South African Revenue Service

BINDING GENERAL RULING (VAT) 64

DATE: 21 June 2023

ACT : VALUE-ADDED TAX ACT 89 OF 1991

SECTION : SECTIONS 18D, 18(1), 16(3)(*o*), 10(29) AND 9(13)

SUBJECT : TEMPORARY APPLICATION OF NEW DWELLINGS FOR EXEMPT SUPPLIES SIMULTANEOUSLY HELD BY DEVELOPERS FOR TAXABLE PURPOSES

Preamble

For purposes of this ruling –

- **"BGR"** means a binding general ruling issued under section 89 of the Tax Administration Act 28 of 2011;
- **"OMV"** means the open market value of the property as defined in section 3;
- **"section"** means a section of the VAT Act;
- **"TA Act"** means the Tax Administration Act 28 of 2011;
- **"VAT"** means value-added tax;
- **"VAT Act"** means the Value-Added Tax Act 89 of 1991; and
- any other word or expression bears the meaning ascribed to it in the VAT Act.

All BGRs, Acts and Annexure C referred to in this BGR are available on the SARS website at **www.sars.gov.za**. Unless indicated otherwise, the latest issues of these documents should be consulted.

1. Purpose

This BGR clarifies the VAT treatment of newly built residential dwellings that have been developed and held for sale under a taxable supply by developers, but that are simultaneously temporarily applied to make exempt supplies of residential accommodation in a dwelling.

2. Background

Property developers have submitted over the years that they experience certain difficulties in complying with the VAT law when they develop residential properties for sale in difficult economic times. The difficulty arises in that there are high holding costs associated with the development, marketing and sale of properties. As a result, developers often let newly developed dwellings out as residential accommodation to cover some of the holding costs whilst the properties are marketed for sale. When this occurs, section 18(1) will be triggered at the time that any property is applied to make exempt supplies as contemplated in section 12(*c*) (albeit temporarily). As a result, the developer will be required to declare output tax on the OMV of the property at the time of such change in application.

In order to provide some relief in this regard, the VAT Act was amended with effect from 10 January 2012 by the insertion of a relief provision in the form of section 18B. Under section 18B, the liability of the developer to declare output tax on the change in use adjustment that would have otherwise been required under section 18(1) was suspended for a maximum period of 36 months. Under section 18B(3), the developer would only have to declare output tax at a later date, being the earlier of the date that the temporary letting period had been exceeded, or the property was permanently applied for a non-taxable purpose. Developers that experienced such difficulties were previously allowed to temporarily let the affected properties for a period of up to 36 months during the relief period that commenced on 10 January 2012 and ceased to apply on 1 January 2018.[1]

Section 18B was a temporary measure with a limited lifespan, but a more permanent relief mechanism in the form of section 18D (together with associated provisions, being sections 9(13), 10(29) and 16(3)(*o*)) has now been introduced with effect from 1 April 2022 to deal with temporary letting by developers.[2] Whilst there are some similarities between section 18B and section 18D, there are also some important differences.

For example –

- the term "developer" was defined in both sections 18B and 18D, but "temporarily applied" has only been defined in section 18D;
- the temporary letting period has been reduced from a maximum of 36 months in section 18B, to a maximum of 12 months under section 18D;
- section 18D requires that the adjustment is made at the time the property is temporarily applied for letting, instead of only at the end of the relief period as was the case under section 18B; and
- the consideration used for calculating the required output tax adjustment under section 18D is an amount equal to the adjusted cost to the vendor of the construction, extension or improvement to the fixed property[3] rather than the OMV of the entire fixed property concerned as would have been the case under section 18B.

3. Discussion

Section 18D applies to any newly developed units of fixed property that are "temporarily applied" for exempt supplies as contemplated in section 12(*c*) for the first time on or after 1 April 2022. Section 18D(1) defines the terms "developer" and "temporarily applied" for the purposes of section 18D.

The definition of "developer" as defined in section 18D(1)(*a*) is a replication of the definition that was previously in section 18B(1) and refers to a person who develops fixed property for sale in the course or furtherance of an enterprise.

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1 See BGR 48 "The Temporary Letting of Dwellings by Developers and the Expiry of Section 18B" and BGR 55 "Sale of Dwellings by Fixed Property Developers following a Change in Use Adjustment under Section 18(1) or 18B(3)".

2 See the Taxation Laws Amendment Act, 2021 as per *GG* 45787 of 19 January 2022 and the Taxation Laws Amendment Act, 2022 as per *GG* 47826 of 5 January 2023.

3 It has been proposed that the valuation rule in section 10(29) should be clarified. (See ANNEXURE C: ADDITIONAL TAX POLICY AND ADMINISTRATIVE ADJUSTMENTS – 2023 Budget Review – pages149 and 150.)

The term “temporarily applied” as defined in section 18D(1)(*b*) refers, in short, to any leasing of newly developed dwelling units by the developer for use as residential accommodation for a period of 12 months or less whilst the property continues to be marketed for sale. The term “temporarily applied” is interpreted to mean a fixed period of 12 months or less or shorter periods that, in aggregate, do not exceed 12 months in respect of each unit of property concerned. It is also considered that a monthly lease for an unspecified period also falls within the meaning of “temporarily applied” but only for a maximum period of 12 months. Should that monthly lease continue beyond 12 months, it means that the developer would have exhausted the relief under section 18D for that particular property and must accordingly make an output tax adjustment on the OMV of that property as required under section 18(1). In the case of a fixed period lease exceeding 12 months from the beginning, section 18D will not apply at all. Instead, the relevant adjustment under section 18(1) must be made on the OMV of the property at the time the property is applied for exempt supplies.[4]

It follows that, only when the supplier is a “developer” and the property concerned is “temporarily applied” as defined in section 18(1)(*b*) for residential accommodation for a period of 12 months or less, can the dispensation under section 18D apply. In all other cases, the change in application from taxable supplies (sale of dwellings by a developer) to exempt supplies (supply of residential accommodation in a dwelling), section 18(1) will apply. The output tax adjustment based on the OMV under section 18(1) will also apply for any temporary letting of dwellings by developers that occurs between 1 January 2018 and 31 March 2022, which is the period between the date that section 18B ceased to apply and the date that section 18D came into effect.

Section 18D(2) requires that, as soon as the property has been temporarily applied for exempt supplies, the developer must make an output tax adjustment based on the “adjusted cost”[5] of the construction, extension or improvement to the fixed property.[6] No output tax will be payable on the rentals as they constitute consideration paid or payable in respect of exempt supplies.

If a property is sold during the 12-month period that it is temporarily applied for exempt supplies, that supply will remain a taxable supply under section 7(1)(*a*). The developer will be able to claw back as an input tax adjustment under section 16(3)(*o*), the same amount that was previously declared as output tax under section 18D(2) on the adjusted cost of the construction, extension or improvement to the fixed property when the unit was first temporarily applied for exempt supplies. The adjustment may be made in the same tax period as the time of supply for the property under section 9(3)(*d*). Similarly, an input tax adjustment under section 16(3)(*o*) will become available to a developer if there is any permanent change in intention or application of a dwelling that requires an adjustment to be made on the OMV of the property under section 18(1) during the 12-month period that the property is being temporarily applied

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4 As such, there will never be a situation in which section 18D(5)(*c*) applies. (See ANNEXURE C: ADDITIONAL TAX POLICY AND ADMINISTRATIVE ADJUSTMENTS – 2023 Budget Review – pages149 and 150 in which it is proposed that section 18D(5)(*c*) be deleted.)

5 The “adjusted cost” is defined in section 1(1). In short, it refers to the cost incurred by a vendor to acquire any goods or services either under a taxable supply, or a non-taxable supply, but in either case, if that vendor is, or may be entitled to claim an input tax deduction on such acquisitions.

6 See section 10(29). The adjustment is based on the “adjusted cost” of the construction, extension or improvement to the fixed property and does not include the adjusted cost of acquisition of the property itself. See also footnote 3 regarding the proposal to clarify this valuation rule. At issue is whether the term “adjusted cost” contemplated in section 10(29) also includes the cost of the land. If the valuation rule is amended, it is likely to apply only from a future date.

for exempt supplies. The adjustment may be made in the same tax period as the time of supply for the change in use under section 18(1).

When the temporary letting ceases altogether within the 12-month period allowed under section 18D, the developer will also be entitled at that time to claw back under section 16(3)(*o*), the output tax that was previously declared under section 18D(2).[7] However, the developer must, in that case, have proper and convincing documentary proof that the temporary letting has in fact ceased completely during the 12-month period allowed under section 18D. Any subsequent sale of the dwelling will be a taxable supply under section 7(1)(*a*) read with section 9(3)(*d*).

A developer must declare output tax under section 18(1) on the OMV of any dwelling units that remain unsold if the property continues to be let for a period exceeding 12 months in aggregate after it was first temporarily applied for exempt supplies. The adjustment must be made in the tax period covering the first day of the 13th month of letting.[8] However, in this case, the developer will also be able to claw back an input tax deduction under section 16(3)(*o*) as explained above. Any subsequent sale of the affected properties after the tax period in which the section 18(1) adjustment was required to be made, will not be regarded as taxable supplies. Instead, the purchasers will be liable to pay transfer duty on the transactions concerned.

4. Ruling

This ruling constitutes a BGR issued under section 89 of the TA Act insofar as it relates to the rulings under **4.1** to **4.5**.

4.1 Adjustment for dwellings temporary applied for exempt supplies

A developer that temporarily applies any dwellings for exempt supplies under section 12(*c*) must make an output tax adjustment under section 18D(2) based on the adjusted cost of the construction, extension or improvement to the fixed property as contemplated in section 10(29). Under section 9(13) the time of supply for the adjustment is the date that the agreement for the letting and hiring of the accommodation in a dwelling comes into effect.[9]

4.2 Sale of dwellings whilst being temporarily applied for exempt supplies

The sale of any dwelling referred to in **4.1** during the 12-month period in which it was temporarily applied for exempt supplies under section 12(*c*) will be a taxable supply as contemplated in section 7(1)(*a*). The consideration for the supply will be the amount paid or payable for the property, or the OMV of said property, as determined in accordance with section 10(2).[10] The time of supply rule for fixed property under section 9(3)(*d*) will be applicable.

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7 See section 18D(5)(*b*).

8 See, however, footnote 10 concerning a situation that involves multiple lettings.

9 This is the date on which the lease term commences (or is extended in the case of multiple leasing events) and not the date that the lease agreement or extension is signed.

10 Section 10(2) applies unless otherwise provided in section 10. For example, if the transacting parties are “connected persons” as defined in section 1(1), then the special value of supply rule under section 10(4) may be applicable in certain situations.

4.3 Adjustment after expiry of the prescribed 12-month period

A developer will be required to make an output tax adjustment based on the OMV of the property under section 18(1) read with section 10(7) if any dwelling referred to in **4.1** is let for a period in aggregate of more than 12 months. The time of supply under section 9(6) is the day immediately after the 12-month period referred to in the definition of "temporarily applied" in section 18D(1)(*b*) has been exceeded.[11] The subsequent sale of such a property will not be a taxable supply under section 7(1)(*a*), but instead, the purchaser will be required to pay transfer duty.

4.4 Claw-back deduction under section 16(3)(o)

Under section 18D(5), the developer in the situations described in **4.2** and **4.3** above will be entitled to claw back the output tax previously declared pursuant to section 18D(2) by way of a deduction under section 16(3)(*o*). The deduction will therefore only apply if the developer has previously been required to declare output tax as contemplated in section 18D(2). The deduction is calculated by applying the tax fraction to the adjusted cost of the construction, extension or improvement to the fixed property and may be made in the same tax period within which the time of supply of the sale of the fixed property falls or the adjustment under section 18(1) occurs – as the case may be.

The claw-back deduction under section 16(3)(*o*) is also allowed to the developer if the temporary application of the property for exempt supplies ceases completely within a period of 12 months. The subsequent sale of such a property will be a taxable supply under section 7(1)(*a*).

No deduction is allowed under section 16(3)(*o*) in the case of a situation described in section 18D(5)(*c*). The reason is that the situation referred to in section 18D(5)(*c*) cannot find application as it is excluded from the definition of "temporarily applied" by way of the proviso to section 18D(1)(*b*). Consequently, there could never have been any output tax previously declared under section 18D(2) to recover under section 16(3)(*o*).

4.5 Effective date and scope of application

Section 18D applies only to any newly developed units of fixed property that are "temporarily applied" for exempt supplies as contemplated in section 12(*c*) for the first time on or after 1 April 2022.

Section 18D does not apply to –

- any property which is the subject of a fixed period lease exceeding 12 months as contemplated in the proviso to the definition of "temporarily applied" in section 18D(1)(*b*);
- any temporary letting of dwellings by developers that were previously subject to the provisions of section 18B; or

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[11] In a case of multiple temporary letting periods, the adjustment must be made at the commencement of the final leasing period that will cause the aggregate 12-month period to be exceeded and not at the end of an aggregate period of 12 months or at the end of the final lease period. For example, if the first temporary letting period under a lease is for six months and thereafter a further lease for eight months is concluded with another tenant, the output tax adjustment must be made at the beginning of the second lease period.

- any temporary letting of dwellings by developers between 1 January 2018 and 31 March 2022.

5. Period for which this ruling is valid

This BGR applies from the date of issue until it is withdrawn, amended or the relevant legislation is amended.

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