. The time of supply is 28 February 2023.

As the fixed property is disposed of for a consideration of R3 105 000, output tax of R405 000 ( $R3\,105\,000 \times 15/115$ ) should be accounted for. The time of supply is the date of registration of the property or when payment is received, whichever is the earlier – being 28 February 2023.

Mr X is allowed to deduct an input tax on the adjusted cost of the fixed property. Therefore, Mr X can claim an additional input tax of R240 000 ( $R1\,840\,000 \times 15/115$ ). The purpose of the additional input tax is to effectively reverse the output tax adjustment that was made when Mr X 'temporarily applied' the fixed property in supplying accommodation in a dwelling.

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# Talk Shop

by Platinum Global

## Is The Market Building Too Expensive Properties?

Just look around Bloemfontein and you will see lots going on in the development world, but nearly all of it is in the upper end of the market. Look around in the northern suburbs, Langenhoven Park, even on the small holdings. 90% of what is being built is over R1.5 million, certainly not for the man in the street and is the price of a very substantial house in many respectable suburbs in the city.

While we all understand the cost of ground and services are expensive there is a real need for higher density less expensive properties for the mass market. Vista Park is a prime example of small sites (400 sq m) selling for excellent prices on which modern properties are being built. About 20% of them are 300 sq m double storey properties. Interestingly most of them do not have gardens at all but are paved wall to wall. What is needed are more moderate homes, flats, townhouses for the bigger market. There is a big opportunity for developers in this market.

## No Rush Back To The Office

While there are a few owners of Stitle units wanting to have face to face meetings, online meetings have become the norm. It is just another indication that the demand for office space is not likely to grow soon. We can see in the market that there are large numbers of vacant and under utilized offices across the city. The demand is simply not there.

What can be done with these offices to create an income. Firstly we should remember that many of them are simply converted houses, so a possible solution is to return them to their original use as a single home or to split them into a number of small apartments. The market for such units is good at the moment and it is a realistic option, providing that the bathroom facilities are there or can be easily put in. The same can be said for small offices, especially in Westdene as most house sized units are too large for smaller businesses.

Something needs to be done because landlords cannot continue to suffer from these properties standing vacant.

## Are We Designing Right?

The one thing we can learn from History is that times change. When I started in the property industry we still used typewriters and there were no fax machines or computers!

But do our current designs take a realistic future into account. In the past we included too little parking because everyone used public transport – will that be the same in 10 years' time? What about electric cars – who is providing charging points in their design? Or is it more realistic to allow for Hydrogen powered cars? Myself I think the later as not even the first world countries can produce that amount of electricity – Eskom won't cope. In parts of the country, buses are definitely an option for many if not here. But think home schooling, work from home and you could find that there is less of a demand for cars. And less of a demand for parking or will the cost of parking be a luxury that you will have to pay the earth for? Adding storage rooms to your design would make a new scheme attractive to buyers and tenants. Currently I see lots of bikes in lounges and on stoeps. What about adding facilities to your new schemes, a gym for example, squash court, pool. Clubhouse? Large schemes could provide a creche of milk and bread shop. Makes you think!

## New Property Professionals Bill Will Have Major Effect On Sector

Everyone knows that the Estate Agency Affairs Board has been a joke and their transformation into the Property Professionals Council is not likely to change that situation very soon. But the new act adds some heavyweight changes that could affect the industry severely. Firstly, developers will not be able to sell their own units without being registered with the board. Normally developers develop in different entities from their own businesses to keep each project isolated from a financial control point of view. Only staff directly employed by the development company would be allowed to sell units for the developer. In future anyone who does any letting, selling, or management on behalf of another will need to be registered as a Property Professional Representative Council. No transfers will be able to be registered by conveyancers without a certificate confirming that the company and agent involved are registered with the board. This is coming rapidly into place and is a bit of a joke given the difficulty of registering new agents. Some companies who are not registered as estate agents will not be able to register as they lack the three year qualification to become Principals.

PLEASE NOTE THAT THE AFTERHOURS EMERGENCY TELEPHONE NUMBER REMAINS 082 881 4711.

Mike Spencer's personal number has changed to 082 082 0990 but his email address at [mike@platinumglobal.co.za](mailto:mike@platinumglobal.co.za) will remain the same.

Mike will continue to head the Residential Sales and Development segment of the business for the time being. He is always available to talk to about new developments from a sales and management point of view. Platinum Global sees itself as a leading agent to work with for new developments including the sale of units, design assistance and practical management aspects of all types of new buildings. It goes without saying that they look forward to managing all those new sectional title schemes that you are busy constructing.



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