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VAT relief for residential property developers after expiry of section 18B

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The South African Revenue Service ("**SARS**") issued Binding General Ruling No. 48 ("**BGR 48**") on 25 July 2018, which provides much needed clarification for residential property developers following the recent cessation of relief under section 18B of the Value-Added Tax Act, 1991 (the "**VAT Act**").

Background

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). In contrast, the letting of a residential property or unit is exempt from VAT.

In principle, VAT incurred by a vendor on the cost of developing residential property for sale may be claimed as an input tax deduction (subject to the normal rules governing input tax deductions). However, where an asset that has been acquired for taxable purposes is applied, albeit temporarily, for exempt or other non-taxable purposes, the vendor is required to make a "change-in-use" adjustment by accounting for output tax on the open market value of that asset on the date the change in use occurred (section 18(1) read with section 9(6) of the VAT Act). 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.

Section 18B of the VAT Act was introduced with effect from 10 January 2012. The provision provided relief to residential property developers by allowing them to temporarily let their residential units (held for sale) for a period of up to 36 months before the VAT under the change in use provisions became payable.

Initially, the relief was due to expire on 1 January 2015, but was subsequently extended to 1 January 2018 when it ceased to apply ("**the relief period**").

Practical implications

The 36-month period previously provided under section 18B ceased to exist on 1 January 2018 and was considered by many to immediately trigger the change in use provisions under section 18(1) of the VAT Act. No transitional rules existed to indicate otherwise and SARS' *VAT 409 Guide for Fixed Property and Construction* (dated 27 September 2016) indicated that "the relief [under section 18B] may continue to apply in respect of dwellings that have been temporarily let until … the relief period expires [on 1 January 2018]".

This meant that, in terms of the applicable time of supply rule in section 9(6) of the VAT Act, residential property developers had an immediate VAT liability at (the then prevailing rate of) 14% on the open market value of all unsold residential properties temporarily let out as dwellings as at 1 January 2018.

Residential property developers were advised that the output tax adjustment must be declared in their January 2018 or February 2018 VAT returns (depending on the developer's VAT return filing frequency). The related VAT payment was therefore due to SARS on or before the end of February 2018 or March 2018, as applicable.

Given the mammoth cash flow impact on the residential property industry, it has, until now, been unclear how many developers acted on this interpretation and SARS was unusually quiet on the topic.

SARS BGR 48

BGR 48 provides a general dispensation to residential property developers who temporarily let residential properties held for sale and provides that:

- developers are only required to make the section 18(1) change in use adjustment in the tax period during which the 36-month period ends, even if this period only expires after 31 December 2017 (thus notwithstanding section 9(6) of the VAT Act and the fact that section 18B no longer exists); and
- the 36-month period is calculated from the date that the temporary letting agreement was entered into for the first time from 10 January 2012 to 31 December 2017.

BGR 48 is effective from 25 July 2018 and does not apply to dwellings that are temporarily let on or after 1 January 2018. Notably, BGR 48 does not provide any guidance on how the change in the VAT rate on 1 April 2018 from 14% to 15% could affect developers' change in use calculations. In addition, BGR 48 appears to be contradictory in terms of whether the relief applies on a property-by-property or a lease-by-lease basis.

Better late than never

Although it would have been preferable if this ruling was published around the time section 18B expired, it provides much needed clarity and cash flow relief to residential property developers who temporarily let out their trading stock, particularly to those who awaited further guidance from SARS.

Unfortunately for those developers who promptly accounted for the change in use VAT liability in January 2018 when section 18B expired, there may be no opportunity to benefit from the relief now afforded by BGR 48, which may last until 31 December 2020.

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