THE EFFECT OF VALUE-ADDED TAX ON SMALL TO MEDIUM-SIZED DEVELOPERS OF RESIDENTIAL PROPERTIES IN SOUTH AFRICA

by

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This dissertation deals with the effect of value-added tax on small to medium-sized developers of residential properties in South Africa.

Firstly, the way value-added tax is applied to residential properties in South Africa was established. It was ascertained that no special concessions exist with regard to housing.

Secondly, the application of value-added tax to residential properties in the United Kingdom was discussed. It was ascertained that supplies relating to new residential premises are zero-rated.

Thirdly, the application of goods and services tax to residential properties in Canada was discussed. Canadian goods and services tax and harmonious sales tax legislation contains a broad range of special concessions relating to residential property developments. The harmonious sales tax which applies in some provinces, is a combination of goods and services tax and a provincial sales tax.

Fourthly, the way goods and services tax is applied to residential property developments in Australia was determined. Australian legislation provides for a margin scheme to be applied to the development of residential properties. In terms of the margin scheme, goods and services tax is payable on the basis of profit rather than turnover.
Transfer duty as applied in South Africa was examined as an alternative to the value-added tax being applied on residential properties developed by developers registered for value-added tax purposes.

The legislation with regard to developers of residential properties registered for value-added tax, goods and services tax and harmonious sales tax purposes was measured against the principles of taxation. On the basis of these results, an alternative to the current application of value-added tax relating to developers registered for value-added tax purposes in South Africa was proposed that would be in line with that of the selected countries.
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CHAPTER 1

INTRODUCTION

1.1 TITLE

The effect of value-added tax on small to medium-sized developers of residential properties in South Africa

1.2 DEFINITION OF THE PROBLEM

Prior to the implementation of value-added tax (VAT) in South Africa, members of the construction industry expressed fears that the introduction of VAT would result in sharp cost increases (Gunning 1991:42; Botha 1990:16). These increases were put at between 4% and 7%, depending on whether the land was supplied by the contractor or not (South Africa 1991).

The above-mentioned proposed implementation of VAT and the resulting cost increases must be seen against the background of rising interest rates and dramatic increases in building costs (Financial Mail 1988:79).

In 1991 from a sales point of view, income of potential buyers had hardly kept up with inflation (Snyman 1992:79). No cost increases could therefore be passed on to the consumer, but they would have to be absorbed by the developers, who were already functioning in a hard-pressed industry (Financial Mail 1988:79).
Subsequent to the implementation of VAT, the increase in VAT from 10% to 14% in 1993 raised further concerns.

According to NBS Devco MD David Govern, the increase in VAT from 10% to 14% in 1993 came at a time when most developers were not able to absorb further construction cost increases. According to him, in 33 years of trading, the margins in the property development industry had never been as low as they were at that time (Financial Mail 1993:79).

Samuel Seef, MD of Seef Residential Properties, stated that the increase in VAT would have an "absolutely disastrous effect on new residential developments where VAT applies" (Preece 1993:3).

It is a known fact that there is a relationship between the prices of new and existing residential properties (Snyman 1992:20). This is because prospective homeowners have a choice between buying an existing home and building a new home (Snyman 1992:21).

The registered developer is therefore left in more of a predicament as he has to compete with existing residential properties that are exempt from VAT, but subject to transfer duty (Van den Berg 1991:629).

According to examples given in an article dealing with the differences between VAT and transfer duty, it is claimed that the VAT component exceeds the transfer duty by between 150% and 1300%, depending on the price of the residential property (Delport 1993:36).
The question which now arises is whether there is an alternative to the current application of VAT that will ensure the financial survival of the small to medium-sized developer of residential properties in South Africa and place him in a competitive position vis-à-vis sellers of existing houses and incidental developers.

1.3 OBJECTIVES

The primary objective of this study is to critically evaluate current VAT legislation and practices relating to small to medium-sized developers of residential properties in South Africa with a view to determining shortcomings and making recommendations for possible improvements.

This study aims to examine in detail the application of VAT and its effect on the various development scenarios.

In order to determine possible solutions or alternatives to shortcomings revealed by the South African study, a literature study will be done on the application of VAT to residential properties in the United Kingdom, Canada and Australia. The basis for this study will be the same as that for the South African study. Amendments to the VAT and GST Acts up to the following dates have been taken into account:

- South Africa: 30 September 2001
- United Kingdom: 1 July 2001
- Canada: 30 June 2000
- Australia: 1 July 2000

The application of transfer duty will also be examined as an alternative to VAT, in an attempt to place the developer of
new properties registered for VAT purposes in the same position as sellers of existing houses and developers not registered (incidental) for VAT purposes.

This research is necessary in the South African context, given the sociopolitical importance of housing, especially affordable housing (Report of the VATCOM). In the current socioeconomic climate, it is of prime importance to support industries like the building industry that employ a large workforce.

In South Africa, it is mainly the individual that bears a heavy tax burden with regard to either VAT or transfer duty (Franzsen 1993:1071). This because the individual is not in a position to deduct the VAT or transfer duty paid for tax purposes or shift the tax liability to the taxpayers in general (Franzsen 1993: 1071). Bearing in mind that the purchase of a house is the biggest investment made by most individuals in their lifetime, this heavy tax burden in respect of VAT or transfer duty very often contributes to making housing unaffordable to the man in the street.

1.4 RESEARCH DESIGN

This research proposes to:
- examine current South African legislation and practices with regard to VAT on residential properties applicable to both developers registered for VAT purposes and developers not registered for VAT purposes
- examine current legislation and literature dealing with VAT in the United Kingdom, Canada and Australia
determine similarities and differences in the VAT systems applied in South Africa and the selected countries in an attempt to find possible solutions to shortcomings in the South African VAT system relating to developers of residential properties.

- evaluate the current situation, draw certain conclusions and make recommendations from this study.

In the discussion of the VAT and GST Acts of the various countries, definitions are discussed. These definitions are a summary of the meaning of the definitions, as the definitions stated in some of the acts are very long and complicated.

1.5 EXCHANGE RATES

The following are the exchange rates of the countries dealt with in this study as at 30 November 2001:

- United Kingdom £1 = R13,2362
- Canada C$1 = R5,8262
- Australia A$1 = R4,6566

The current exchange rates have not been applied in the examples used to illustrate this study.

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CHAPTER 2

THE NATURE, ORIGIN AND DEVELOPMENT OF VALUE-ADDED TAX

2.1 INTRODUCTION

Before the VAT implications relating specifically to the small to medium-sized developers of residential properties in South Africa can be considered, information relating to the general background of VAT is imperative.

This chapter deals with this background, namely, the principles that are important to any tax system, the nature of VAT, and where it fits into the tax system. The origin of VAT and its subsequent development are also briefly discussed.

2.2 PRINCIPLES OF TAXATION

The principles of taxation are the basic criteria against which any tax system should be measured to determine if it is a "good" tax system (Woellner, Vella & Chippindale 1990:27).

When the principles of taxation are mentioned, the famous four canons of Adam Smith come to mind, namely equality or ability, certainty, convenience, and economy (Stamp 1936:3).

According to Stamp (1936:3), these principles were "progenitors of thought." In our complex modern world, we cannot, however, claim to find the whole "duty of man and the State" (Stamp 1936:3) in them. These principles should be
elaborated upon and analysed in greater detail so that they are relevant to the circumstances we are faced with today. A brief discussion of the principles of taxation that are relevant to modern times is given in the following sections.

2.2.1 Simplicity and certainty

A tax system should firstly be simple enough to allow the majority of citizens to understand its basic elements. Secondly, it should be "simple to operate", resulting in reasonable costs in relation to the tax collected. These costs are twofold, namely "administrative costs" that are borne by the authorities, and "compliance costs" borne by the taxpayer. The "compliance costs" include the reading of relevant booklets with instructions for the completion of the forms, the completion of the forms and the cost of obtaining professional help or advice (Lewis 1982:9).

The VAT system introduced in South Africa aims to comply with the principle of simplicity by using a single VAT rate, keeping the exemptions to a minimum and aiming to apply the tax to a very broad base of goods and services. It is believed that all these factors will contribute to keeping the compliance costs to a minimum (Report of the VATCOM 1991:7).

Certainty dictates that a taxpayer should be able to calculate his tax liability in advance with reasonable accuracy (Lewis 1982:11). Certainty is linked to the principle of simplicity (Woellner, Vella & Chippindale 1990:32).
2.2.2 Equity or fairness

Equity or fairness means that every taxpayer should contribute his "fair share". There is, however, no agreement on the definition of "fair share" (Rebhun 1982:27).

Rebhun (1982:27) identifies two approaches to equity, namely the benefit approach and the ability-to-pay approach. In terms of the benefit approach, originally advocated by Adam Smith, every taxpayer pays tax according to the benefits that he enjoys. In contrast to this, the ability-to-pay approach only focuses on the means of the taxpayer. This has been the approach that has been favoured in the twentieth century (Rebhun 1982:27).

Lewis (1982:10) identifies horizontal equity as the "equal treatment of taxpayers with similar taxable capacities". Vertical equity on the other hand implies that taxpayers with different taxable incomes should bear different tax burdens.

The question whether VAT complies with the principle of equity or fairness is a very contentious issue. One line of reasoning in evaluating whether VAT is equitable or fair is to determine whether a constant ratio exists between the tax load and the expenditure. VAT appears to comply with this approach (Report of the VATCOM 1991:5). This in fact boils down to the benefit approach (see paragraph 2.2.2).

Another line of reasoning states that where the burden of VAT falls determines if it is an "equitable and progressive" tax or an "inequitable and regressive" tax. Where the burden of
VAT is borne mainly by the entrepreneur, thereby resulting in a minimal or no increase in the price of goods and services. VAT is deemed to be an "equitable and progressive" tax. However, where the burden of VAT is passed on to the consumer, resulting in increased prices, VAT is deemed to be an "unequitable and regressive" tax (Rebhun 1982:27-28).

Yet another line of reasoning states that VAT has a greater effect on low income households, as the ratio of consumption to income drops as the scale of income increases (Report of the VATCOM 1991:5). The exemption of basic foods and necessities in an attempt to rectify this imbalance is an inefficient way of dealing with the problem and is condemned by most VAT experts worldwide. It is generally believed that methods outside the tax system should be used to alleviate the needs of the poor (Report of the VATCOM 1991:6).

Rebhun (1984:28) believes, however, that a multiple-rate system could be used by the authorities to change VAT into an "equitable and progressive" tax. This author states that reduced, standard and luxury rates could be used, where basic necessities are taxed at the reduced rate and luxurious goods and services at the luxury rate. Any other goods and services would be taxed at the standard rate. The Report of the VATCOM (1991:4) mentions that, for this very reason, many VAT systems have multiple rates. It also states that multiple-rate VAT systems are "acknowledged" to be inefficient and result in a "significant" increase in compliance costs.

It should be borne in mind, however, that the VAT system should not be looked at in isolation. The progressive income tax system in use in South Africa plays an important role in
the redistribution of income, thereby contributing to equity and fairness as a whole (Report of the VATCOM 1991:6).

2.2.3 Efficiency and neutrality

Neutrality in a tax system is indicated when "decisions are not influenced by tax factors" (Rebhun 1982:30).

Rebhun (1982:30) presents certain guidelines that should be followed in evaluating whether the tax meets the principle of neutrality. These guidelines are that the tax:
- should be levied equally on enterprises, irrespective of whether they are profitable or non-profitable
- does not show bias between businesses irrespective of whether they are using debt or equity financing
- does not benefit integrated producers over small entrepreneurs and speciality industries
- is not affected by the form of business used, for example a company, partnership or sole proprietorship
- deals with capital-intensive or labour-intensive industries in the same manner

According to Rebhun (1982:30), the neutrality of a tax can only be determined in relation to another tax. The neutrality of VAT will be determined in relation to the South African General Sales Tax (GST) which was replaced by VAT.

Under the GST system, many services and basic foodstuffs were not subject to GST. This distorted consumer preferences and therefore affected neutrality. On the other hand, the VAT system is based on making a broad range of goods and services
subject to VAT, so that the influence on consumer preferences is smaller, resulting in greater neutrality (Report of the VATCOM 1991:5).

Indirect taxes should be neutral with regard to the production and distribution routes used. As the GST system taxed business inputs, the amount of GST paid would have depended on the production and distribution chain used and would therefore not have satisfied the requirements of the neutrality principle. As VAT allows credit for taxes paid in previous stages, the production and distribution route should generally not have a major effect on the VAT payable, so that the test of neutrality is met (Report of the VATCOM 1991:5).

2.2.4 Flexibility

Flexibility in a tax system is considered to have been accomplished when both the tax structure and the rates can be changed without this giving rise to delays or problems. The reasoning behind this is that any change should have an immediate effect on the income earned by the state or alternatively cause an immediate change in the behaviour of taxpayers (Woellner, Vella & Chippindale 1990:33).

As the rates of sales taxes or VAT can easily be changed, resulting in immediate price changes and consequent changes in the behaviour of taxpayers, these taxes are deemed to be very flexible (Woellner, Vella & Chippindale 1990:33).
2.2.5 Evidence

Evidence is the extent to which taxpayers are knowledgeable about the amount of tax that they are liable for (Woellner, Vella & Chippindale 1990:33).

Taxes based on sales tend to have a lower evidence than direct taxes, as in most systems they are included in the total selling price and are not shown separately (Woellner, Vella & Chippindale 1990:33).

2.2.6 Fiscal adequacy

Woellner, Vella and Chippindale (1990:34) describe fiscal adequacy as the condition where "the tax should generate the requisite amount of revenue needed by the government".

VAT meets the principle of fiscal adequacy because the main argument advanced in favour of VAT is that it is an effective way of raising "large and buoyant revenue" for the government (Report of the VATCOM 1991:2).

2.2.7 Political acceptability

Political acceptability implies that the tax should not give rise to political difficulties in the relevant country or within other tax jurisdictions (Woellner, Vella & Chippindale 1990:34).
VAT, as an indirect consumption based tax, is perceived as being accepted more readily than direct taxes by both the public and politicians (McManus 1990:5).

2.2.8 Suitability for achieving macro-level objectives

Taxation should promote the economic macro-level objectives of the government, such as the reduction in unemployment levels, lowering of inflation, or the optimisation of economic stability and growth (Woellner, Vella & Chippindale 1990:34).

2.3 VAT A DIRECT OR INDIRECT TAX?

Any taxes payable can be classified into direct or indirect taxes, but the distinction is often difficult to make (Due 1988:19).

A direct tax is collected directly from the person who is required to bear the tax burden, which in effect results in a reduction of actual income. Examples of direct taxes are income tax, wealth and property tax and poll tax (Due 1988:19).

Indirect taxes on the other hand are collected by persons other than those required to bear the burden of the tax (Due 1988:19). VAT fits neatly into the classification of an indirect tax as the person bearing the tax is not directly assessed by the Revenue authorities, but is indirectly assessed as he enters into transactions (Ernst & Young 2001:1).
Depending on the method of collection, indirect taxes can be split into two main categories, namely,
- Single stage taxes which may be imposed on sales at any stage from the manufacture of the goods to their retail sale. Manufacturer's sales tax is imposed on sales from the manufacturer to the wholesaler. Wholesale sales tax is imposed on sales from the wholesaler to the retailer and retail sales tax on sales from the retailer to the consumer.
- Multi-stage taxes which are imposed at each stage of the production and distribution chain when goods or services are supplied (Report of the VATCOM 1991:2).

Multi-stage taxes can be non-cumulative or value-added, thus allowing credit for taxes paid in previous stages, or they can be cumulative or cascading, thereby not allowing credit for taxes paid previously (Third Report of the Commission on Taxation 1984:40-41).

2.4 CONCEPT OF VAT

VAT is the tax charge that an enterprise is liable to collect on behalf of the relevant revenue authorities on the value that it has added in the course of selling its goods or services. The value that is added is determined by taking the sales value of goods or services rendered and deducting all amounts incurred on the acquisition of the goods or services from third parties. The value that is added usually represents salaries and wages, financing costs and profit (Third Report of the Commission on Taxation 1984:51).
VAT therefore aims to tax only the value that is added at each stage, and not the total turnover. In the detailed operation of the tax, VAT on the full turnover is charged at every stage, but a credit is allowed against this, for all VAT paid on the purchase of goods and services (Third Report of the Commission on Taxation 1984:51). The VAT charged on the full turnover is called output tax, whereas the VAT paid on the purchase of goods is called input tax (Ernst & Young 2001:1).

According to James (1991:1), VAT is an indirect tax that is applied to the consumption of a wide range of goods and services. It is a multi-stage tax, in that it is imposed at all stages of a production and distribution chain. VAT is a non-cumulative tax as a credit will be allowed for tax paid at earlier stages of the production or distribution of the goods and services.

2.5 VAT SYSTEMS, METHODS AND BASES

2.5.1 Types of VAT systems

In an economy, the value added can be calculated in three different ways, namely on the gross national product, on the net national product or on consumption. Most VAT systems apply the consumption type of VAT. These three types of VAT will be looked at briefly below.

Under the gross national product type of VAT, the value that is added is based on capital and consumer goods and is charged at every stage of the production and distribution
process (Third Report of the Commission on Taxation 1984:51). The result of this is that capital of enterprises is taxed, resulting in cascading (Report of the VATCOM 1991:3).

In terms of the net national product type of VAT, capital is written off over the useful life of the capital goods acquired (Report of the VATCOM 1991:3). The VAT would therefore be based on the gross receipts less intermediate goods purchased and depreciation (Third Report of the Commission on Taxation 1984:52).

The consumption type of VAT allows capital goods to be deducted from the gross national product. The VAT is therefore based on the gross receipts from the sale of goods or the rendering of services, less all purchases of intermediate goods as well as capital expenditure (Third Report of the Commission on Taxation 1984:52). The advantage of this system is that no cascading of tax occurs (Report of the VATCOM 1991:3).

2.5.2 Methods of accounting for VAT

Two methods of accounting for VAT are used, namely the invoice and the payments basis. In terms of the invoice basis, input tax is claimed when a tax invoice is received from a supplier. Output tax is payable at the earlier of having issued an invoice or having received payment from customers (James 1991:45).
According to the payments basis of accounting for VAT, input tax is claimed when payments are made to suppliers and output tax is payable when payments are received from customers (James 1991:45).

2.5.3 Bases for VAT

VAT can either be origin-based or destination-based. Where VAT is origin-based, VAT is charged in the country of origin, irrespective of where the goods or services are consumed. Imports are exempted from VAT, and VAT is charged on exports (Report of the VATCOM 1991:2).

Destination-based VAT charges VAT on goods and services where they are consumed, irrespective of where they have been produced. Imports are taxed when imported to the country where they will be consumed, and exports are exempt from VAT (Report of the VATCOM 1991:2).

The charging of VAT on exports renders the products exported less competitive, especially if one bears in mind that most countries apply destination-based VAT and will subject the goods to further VAT upon importation (Report of the VATCOM 1991:2).

In South Africa, a destination-based VAT is used, as was stated in paragraph 3.5.3 of chapter 3.
2.6 ORIGIN AND DEVELOPMENT OF VAT

VAT developed from turnover taxes (see paragraph 2.6.2). The origin and development of turnover taxes will therefore firstly be discussed, and this will be followed by a brief discussion of the origin and development of VAT. The development of the general sales tax and VAT in South Africa will then be discussed briefly.

2.6.1 Origin and development of turnover taxes

Ancient civilisations and particularly the ancient Romans had a very different way of regarding taxation from that of modern times. Direct taxation of Roman citizens was regarded as "humiliating and undignified". It therefore followed that they relied very heavily on indirect taxation. Even this indirect taxation was not aimed at Roman citizens, but rather at their subjects living in the provinces (Coffield 1970:3).

From 242 BC, inhabitants of the provinces outside Italy such as Asia, Africa, Macedonia and Sicily retained possession of their land, but had to pay a certain proportion of the produce to the Roman state. This amount payable to the Roman state was called decumae or tenths and could be regarded as an early form of turnover tax (Coffield 1970:8).

Another source states that in about the same period dealt with in the previous paragraph, namely the Ptolemaic period, a tax was payable on the sale of washing soda (Wallace 1938:224). The Ptolemaic period refers to a period from
323 BC to 30 BC. Ptolemy was the name taken by numerous Greek kings who ruled Egypt during this period, the first one being Ptolemy I. Ptolemy I was a Macedonian general in the army of Alexander the Great. When Alexander died in 323 BC, his empire was divided and Ptolemy I received Egypt (Cayne 1969:358).

The Egyptians never accepted the Ptolemies and uprisings were a regular occurrence. Inefficient Ptolemaic rulers, the last of which was Cleopatra VII, strengthened Roman domination. Cleopatra VII tried to maintain her throne by recruiting first Julius Caesar and later Mark Antony. Despite these measures, Egypt was incorporated into the Roman Empire when Octavian (later known as the Roman emperor Augustus) gained victory in battle over Mark Antony (Cayne 1969:359).

Augustus ruled the Roman empire from 27 BC to 14 AD (Cayne 1969:137). Even at this early stage of civilisation, a general purchase tax, the *centesima rerum venalium* was initiated by Augustus to gratify his veterans (Schmölders 1966:IV-7). According to Coffield (1970:26), the *centesima rerum venalium* was a tax on the proceeds of public auctions. As public auctions were a regular occurrence in the early Roman Empire, this sheds light on why Schmölders calls the *centesima rerum venalium* a general purchase tax. The proceeds of this tax were for the benefit of the war pension fund (Coffield 1970:26).

Not long afterwards, Nero ruled the Roman empire from 54 AD to 68 AD (Cayne 1969:137). When Nero changed the four per
cent tax previously paid on the slave trade to a duty paid by the seller, he was in fact changing a direct tax on expenditure to an indirect turnover tax (Schmölders 1966: IV-7).

More information has been found with regard to a sales tax in the Roman period. According to Wallace (1938:224-225), evidence exists that a sales tax was paid by the importers at the market at the Serapeum in Oxyrhynchus on the sale of oil, dates, cucumbers, pumpkins and vegetables. A tax was also levied on the sale of beans, condiments and salt. The author believes that the sales tax mentioned was not limited to that specific market but was most likely also used elsewhere in Egypt.

Prior to indications that turnover taxes were introduced in the Ptolemaic and Roman periods, experts in turnover taxes accepted the theory advocated by A Smith that the Spanish alcabala was the forerunner of turnover taxes. The Spanish alcabala was a broadly-based general excise duty (Schmölders 1966:IV-31) that was introduced in the fourteenth century (Due 1988:21). Throughout the Middle ages, the "turnover tax ... dominates the taxation struggles" not only in Spain, but also in France, Germany and Italy (Schmölders 1966:IV-8).

The turnover tax then gave way to early forms of tax on earnings and property only to reappear in the 19th century, firstly in Bremen and then in the USA. It was, however, during the First World War and especially in the period that followed that it prospered. This was due to the fact that
the First World War had resulted in most countries being under severe financial pressure. Turnover taxes appeared to be the answer to this problem. This was the beginning of the advancement of turnover taxes in the tax systems of Europe with France appearing to be in the lead (Schmölders 1966: IV-8).

Turnover tax gained ground in France in 1917, when a luxury tax was introduced as part of the French stamp duty system. In 1918 and 1919, the German Warenumsatzstempel (goods turnover stamp) of 1916 was transformed into a general turnover tax by which all goods supplied and all services rendered were taxable (Schmölders 1966:IV-8).

Around approximately the same time when the turnover tax was being implemented in Germany, turnover tax was implemented in Italy in 1919 and in Belgium in 1921 (Schmölders 1966:IV-8).

In 1920, in between the two above dates, France introduced a general turnover tax which evolved from the French luxury tax, but was influenced by the German all-stage tax. Soon after the implementation of the general turnover tax, the French legislators found, however, that this cumulative tax was increasing the cost of living and was benefiting large multistage firms at the expense of small firms (Schmölders 1966:IV-17-18). This led to a single-stage manufacturer's tax being implemented in 1936. In 1939, a cumulative transactions tax was linked to the manufacturer's tax, and in 1941 an additional tax supplemented the above-mentioned taxes. In addition to this, the rates of the manufacturer's tax were also raised constantly to meet increasing financial needs. After 1948, the single-stage manufacturer's tax was
changed to a multi-stage manufacturer's tax. The replacement tax also differed from the single-stage tax in that it was non-cumulative, resulting in tax paid on goods purchased being deductible (Schmölders 1966:IV-18). The introduction of VAT in France followed in 1954/55 (see paragraph 2.6.2). While France was going through the various stages of turnover taxes discussed in the previous paragraph, other countries were also looking to turnover taxes as additional sources of revenue, the USA and the USSR were among these countries. In 1929, many states in the USA were left no choice but to adopt a system of turnover taxes in order to avert a financial crisis (Schmölders 1966:IV-8).

Shortly afterwards, in 1930, turnover tax was introduced in the USSR in the "big financial reform as an instrument of overall production planning and economic control in the Soviet rearmament and war economy" (Schmölders 1966:IV-8).

In the same year, Australia implemented a wholesale sales tax (WST), the main concepts of which remained unchanged until recently (Somers 1995:627).

During the Second World War, turnover taxes flourished in countries like Great Britain, Switzerland and Sweden, all of which had previously successfully resisted them. Great Britain implemented turnover taxes in 1940 and Switzerland and Sweden followed the year after (Schmölders 1966:IV-8).

When first introduced, turnover tax appeared, according to Schmölders (1966:IV-14), to be a "crisis tax, the true war
and postwar tax". He now believes that this argument can no longer be advanced as this system has now developed into a "planned financial system".

2.6.2 Origin and development of VAT

The principle of taxing the value added at every stage of the production and distribution channel originated in Western Europe. In 1921, the German industrialist and financier, Carl Frederich von Siemens, proposed a value-added tax as a replacement for the German turnover tax. TS Adams and subsequently Gerhard Colm tried to promote the concept in the United States, but no progress was made towards implementation (Due 1988:122-123).

According to Due (1988:123), France initiated the implementation of VAT in 1948, by introducing a "value-added tax technique" into the manufacturer's sales tax in the form of a levy (see paragraph 2.6.1). During 1954/55, a VAT applicable only to the manufacturing sector replaced the levy and manufacturer's sales tax. In an attempt to eliminate the cascading effect caused by inputs not previously allowed, wholesalers and retailers were subsequently included in the VAT chain. The main reasoning behind this move was to give French manufacturers the competitive edge.

With the formation of the European Common Market, it became clear that the various turnover taxes had to be rationalised. Professor F Neumark headed a commission which investigated the whole issue in detail. It was decided that the form of VAT that was being applied in France was the answer to the proposed rationalisation.
As a result, the EEC issued the First and Second Directives to member countries in 1967 instructing them to adopt a common VAT system based on the French VAT system. This common VAT system would replace the various systems of turnover taxes that were in existence at that time. Ironically, Denmark which was not an EEC member at the time, was the first to adopt a VAT system in 1967 (Due 1988:123).

The EEC members were, in terms of the directives, bound to the implementation of a common VAT system by 1 January 1982. On entry to the EEC, new members were expected to implement the common system of VAT (Packer 1988:4). Gradually the member countries acceded to the request, Italy being the last to do so, in 1973. The United Kingdom and Ireland implemented VAT when they joined the Common Market in 1973, and Spain, Portugal and Greece followed as they became members. Other non-member countries soon followed, with the result that VAT is almost universally applied in Western Europe (Due 1988:123).

Between 1969 and 1980, most of the Latin American countries changed over to a VAT system from a sales or turnover tax system (Due 1988:125).

In 1986, VAT was introduced in New Zealand, where it is known as the Goods and Services Tax (GST) (Somers 1995:703). The VAT system introduced in South Africa was, in essence, based on the New Zealand system (Report of the VATCOM 1991:2).

In 1991, Canada implemented a VAT known as the Goods and Services Tax at the federal level, replacing the former sales tax (Somers 1995:507).
VAT gradually gained popularity internationally and by 1991 VAT had been implemented in more than 50 countries worldwide (James 1991:1).

2.6.3 Development of the general sales tax and VAT in South Africa

On 3 July 1978, South Africa introduced a retail general sales tax (GST) at a rate of 4% (Ernst & Young 1991a:327). This was done in terms of the Sales Tax Act 103 of 1978. According to McManus (1990:7), the former Minister of Finance remarked that it was "the start of what could be termed a tax reform programme.... a gradual move from direct to indirect taxation".

As was the case with most other countries, GST was firstly introduced as a further source of revenue for the state. By introducing GST, the government broadened the tax base, thereby including persons who had never been taxed on income before. A further objective was to lighten the tax load of individuals (McManus 1990:7).

As the GST rate increased in stages, from 4% in 1978 to 13% in 1989, certain disadvantages with regard to GST became more evident. Owing to a general perception that South Africans were overtaxed and the fact that GST had been discredited in the eyes of the taxpayers, the government appointed the Margo commission to investigate the South African tax structure (McManus 1990:47).
The Margo Commission (1987:331) summarised the following advantages of sales taxes:

- Owing to the broad base of sales taxes, considerable amounts of revenue can be collected at comparatively low rates.

- Sales taxes may be used as "an instrument of fiscal policy" because of the sensitivity of these taxes. This sensitivity provides a swift and regular inflow of tax revenue and an almost instantaneous reaction is observed to an adjustment in the rate.

- The legislation governing sales taxes as well as the process of collection of these taxes can be very simple.

- Unlike some other taxes such as an income tax, the employee responsible for the sales tax of a trader would probably acquire a reasonable understanding of the legislation and its practical application.

- Amounts on single transactions tend to be small, which tends to limit controversy between the authorities and the taxpayer.

- Another advantage of the relatively small amounts on single transactions is that, as long as rates remain reasonably low, it is "relatively painless" to make the relevant payments, thereby reducing avoidance or evasion of these taxes.

The Margo Commission (1987:332-333) also identified the disadvantages of sales taxes and supplied the following brief analysis:

- Sales taxes are normally regressive (see paragraph 2.2.2).

- The introduction of, or the increase in sales taxes, usually influences prices directly. This is usually due
to the fact that returns on investments are calculated on an "after-tax basis", and investors aim to maintain after-tax yields. Innumerable studies have indicated that prices of goods and services have increased by amounts exceeding the amounts of tax levied. It should, however, be noted that where the public were well informed of the features and the amounts involved at the introduction of or any subsequent increase in the sales taxes, the increase in the prices of goods and services were limited to the tax levied or the increase in the tax levied. This public awareness could help to limit price increases which in turn could prevent the start of a "price-wage spiral".

Unless carefully devised, sales taxes could lead to double taxation and price increases. The South African system of GST limited double taxation as the tax was only levied on the sale to the final consumer. Double taxation was, however, a problem in a few cases, one of which was where capital goods were used in the production process.

Additional staff could be required for the collection and administration of the sales tax. The actual collection costs of sales taxes are extremely low in relation to the revenue collected, warranting additional staff appointments if required. Over and above this, this argument is no longer valid as it is unlikely that any direct tax could raise amounts equal to the revenue derived from GST. If GST were abandoned, another indirect tax would have to replace it, obviously accompanied by those collection and administration costs.
- The number of points of collection, the frequency with which payments have to be made, the onus to retain vouchers, maintain records, and complete and submit returns, places a heavy burden on the authorities as well as on the taxpayer. Added to this, amendments to the sales tax legislation aggravate this administrative burden.

- The authorities are often held responsible for high prices or unusual price increases as a result of public awareness of sales taxes.

- Numerous methods of evading sales taxes exist, including the under-statement of sales or incorrect classifications of sales of goods and services as exempt. A system of multiple rates also makes it possible that sales of certain goods and services could be included under a lower rate than that provided for in the legislation.

As can be seen from the brief analysis included under the disadvantages stated above, many of the shortcomings of sales taxes can be reduced by specific provisions in sales tax legislation (Margo Commission 1987:332).

Ernst and Young (1991b:1) appear to have summed up the position of the GST system in South Africa by stating that it was regarded as being:

- "prone to evasion"
- unnecessarily complicated owing to different rules being applied to different industries
- "economically inefficient" owing to a noteworthy element of double taxation
After weighing up the advantages and disadvantages of sales taxes, the recommendation of the Margo Commission (1987:333) was that the advantages outweighed the disadvantages and that a broadly-based sales tax (which does not yet differentiate between a retail sales tax and a value-added tax) should be depended upon to render the revenue required. Part of the reasoning was that a broadly-based tax on sales of goods and services was essential in a country like South Africa with a substantial Third World component. The relative simplicity of this type of tax was also a factor.

After having concluded that a broadly-based sales tax should form part of a future system of taxation in South Africa, it was necessary to look at other factors relating to the GST system, namely:

- When GST was implemented in 1978, it was intended to be a tax with a broad base at a low rate. Gradual exemptions with regard to foodstuffs and intermediate goods and services eroded the broad base. On the other hand, advertising and publicity services were absorbed into the base, broadening it. The erosion with regard to foodstuffs had a major impact on the tax base. The list of exempted foodstuffs appeared to be limited, but, on further scrutiny it was found that 72% of the total foodstuffs consumed were exempt from GST. Over and above this, it was found that these exemptions had little effect in reducing the regressive nature of GST as it was found that the low, middle and high income groups almost benefited to the same extent from these exemptions. Of the lower income group, 78,96% of their food consumption was in terms of exempted foodstuffs, in the middle income group, 73,06% and in the high income
group, 65.51%. This again proved that exemptions do not usually provide relief where intended, and should therefore be avoided.

The GST system contained an element of double taxation in the form of GST on capital expenditure. The double taxation resulted firstly from GST that had to be paid on the purchase price of the capital goods. Secondly, the depreciation on the capital goods was accounted for when the selling price of the goods was determined. This selling price of the goods was subject to GST, and therefore included an element of double taxation. As capital goods represented more than 17% of the GST base, the double taxation was noteworthy.

The GST payable on intermediate goods and services resulted in double taxation. The effect of the GST on the prices was, however, worse on intermediate goods than on capital expenditure as the effect was immediate, and not spread over the life of the asset in the form of a depreciation charge.

A considerable and ever increasing resistance to GST started forming with every rate increase. The increase from 7% to 10% on 1 July 1984 appears to have caused the most problems in terms of resistance to GST. This observation is borne out by international experience which is that where rates approach 10%, retail sales taxes such as GST encounter serious difficulties. The increases in rates also appear to have resulted in an acceleration in evasion of GST which caused considerable concern.

From all the above points, it was concluded that GST rates had passed the optimum level. Double taxation on capital and
intermediate goods and services had compounded the rate problems. In addition to this, evasion levels of between 15% and 28% of GST were estimated. The time had undoubtedly come to address the tax base as well as the high rates (Margo Commission 1987:334-338).

The Margo Commission (1987:339-342) compared the systems of VAT and GST in detail. A word of caution is however appropriate at this stage. Supporters of a particular system may identify advantages of that particular system over the other system. Often, these advantages could be integrated into the other system by including specific provisions in the legislation. The main differences between GST and VAT will now be discussed briefly:

- As VAT is collected at every stage of the production and distribution chain, the effect is quicker, therefore VAT is more sensitive to changes than GST.
- In terms of the number of collection points and the ease of collection, GST is definitely a cut above VAT. This is because GST has a small number of points of collection compared to VAT and far fewer refunds than VAT. As refunds involve a fair amount of risk, effective controls are required to limit this risk.
- As many small amounts are collected from various taxpayers, VAT is superior to GST with regard to the impact of the value of the amounts collected.
- With regard to regression and the effect on prices, VAT appears to have an advantage over GST. As the VAT is collected over the whole production and distribution chain, many suppliers in the chain will be large businesses that have the expertise to negotiate better prices. The tendency will most likely be to force the
supplier to absorb part of the VAT and only pass a part on. The end effect should then be that only part of the VAT is passed on to the consumer.

In terms of the keeping of records and the completion of returns, as well as the compliance of taxpayers, the VAT system undoubtedly appears to involve more costs for both the authorities and the taxpayers than the GST system. On closer scrutiny, it has, however, been found that the additional workload is not as great as was initially believed. This is due to the fact that taxpayers were required to register for GST purposes in order to qualify for tax free inputs. As a result of this, the VAT system has necessitated very few additional registrations.

Where evasion is considered, VAT appears to be superior to GST. Three advantages of a VAT system have been determined. The first advantage concerns a clearer audit trail. Where purchases or sales figures are tampered with, the computer can pick up the distortion and initiate a field audit. A major proportion of the tax is collected from large businesses. These businesses usually have efficient systems with good internal controls and are subject to external audits. In theory, these businesses would be less likely to support the evasion of taxes than small businesses. Thirdly, as the amount of tax collected at every collection point is so much smaller than with GST, the motivation to evade VAT is diminished considerably.

With regard to the cost of a new system, the implementation of a system of VAT would obviously result in higher costs than those of the GST system that was in operation. It was anticipated that the implementation
of VAT would go hand in hand with the education of the public as well as the staff at the revenue offices. Compliance costs would also be higher than under the GST system. It was, however, believed that the benefits gained under this system would warrant the costs.

- GST maintained an unusually broad base through the inclusion of capital and intermediate goods. It is unlikely that these components could be taxed under a VAT system without experiencing major practical problems, therefore VAT would not be able to maintain a base of the same size as GST.

- In as far as international acceptance goes, VAT is far superior to GST. VAT has been implemented in many countries worldwide and the trend is for more and more countries to change to it. The form of GST that was used in South Africa is, however, unique.

- Where capacity for multiple rates is considered, GST would certainly be more versatile than VAT owing to the fact that only one collection point exists in each cycle.

- A VAT system surpasses a GST system with regard to the adaptability to a Regional Services Council system. In a VAT system, this is because value added can be ascertained at every stage in the production and distribution chain.

- In terms of the perception regarding VAT and GST, VAT is certainly perceived in a more positive light than GST. When GST was introduced in 1978, it facilitated relief from income tax by instituting a charge for the use of the resources of society. In this way it included persons who had never been taxed on income before, owing to practical problems. Over time, views with regard to
GST hardened, and it was no longer perceived in a positive light. VAT has a far greater chance of being seen in a positive light. VAT is also seen to be less prone to evasion and it can be expected that this impression will contribute towards diminishing evasion levels.

According to James (1991:1), in the South African context, VAT has two distinct advantages over GST:
- From the Receiver of Revenue's point of view, evasion of VAT is more difficult.
- From the consumer's point of view, double taxation is eliminated.

On completion of the comparison between VAT and GST, the Margo Commission (1987:342) concluded that GST should be retained, but that the rate should be reduced to 7.5% or lower and that the system should be simplified by removing exemptions and excluding capital and intermediate goods. It further recommended that if these changes could not be made to the system of GST, an invoice VAT system should be introduced.

In The White Paper on the Margo Report (1988:11) the Government's reaction to the above recommendations was that the levels of Government spending would make it problematical to reduce the GST rate to 7.5% and virtually impossible to reduce the rate even further to 4%. The Government adopted a proposal that GST be removed and that VAT be introduced.
In 1988, it was announced that South Africa had decided to change from the GST system to a VAT system, effective from 30 September 1991 (James 1991:1).

2.7 SUMMARY

This chapter firstly dealt with the criteria which all taxes should comply with to be classified as "good" taxes.

Thereafter, the nature of VAT was looked at. According to the classification, VAT was found to be an indirect tax. This was followed by conceptualising VAT and describing various types of VAT systems, methods of accounting for VAT and bases for VAT.

Lastly, a global overview of the origin and development of VAT was given, followed by a section dealing specifically with South Africa. It was found that VAT evolved from a system of turnover taxes. Turnover taxes originated in the very distant past, but became more commonly used after the First and Second World Wars when most countries were in desperate need of finance to build up their post-war economies.

In 1967, VAT became more commonly used after the EEC issued a directive for a common VAT system. Many countries followed this directive of the EEC and by 1991, when South Africa implemented VAT, more than 50 countries were applying a system of VAT.
Where the basic principles, concept, systems, methods and bases of VAT have been discussed in this chapter, the following chapter will specifically look at the VAT system in operation in South Africa as well as how it is applied to small to medium-sized developers of residential properties.

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CHAPTER 3

THE APPLICATION OF VALUE-ADDED TAX TO SMALL TO MEDIUM-SIZED DEVELOPERS OF RESIDENTIAL PROPERTIES IN SOUTH AFRICA

3.1 INTRODUCTION

Whereas part of the previous chapter looked, from a global perspective, at the most commonly used concepts of VAT, various types of VAT systems, different methods of accounting for VAT and bases for VAT, this chapter will firstly look at these headings from a South African perspective, specifically in terms of the provisions of the South African VAT legislation.

Secondly, the provisions of this legislation with regard to what constitutes a supply of goods or services will be determined with specific reference to residential properties.

In the following section the provisions of South African legislation relating to registration are dealt with, with specific reference to developers of residential properties.

Fourthly, the way in which the above-mentioned provisions are applied to the small to medium-sized developer of residential properties will be discussed with reference to various possible situations.
3.2 BACKGROUND ON VAT IN SOUTH AFRICA

VAT, which was introduced into South Africa on 30 September 1991, is governed by the Value-Added Tax Act 89 of 1991, as amended (hereafter referred to as the Act). The Act is administered by the local Receivers of Revenue (Somers 1995:482) under the control of the Commissioner for the South African Revenue Service (Value-Added Tax Act 89 of 1991 s1 and s4).

VAT on imports is currently being administered by the Department of Customs and Excise (Somers 1995:482).

3.3 TERMINOLOGY RELATING TO VAT IN SOUTH AFRICA

According to section 1 of the Act, the following definitions apply to VAT:

- "commencement date" is stated as being 30 September 1991.

- "commercial rental establishment" includes
  
  (a) accommodation which is provided to five or more persons at a periodic charge in a hotel, motel, boarding house, inn, hostel or any other establishment which provides accommodation on a regular or normal basis; or

  (b) residential accommodation, other than that in (a) above, regularly provided in a house, apartment, flat or room let out for periods not exceeding 45
days and where the annual rental income exceeds or is expected to exceed R48 000 in terms of section 81(1)(a) of Act 53 of 1999; or
(bA) accommodation in a house, flat, apartment, room, caravan, houseboat or camping site owned or leased by a business that-
(i) lets at least five residential units of those mentioned in (bA) above in the course of the business;
(ii) earns, or is expected to earn, at least R48 000 per annum from the letting of the residential units mentioned in (bA) in terms of section 81(1)(b) of Act 53 of 1999; and
(iii) normally or regularly holds such property for letting for periods of 45 days or fewer; or
(c) any hospital, hospice, nursing home and convalescent home, or rest home; or
(d) any place of detention managed by any other person in terms of an agreement with a public authority, but excludes specific establishments, which will not be discussed in detail here, as they are beyond the scope of this study.

"consideration" is defined with regard to the supply of goods or services as including any payment made or to be made. This payment could be in monetary or other terms. A deposit will only be considered as payment for the supply of goods or services once it has been utilised as consideration for the supply or when the deposit is relinquished.
- "dwelling" includes any building, premises, structure or place used mainly by a natural person as a place of residence. A commercial rental organisation is excluded.

- "enterprise" is defined as relating to a vendor where any activity or enterprise is "carried on continuously or regularly by any person" in South Africa in the course of or for the furtherance of supplying goods or services to another for a consideration. This activity or enterprise may be performed wholly or partly in the Republic and may or may not be for gain.

In the definition of "enterprise", local authorities are specifically excluded as they are dealt with in detail in subparagraphs (b)(i) and (c) of this definition. As local authorities, welfare organisations and share block companies fall outside the scope of this study, the detailed provisions surrounding such entities, which are also covered in this subparagraph, will not be discussed here.

The definition of "enterprise" includes the following provisions:

(i) anything done with regard to the opening or closing down of an "enterprise" or activity will be considered to be done in the course of or for the furtherance of the "enterprise" or activity;

(ii) goods or services supplied outside South Africa from a branch or main business of an enterprise permanently situated outside South Africa will not
be deemed to be in the course of or for the furtherance of the enterprise or activity where—
(aa) the branch or main business can be identified separately;
(bb) the business maintains separate accounting systems with regard to the branch or the main business;
(iii) the services supplied by an employee to an employer are not deemed to be included in the definition of an "enterprise";
(iv) a "private or recreational pursuit or hobby" is not considered to be the carrying on of an enterprise;
(v) the making of exempt supplies is not deemed to be the carrying on of an enterprise.

Subparagraphs (vi) and (vii) deal with the underwriting of insurance by Underwriting Members of Lloyd's of London and the Multilateral Motor Vehicle Accidents Fund Act. As these topics are beyond the scope of this study, they will not be dealt with here.

- "exempt supply" is a supply that is exempt from tax, in terms of section 12 of the Act.

- "fixed property" is defined as being:
  - land with improvements thereto;
  - any unit as defined in the Sectional Titles Act 95 of 1986;
  - any share in a share block company bestowing an interest in or a right to immovable property;
- any time sharing interest as defined in the Property Time-sharing Control Act 75 of 1983; or
- any real right in any such land, unit, share or time-sharing interest.

- "goods" are defined as "corporeal movable things, fixed property and any real right in any such thing or fixed property", but excludes:
  (a) money;
  (b) any claim by means of a mortgage bond or pledge of fixed property or any such thing; and
  (c) any stamp, form or card bearing a monetary value that has been sold or issued by the State as payment of any tax or duty levied under any Act of Parliament, except when it is sold or imported as a collector's piece or investment article after its original sale or issue.

- "input tax" relates to a vendor and means
  (a) the tax charged and payable in terms of section 7 of the Act:
    (i) by a supplier on goods or services supplied by him to the vendor; or
    (ii) by a vendor on goods imported by him; or
    (iii) by a vendor in terms of section 7(3) of the Act, dealing with goods subject to excise duty where the price at which the goods have been supplied does not include excise duty and VAT becomes payable in terms of section 7(1)(a) of the Act (Value-added Tax Act 89 of 1991 s7(3)).
(b) where any second-hand goods located in the Republic are purchased by a vendor, the "input tax" will be the current tax fraction at the time of payment, applied to the lower of the open market value or the consideration in money for the goods. Where the second-hand goods consist of fixed property or shares in a share block company, the following regulations will however apply:

(i) in the case of fixed property, the amount of "input tax" will not exceed the amount payable in respect of transfer duty that is payable on the acquisition in terms of the Transfer Duty Act or the amount that would have been payable if no exemptions had applied; or

(ii) in a case of the original issue or transfer of shares in a share block company, the "input tax" will not exceed the amount that would be payable in respect of stamp duty or that would have been payable if no exemptions had applied.

(c) This section of the definition relates to goods repossessed under an instalment credit agreement. As it has no bearing on this study, it will not be discussed here.

"output tax" means the tax charged by a vendor on the supply of goods or services in terms of section 7(1)(a) of the Act which determines that VAT should be levied on
the supply of all goods or services supplied by a vendor, except where exemptions apply (Value-Added Tax Act 89 of 1991 s7(1)(a)).

- "person" is defined as including any
  - public or local authority;
  - company;
  - corporate or unincorporated body of persons;
  - trust fund; or
  - estate of an insolvent or deceased person.

- "recipient" with regard to a supply of goods or services is the "person" to whom the supply is made.

- "residential rental establishment" means a "commercial rental establishment" as defined above where at least 70% of the persons to whom the domestic goods and services are rendered will stay for at least 45 days.

- "sale" includes an agreement for purchase and sale including any deal or action whereby ownership of goods passes, or will pass, from one person to another.

- "second-hand goods" means
  (a) goods that have been used or formerly owned; or
  (b) a unit transferred as provided for in terms of the Share Blocks Control Act, but excludes animals as well as goods supplied according to section 11(1)(k) of the Act, being gold coins issued in terms of the South African Reserve Bank Act 90 of 1989.
"services" are stated as being anything done or to be done including:
- any right granted, assigned, ceded or surrendered;
or
- any facility or benefit being made available but excluding a supply of goods, money or any stamp, form or card proposed in paragraph (c) of the definition of "goods".

"supplier" means the person supplying the goods or services.

"supply" is defined as including performance in terms of a sale, rental agreement, instalment credit agreement and all other forms of supply, irrespective of whether the supply is voluntary, compulsory by law, or of where the supply is effected. Any derivative of supply shall also be deemed to be a supply.

"tax" is the tax chargeable in terms of this Act.

"taxable supply" is any supply of goods or services on which tax is chargeable in terms of section 7(1)(a) of the Act. Tax chargeable in terms of section 11 of the Act at a rate of zero per cent is included in this definition.

"tax fraction" is the fraction calculated as follows $r / (100 + r)$ where $r$ is the tax rate as provided for in section 7(1) of the Act.

"vendor" means any person who is registered or who is required to be registered in terms of the Act (Value-Added Tax Act 89 of 1991 s1).

3.4 CONCEPT OF VAT AS APPLIED IN SOUTH AFRICA

The VAT that has been introduced in South Africa is a broadly based, multi-stage (see paragraph 2.3), non-cumulative, consumption type (see paragraph 2.5.1) of VAT that is levied on a wide range of goods and services (James 1991:1).

A brief explanation of the meaning of the terms "broadly based" and "non-cumulative" included in the above description of the concept of VAT should be supplied at this point.

"Broadly based" means that a wide range of goods or services would be subject to VAT (The Margo Report 1988:31). The South African VAT is most certainly broadly based, as, in terms of section 7 of the Act, a wide range of "goods" or "services" (see paragraph 3.3) are included (Value-Added Tax Act 89 of 1991 s7). The intention when formulating the Act was to limit the exceptions, zero-ratings, and exemptions in order to simplify the system, thereby reducing compliance costs and limiting the chance of evasion (Report of the VATCOM 1991:10).

"Non-cumulative" suggests that credit would be allowed for tax paid at previous stages (Report of the VATCOM
In terms of section 16(1) of the Act, a "vendor" is responsible for calculating the VAT payable by him in terms of this section, in respect of every period during which he has carried on an "enterprise" (Value-Added Tax Act 89 of 1991 s16(1)).

Before discussing the calculation of the VAT payable, the terms "vendor" and "enterprise" should be discussed.

In section 1 of the Act, a "vendor" (see paragraph 3.3) is defined as a "person" who is, or is required to be, registered in terms of the Act (Value-Added Tax Act 89 of 1991 s1). The provisions for registration will not be discussed here, as they are covered in paragraph 3.8.

According to section 1 of the Act, for an activity to be classified as an "enterprise" (see paragraph 3.3), the activity should be performed "continuously or regularly", by a "person" who is a "vendor", "in the course of or for the furtherance" of the enterprise, for a "consideration" (Value-Added Tax Act 89 of 1991 s1).

In order to determine whether an "enterprise" is being carried on, the meaning of the various terms mentioned above should be determined.
The first term that should be looked at is "continuously or regularly", which is not specifically defined in section 1 of the Act (Kruger & Bennet 2001:1-3-5).

The view that an enterprise should be an on-going activity is, however, fundamental to the concept of an "enterprise". Consequently, once-off private transactions would not be deemed to be the carrying on of an "enterprise". Where any of these private transactions are repeated or carried on for quite some time they could, however, be deemed to be meeting the requirements for an "enterprise" (Beneke 1991:18).

From the above discussion of "continuously or regularly", where only this one element of the definition of an enterprise is considered, it appears that all developers of residential properties, other than a developer that only does one development, would be deemed to be carrying on an enterprise.

From the definition of "person" (see paragraph 3.3), it is apparent that any form of business that could be carried on by a developer of residential properties is encompassed in the definition of "person", therefore if we look at this element alone, an "enterprise" would be carried on.

The third element of the definition of an "enterprise" that should be determined is the meaning of "in the course of or for the furtherance" of the enterprise.

"In the course of or for the furtherance" is not defined in section 1 of the Act. According to the Guide for Vendors VAT
404 (paragraph 5.2.4), a "discernible relationship or connection" should exist "between the supply and the activities of the enterprise" for a supply to be in the "course of or for the furtherance" of an enterprise.

According to Kruger & Bennet (2001:1-3-7), the term "in the course of or for the furtherance" would include all supplies related to the enterprise. Where a retailer of children's clothing sells an office desk it would most likely constitute a taxable supply, as it would be taking place in the course of the business.

Private or exempt items, for example the sale of the house of a retailer, where the house has never been part of his business premises, would, however, not be regarded as being in the course of business (Kruger & Bennet 2001:1-3-8).

From the above discussion, it would appear that all supplies of residential properties by developers would be considered as being in the "course of or for the furtherance" of the enterprise.

The last part of the definition of "enterprise" states that a "consideration" (see paragraph 3.3) must be given in return for the supply of goods or services. As the consideration need not, in terms of section 1 of the Act, be monetary, this part of meeting the requirements of carrying on an "enterprise" would have been met as soon as a developer had received a "consideration", monetary or otherwise (Value-Added Tax Act 89 of 1991 s1).
After having discussed the terms "vendor" and "enterprise", which are included in the provisions of section 16(1) of the Act - a section that deals with the obligation of a "vendor" to calculate and pay VAT in respect of every period that he has carried on an "enterprise", - we should determine how the VAT payable should be calculated.

Section 16(3) of the Act provides that the sum of the "input tax" should be deducted from the sum of the "output tax" to determine the amount of VAT due by the "vendor" to the authorities (Value-Added Tax Act 89 of 1991 s16(3)).

In order to calculate the VAT due by the "vendor" to the authorities, a vendor should firstly determine the "input tax" due to the vendor.

In terms of section 1 of the Act, in general, "input tax" (see paragraph 3.3) is the VAT charged by the supplier on the supply of goods or services to the "vendor" (Value-Added Tax Act 89 of 1991 s1).

According to section 16(2) of the Act, a deduction for input tax will only be made where:

(a) a tax invoice, debit or credit note in terms of section 20 or 21 of the Act is in the possession of the vendor at the time when the return with regard to that supply is submitted; or

(b) in terms of section 20(6) of the Act the amount of the invoice is less than R20, or according to section 20(7) of the Act a tax invoice is not required where the Commissioner is satisfied that sufficient documentation exists; or
(c) second-hand goods are supplied in terms of section 20(8) of the Act; or

(d) at the time of submitting the VAT return, a bill of entry or sufficient records have been issued in terms of the Customs and Excise Act as well as the receipt for the payment of that tax with regard to the importation (Value-Added Tax Act 89 of 1991 s16(2), s20(6) and s20(7)).

In terms of section 16(3)(a) of the Act, where a vendor accounts for tax payable on an invoice basis (see paragraph 3.6.2), the amount of the input tax will be determined as follows:

(i) on the supply of goods and services made to the vendor during the tax period;

(ii) on the supply of second-hand fixed property, where transfer duty is payable in terms of the Transfer Duty Act, or the original issue or registration in respect of which stamp duty is payable in terms of the Stamp Duties Act, provided that the full transfer or stamp duties have been paid during the tax period; or

(iiA) on taxable supplies relating to sales after 6 June 1996 as provided for in section 9(3)(d) of the Act. Section 9(3)(d) of the Act states that where fixed property is supplied, the supply is deemed to have taken place at the earlier of

- the date of registration of transfer in a deeds registry; or
the date on and the extent to which any payment or consideration for the supply of the fixed property is made (Value-Added Tax Act 89 of 1991 s9(3)(d)) provided that the payment for the consideration has been made during that tax period (Value-Added Tax Act 89 of 1991 s9(3)(d) and s16(3)(a)).

According to section 16(3)(b) of the Act, where tax payable is accounted for on a payments basis (see paragraph 3.6.2), the amount of the input tax will be determined as follows:

(i) where a supply of goods or services is made to the vendor in terms of section 9(1), (3)(a), (b) or (d) or (4) of the Act, the extent to which any payment reduces the liability with regard to the purchase price during the tax period. Where the supply comprises second-hand goods as provided for in paragraph (b) of the definition of input tax (see paragraph 3.3), the input tax will only be deducted after the transfer or stamp duty, whichever the case, has been paid;

(ii) where the input tax is charged in terms of section 7(1)(b) of the Act, relating to goods subject to excise duty paid during the tax period; or

(iii) where a supply of goods and services is made to the vendor during the tax period, other than that provided for in subparagraph (i) above.

Subparagraphs (iv) and (v) deal with cases where sections 21(2)(b), 21(7) and 22(1) of the Act apply. These sections cover debit notes and irrecoverable debts, the requirements of which are too detailed for this study.

Sections 16(3)(c), (d), (dA) and (e) of the Act do not relate to this study and will therefore not be discussed here.
According to section 16(3)(f) of the Act, input tax amounts determined in terms of sections 18(4) or (5) of the Act will be deductible from output tax. This section is discussed in detail in paragraph 3.8, therefore no discussion will be entered into here.

In terms of section 16(3)(g) of the Act, where input tax was previously denied and the vendor obtained a tax invoice in this period, the input tax would be allowed in this period.

Section 16(3)(h) of the Act provides the following formula for the determination of the input tax where a supply other than in terms of section 18(2) of the Act is made by a vendor:

\[ A \times B \times C \]

where

A is the tax fraction

B is the lesser of-

(i) (aa) the cost to the vendor of the acquisition, manufacture, assembly, construction or production of the goods or services; or

(bb) the amount represented by B as determined in the formula in section 18(4) of the Act (see paragraph 3.9) where the goods or services were deemed to have been supplied in terms of that section; or

(cc) the amount represented by A in section 10(9) of the Act where an adjustment was made in terms of section 18(2) of the Act (see paragraph 3.8) or
the amount represented by B where an adjustment is made in terms of section 18(5) of the Act (see paragraph 3.9); and
(ii) the open market value at the time when the goods or services are deemed to have been supplied;
C is the percentage use for rendering taxable supplies of the total use as determined before the time of the supply; provided that where the goods are second-hand goods as referred to in paragraph (b) of the definition of input tax in section 1 (see paragraph 3.3), which states that the input tax will be limited to the amount of transfer duty or stamp duty which was or would have been payable and will only be allowed as input tax once these amounts have been paid (Value-Added Tax Act 89 of 1991 s16(3)(h)).

At this point it should be emphasised that where the goods consist of second-hand fixed property, paragraph (b)(i) of the definition of "input tax" in section 1 of the Act (see paragraph 3.3) determines that the input tax that is claimed is limited to the amount payable in respect of transfer duty, or the amount that would have applied if no exemptions had applied (Value-Added Tax Act 89 of 1991 s1).

It should, however, be noted that the provisions of the definition of "input tax" would only apply if the goods or services were obtained by the vendor wholly for use in rendering taxable supplies or consumption for that purpose. Where the goods or services were only partially obtained for the rendering of taxable supplies, only a certain portion, as
detailed in section 17 of the Act, that will not be discussed here, would be allowed as an input tax credit (Kruger & Bennet 2001:1-2-4).

After having determined the "input tax" due to the vendor, the "output tax" (see paragraph 3.3) payable by the "vendor" should be determined.

The definition of "output tax" (see paragraph 3.3) refers to the VAT charged on the supply of goods or services by a "vendor" in terms of section 7(1)(a) of the Act (Value-Added Tax Act 89 of 1991 s1). The imposition of VAT on the supply of goods or services will not be discussed here as it is dealt with in detail in paragraph 3.7.

In terms of section 16(5) of the Act, where the "input tax" exceeds the "output tax", the excess would be refunded to the vendor by the authorities, as provided for in section 44(1) of the Act (Value-Added Tax Act 89 of 1991 s16(5) and s44(1)).

3.5 VAT RATE

In terms of section 7(1)(a) of the Act, VAT is charged on goods or services at a standard rate of 14% (see paragraph 3.7.1).
3.6 VAT SYSTEMS, METHODS AND BASES AS APPLIED IN SOUTH AFRICA

3.6.1 Type of VAT system applied in South Africa

South Africa applies a consumption type of VAT system (James 1991:1). The taxable amount in a consumption type of VAT system is based on the entrepreneur's VAT on sales less VAT on purchases from other entrepreneurs, including the acquisition of new equipment and manufacturing facilities.

Consumption VAT therefore encourages the implementation of new technology and the modernisation of facilities used for production (Rebhun 1982:11).

3.6.2 Methods of accounting for VAT in South Africa

Section 15(1) of the Act stipulates that VAT should be accounted for on an invoice basis (Value-Added Tax Act 89 of 1991 s15(1)).

An alternative basis of accounting for VAT is provided for in section 15(2) of the Act, namely a payments basis. A payments basis may only be used in certain circumstances, with prior consent from the Commissioner for South African Revenue Services (Value-Added Tax Act 89 of 1991 s15(2)).

According to section 15(2) of the Act, where an enterprise wishes to use a payments basis, a written application must be
made by the vendor to the Commissioner. The Commissioner will only consider the application of the vendor if the following criteria have been met:
- the vendor is a public or local authority; or
- the vendor is an association not for gain; or
- the vendor is a natural person or an unincorporated body of persons of which all members are natural persons and
- the full value of the taxable supplies of the vendor does not or is not likely to exceed R2,5 million during a period of twelve months (Value-Added Tax Act 89 of 1991 s15(2)).

In terms of section 15(2A) of the Act, any vendor, excluding a public or local authority, making a supply of goods or services after 5 June 1997, other than fixed property, the value of which exceeds R100 000, is required to account for the VAT on an invoice basis (Value-Added Tax Act 89 of 1991 s15(2A)).

According to section 15(3) of the Act, the R2,5 million limit does not apply where the limit is exceeded purely as a result of one of the following:
- the "cessation of, or a substantial and permanent reduction in the size" of an enterprise; or
- abnormal circumstances that are of a temporary nature; or
- the replacement of capital assets or installations (Value-Added Tax Act 89 of 1991 s15(3)).
3.6.3 Base for VAT in South Africa

South Africa uses a destination based VAT (see paragraph 2.5.3) as imports are, in terms of section 7(1)(b) and (c) of the Act, subject to VAT and exports are, in terms of section 11(1) of the Act, zero-rated (Value-Added Tax Act 89 of 1991 s7(1)(b), (c) and s11(1)).

3.7 SUPPLIES OF GOODS OR SERVICES

Section 7 of the Act deals with the imposition of VAT. According to section 7(1) of the Act, "[s]ubject to the exemptions, exceptions, deductions and adjustments provided for in this Act", VAT is payable on:

(a) goods or services supplied by a vendor on or after the commencement date, in the course of or in furtherance of any enterprise carried on by him;

(b) the importation of goods into South Africa by any person on or after the commencement date;

(c) the supply of imported services by any person on or after the commencement date, calculated at the rate of 14% on the value of the supply or importation, whichever is the case (Value-Added Tax Act 89 of 1991 s7(1)(a), (b) and (c)).

According to section 7(2) of the Act, the VAT on the supply referred to in section 7(1)(a) of the Act, discussed above, should be paid by the vendor, whereas the VAT due on the
importation of goods referred to in section 7(1)(b) of the Act, discussed above, should be paid by the person importing the goods. The VAT due on the importation of services should be paid by the recipient of the services (Value-Added Tax Act 89 of 1991 s7(2)).

Section 7(3) of the Act deals with goods manufactured in South Africa that are subject to excise duty in terms of the Customs and Excise Act. As this does not relate to developers of residential properties, no further discussion of this subsection will be conducted here.

To enable us to understand the implications of section 7(1) of the Act dealing with the imposition of VAT, the definitions of the various elements included in the provisions of this section should be examined.

Firstly, the definition of "goods" should be examined.

From the definition of "goods" (see paragraph 3.3) it is evident that fixed property as well as any right therein has been included in the definition. The definition of "goods" therefore specifically includes "fixed property".

At this stage, it is therefore essential to determine the definition of "fixed property" in terms of the Act.

From the definition of "fixed property" (see paragraph 3.3) it can be seen that any conceivable development of
residential fixed property would fall within the parameters of the definition of "fixed property", which would in turn be included in the definition of "goods".

Secondly, the definition of "services" should be determined. In effect, the definition of "services" (see paragraph 3.3) is formulated so widely that it would encompass everything not classified as "goods" or money. This would result in a situation where it would be basically impossible to avoid VAT on the premise that the commodity supplied was neither "goods" nor "services" (Kruger & Bennet 2001:1-3-3).

The third element of the provisions of section 7(1) of the Act that should be determined relates to "supply".

"Supply" (see paragraph 3.3) is defined extremely widely as including "all forms of supply", regardless of where the supply is made. It would therefore be basically impossible to avoid paying VAT on the grounds of the transaction not constituting a "supply".

According to Kruger & Bennet (2001:1-3-2), supplies made outside South Africa would "generally not be subject to VAT" because they are usually either classified as non-taxable (exempt) or taxed at a rate of 0% (zero-rated).

After having determined the meaning of all the terms included in the provisions of section 7(1) of the Act, dealing with the imposition of VAT, the time of the supply should be discussed.
In terms of section 9(1) of the Act, the supply of goods or services is generally deemed to have been made at the earlier of the issue of the invoice or the payment of a consideration (Value-Added Tax Act 89 of 1991 s9(1)).

Section 9(3)(d) of the Act specifically provides for a supply, by way of sale, of fixed property. In terms of this section, the supply is deemed to have been made at the earlier of the date when the transfer was registered in a deeds registry or the date on which any payment in respect of the supply was made (Value-Added Tax Act 89 of 1991 s9(3)(d)).

After having determined the time of the supply, the value of the supply should be ascertained.

According to section 10(2) of the Act, the value of the supply of goods or services would be the value of the consideration, less the amount representing tax (Value-Added Tax Act 89 of 1991 s10(2)).

Section 10(3) of the Act states the value of the consideration as the amount of money, or if it is not in the form of money, the open market value of the consideration (Value-Added Tax Act 89 of 1991 s10(3)).

In terms of section 10(5) of the Act, where a vendor is deemed to have supplied goods or services in terms of section 8(2) or 9 of the Act, the supply will be deemed to be made at the lesser of the cost or the open market value of the supply. Section 8(2) of the Act provides for situations
where a person ceases to be a vendor and section 9 of the Act deals with the time of the supply (Value-Added Tax Act 89 of 1991 s10(5), 8(2) and 9).

According to section 10(7) of the Act, any supply deemed to be a supply in terms of section 18(1) of the Act (see paragraph 3.9) will be deemed to have been supplied at the open market value (Value-Added Tax Act 89 of 1991 s10(7)).

Section 10(9) of the Act states that where a supply is deemed to have been made in terms of section 18(2) of the Act (see paragraph 3.9), the consideration will be determined by the following formula:

\[ A \times (B - C) \]

where

A is the lesser of the
- cost; or
- deemed consideration represented by "B" in the formula under section 18(4) of the Act; or
- the amount represented by "A" in the formula in section 18(2) of the Act or by "B" in the formula provided for in section 18(5) of the Act; or
- the open market value of the supply at the time when the supply was deemed by section 18(6) of the Act to have taken place;

B is the percentage used for making taxable supplies of the total use of the goods as determined by section 17(1), 18(4) or (5) of the Act in the period before the 12 month period contemplated by "C";

C is the percentage used for taxable supplies in the 12 month period when the decrease in use for purposes of taxable
supplies occurred. Where the percentage in "B" does not exceed "C" by more than 10%, the percentage in "B" will be deemed to be the percentage (Value-Added Tax Act 89 of 1991 s10(9)).

After having determined what is encompassed in the term "supply of goods or services", I shall now discuss the different categories of supplies of goods or services.

Supplies of goods or services can be divided into two categories, namely taxable supplies and exempt supplies (McManus 1990:21).

3.7.1 Taxable supplies

According to section 1 of the Act, a "taxable supply" is a supply of goods or services on which tax is chargeable in terms of section 7(1)(a) of the Act at 14%, also known as a standard-rated supply (see paragraph 3.7), as well as where tax is chargeable at zero per cent in terms of section 11 of the Act (Value-Added Tax Act 89 of 1991 s1).

The term "standard-rated" is not defined or used in the Act. According to Kruger and Bennet (2001:1-4-1) it is, however, a useful umbrella term used to refer to supplies that are subject to VAT at the normal rate. This is in contrast to supplies that are allocated a special band rate for socio-economic, political or other reasons. In South Africa, the vast majority of transactions to which VAT applies will be standard-rated.
Where zero rating applies, the situation arises that VAT is charged at 0% on the relevant supply of goods or services, but all VAT paid in the process of producing or supplying the goods can be claimed back (Ernst & Young 2001:31).

In terms of section 11 of the Act, the following supplies have been zero rated:

- most exports of movable goods or services consumed or rented outside the country, provided that the vendor and the person to whom he is supplying are not connected persons;
- the supply of an enterprise as a going concern to a registered vendor;
- the supply of gold bars, blank coins and various raw materials to the South African Reserve Bank, the South African Mint Company (Proprietary) Limited;
- certain inputs relating to agriculture, subject to specific conditions;
- fuel levy goods defined in section 1 of the Customs and Excise Act, as they are subject to a fuel levy;
- the categories of basic foodstuffs included in Schedule 2 Part B of the Act (Value-Added Tax Act 89 of 1991 s11).

Irrespective of which rate of VAT is applicable to taxable supplies, a full input tax credit for all VAT paid on goods or services acquired is allowed against the output tax (Ernst & Young 2001:31).

After having discussed what constitutes a taxable supply, the meaning of the term "exempt supplies" will now be determined.
3.7.2 Exempt supplies

According to section 1 of the Act (see paragraph 3.3), an exempt supply is a supply that is exempt from VAT in terms of section 12 of the Act (Value-Added Tax Act 89 of 1991 s1).

An exempt supply implies that no VAT is charged on the output of the enterprise, but, at the same time, no input tax credit may be claimed (Ernst & Young 2001:59).

In terms of section 12 of the Act, the following supplies of goods or services are exempt from VAT:
- the supply of financial services, excluding those that would be zero-rated in terms of section 11 of the Act;
- the supply by an organisation not for gain of goods, where at least 80% of the materials used in the making of the goods were donated to the organisation;
- the long-term rental of residential accommodation or land;
- the supply of land by way of sale or letting where the land is situated outside South Africa;
- the supply by a body corporate, share block company or housing development scheme to its members where the supply is funded from contributions by the members;
- all local passenger transport services, excluding air travel;
- education;
- any supply by employee organisations to members, funded from contributions (Value-Added Tax Act 89 of 1991 s12).
Despite various representations made to the Value-Added Tax Committee for the supply of new homes to be zero rated or exempted (Report of the VATCOM 1991:21), it can be seen from the above that sales of residential properties are not included in the above-mentioned list, but are included in the definition of "goods" (see paragraph 3.3) and are therefore subject to the full tax burden.

3.8 REGISTRATION

3.8.1 Developers that should register for VAT purposes

In order to determine which developers of residential properties should register for VAT purposes, the provisions of section 23(1) of the Act governing registration should be ascertained (Value-Added Tax Act 89 of 1991 s23(1)).

According to section 23(1) of the Act, every "person" carrying on an "enterprise" where the total value of the taxable supplies exceeds or is expected to exceed R300 000 in a twelve month period should register for VAT purposes on or after the commencement date (Value-Added Tax Act 89 of 1991 s23(1)).

The various elements of section 23(1) of the Act will now be considered.

The first element of the above-mentioned provision with regard to registration relates to the "person" (see paragraphs 3.3 and 3.4) carrying on the enterprise. As the definition of "person" encompasses both natural and juristic
persons, therefore including all possible forms of enterprises, looking only at this element, all developers of residential properties would have to register for VAT.

It should be noted that once the "person" has been pinpointed, it is the "person" that is the taxable entity, and not the enterprise. This is important because the registerable taxable supply limit of R300 000 applies to the average of the sum of taxable supplies of all enterprises operated by that "person" (Kruger & Bennet 2001:1-12-1).

After having determined that a developer of residential properties would be included in the definition of a "person", the second step in determining whether a developer of residential properties should register in terms of section 23(1) of the Act is to determine whether the criteria for an "enterprise" (see paragraphs 3.3 and 3.4) have been met.

It appears that most developers of residential properties meet this requirement, as their activities would usually be performed on a regular or continuous basis, in the course of or for the furtherance of supplying goods to another, for a consideration.

Once it has been determined whether an "enterprise" is being carried on, the next part of section 23(1) of the Act sets an annual value on the taxable supplies of the person carrying on an "enterprise" as R300 000 (Value-Added Tax Act 89 of 1991 s23(1)).
Where the annual value of the taxable supplies exceeds or is expected to exceed R300 000, a person is required to register for VAT purposes.

Section 23(1) of the Act adds, however, that where the value of taxable supplies by a person exceeds R300 000, solely as a result of one of the following points, namely,

- any closing down of an enterprise or a significant and permanent reduction of the scale or size of the enterprise operated by that person;
- the replacement of any capital asset or plant used in the enterprise operated by that person; or
- abnormal conditions of a passing nature,

the value of taxable supplies will not be deemed to have exceeded R300 000 (Value-Added Tax Act 89 of 1991 s23(1)).

Given the sales value of stands and the cost of building, the taxable supply limit of R300 000 in all probability places the full-time developer of residential properties in a taxable supply bracket exceeding the monetary limit of R300 000.

The last element of the provisions of section 23(1) of the Act dealing with registration requirements states that registration should take place on or after the "commencement date" (see paragraph 3.3).

This part of the provisions of section 23(1) of the Act only serves as information that a developer that has met the requirements for registration in terms of this section should register at the later of 30 September 1991 or the date on
which he became obliged to register in terms of this section of the Act (Value-Added Tax Act 89 of 1991 s23(1)).

3.8.2 Developers that need not register for VAT purposes

Where a developer does not meet the requirements of section 23(1) of the Act (see paragraph 3.7.1), he is not required to register as a vendor for VAT purposes.

The requirements of section 23(1) of the Act are usually not satisfied owing to the fact that "once-off" transactions do not meet the requirements of an "enterprise" (see paragraphs 3.3 and 3.4), as the seller does not qualify to be deemed to be carrying on an "enterprise" (Sahli 1991:28).

3.9 SPECIFIC VAT PROVISIONS RELATING TO RESIDENTIAL LAND AND BUILDINGS

The South African VAT legislation does not include any provisions relating specifically to developers of residential properties.

Owing to the fact that the development of residential properties requires a substantial source of funding and the sale of the properties is subject to market conditions at the time of sale, developers often find themselves in a position where the circumstances necessitate a change in the original intention of the development. Section 18 of the Act specifically provides for adjustments where a change of intention has taken place, therefore a discussion of this section is essential.
Before section 18 of the Act is discussed, the income tax principles relating to intention and change of intention should be examined.

In *SIR v Trust Bank of Africa Ltd* 1975 (3) SA 652 (A), (37 SATC 87), it was stated that the intention had to be sought in the acts and thoughts of the persons managing and controlling the affairs of the company (Clegg 1991:86).

In *CIR v Richmond Estates (Pty) Ltd* 1956 (1) SA 602 (A), (20 SATC 355, the person in control of a one-man company gave evidence as to the intention of the company. According to Clegg (1991:87), there does not appear to be any reason why, in principle, the persons in control of the company cannot give evidence as to the intention of the company.

It is important to note that the original intention at the time that the property was acquired could at any stage be changed. In *Natal Estates Limited v CIR* 1975 (4) SA 177 (A), (37 SATC 193), a property development scheme was done on land acquired as a capital asset. The considerations of this case included the following:

- the intention of the owner at the time of acquisition of the land as well as at the time of sale;
- the objects of the owner; and
- the activities of the owner in relation to the land up to the time when the decision was taken to sell the land (Clegg 1991:108).
After having looked at cases dealing with the intention and the change of intention, I shall discuss the adjustments required by section 18 of the Act.

According to section 18(1) of the Act, where
(a) goods or services have been imported by or supplied to a vendor; or
(b) goods have been manufactured, assembled, constructed or produced by the vendor; or
(c) in terms of subsection (4), goods or services were deemed to have been supplied to him,
where the original intention was to partly or wholly make taxable supplies, where these goods are, at a later date, used wholly for a purpose other than the purpose originally intended, or for a purpose where a deduction of input tax would initially have been denied, the supply would be deemed to have been made in the course of the enterprise, as a taxable supply (Value-Added Tax Act 89 of 1991 s18(1)).

In terms of section 18(2) of the Act, where-
(a) capital goods or services have been supplied to or imported by a vendor; or
(b) capital goods have been manufactured, assembled, constructed or produced by him; or
(c) capital goods or services were deemed by subsection (4) to have been supplied to him,
with the intention of making taxable supplies, either wholly or partly, and the application for this purpose is reduced, the extent to which it is reduced would be deemed to be a taxable supply in the course of the enterprise, at the time of reduction. This section only applies to capital goods or
services with a value exceeding R40 000 or where the goods or services were deemed to be a supply in terms of section 18(4) of the Act, the value of B does not exceed R40 000 (Value-Added Tax Act 89 of 1991 s18(2)).

Where a supply is, in terms of section 18(2) of the Act, deemed a supply, the consideration would be determined in terms of section 10(9) of the Act (see paragraph 3.7).

Section 18(3) of the Act deals with benefits to employees, which are beyond the scope of this study and will therefore not be discussed here.

The provisions of section 18(4) of the Act allow for a deemed supply to be made where, prior to the commencement date (see paragraph 3.3):

(a)(i) goods or services have been supplied to or imported by a person; or
(ii) goods have been manufactured, assembled, constructed or produced by him, for purposes other than consumption, use or supply in the course of business or for a purpose where a deduction of input tax would not have been allowed if the Act had been passed; or

(b)(i) tax has been charged on goods or services supplied to or imported by a person on or after the commencement date; or
(ii) tax has been charged with regard to the supply of goods or services that have been manufactured, assembled, constructed or produced after the commencement date; or
(iii) goods or services deemed by section 18(1) of the Act (see paragraph 3.9) or section 8(2) of the Act, dealing with a person who ceases to be a vendor, to have been supplied, and no deduction of input tax has been made in terms of section 16(3) of the Act; or
(c) second-hand goods have been supplied to a person, not as a taxable supply and no deduction of input tax has been made in terms of section 16(3) of the Act; and the goods or services are subsequently applied for making taxable supplies, a deduction of input tax will, in terms of section 16(3) of the Act, be allowed and the supply shall be deemed to have been made in that tax period, according to the formula:

\[ A \times B \times C \times D \]

where

A is the tax fraction
B is the lesser of-
(i) the cost, including VAT, of the goods or services, provided that where the consideration was, in terms of section 10(4) of the Act, deemed to be the open market value, the cost is deemed to include the market value provided that it exceeds the consideration in money for that supply; or
(ii) the open market value at the time when the supply was deemed to have been made;
C is the ratio of the intended use immediately after the supply over the total intended use, expressed as a percentage provided that where this percentage is 95% or higher, the percentage will be deemed to be 100%; and
D, where paragraph (c) applies, is the ratio of the amount paid, over the total consideration, expressed as a percentage:
provided that-
(i) where a vendor has not been allowed to make a deduction of input tax purely as a result of non-compliance with section 16(2) of the Act, dealing with the requirement of a tax invoice and sufficient records being kept, paragraph (b) of this subsection will not apply;
(ii) in paragraph (c), where second-hand goods consist of (aa) fixed property where transfer duty is payable or would have been payable if no exemption had applied; or
(bb) the original issue of a share in a share block company where stamp duty is payable or would have been payable if no exemption had applied,
the amount determined in this subsection will not exceed the transfer or stamp duty that was payable or would have been payable;
(iii) in paragraph (c), where the second-hand goods consist of fixed property or the original issue of a share in a share block company, the deduction of input tax will only be allowed once the transfer or stamp duty, whichever is applicable, has been paid (Value-Added Tax Act 89 of 1991 s8(2), 16(2), 16(3) and 18(4)).

According to section 18(5) of the Act, where-
(a) capital goods or services have been imported by or supplied to a vendor; or
(b) capital goods have been manufactured, assembled, constructed or produced by him; or
(c) capital goods or services are deemed to have been supplied to him in terms of subsection (4), the purpose of which was to partly render taxable supplies and the extent of the application for use in rendering taxable supplies is increased, the increased portion of the goods or services will be deemed to be supplied by him and a deduction of input tax in terms of section 16(3) of the Act will be allowed according to the formula:

\[ A \times B \times (C - D) \]

where

A is the tax fraction
B is the lesser of-

(i)(aa) the cost, including VAT on the acquisition, manufacture, assembly or construction of the goods or services; or

(bb) the value determined for "B" in terms of section 18(4) of the Act, where a supply of goods or services was deemed to have been made under this section; or

(cc) where an adjustment has been made in terms of section 18(2) of the Act, the value of "A" as determined in terms of section 10(9) of the Act, or where an adjustment has been made in terms of this subsection, the value of "B" as determined in this subsection, whichever is the most recent adjustment; and

(ii) the open market value at the time when the increased use or application of the goods or services is deemed in terms of subsection (6) to have taken place;
C is the percentage use for rendering taxable supplies over the total use during the 12 month period when the increased usage took place; but where the percentage calculated for C does not exceed the percentage calculated in D by more than 10% of the actual use or application, the percentage in D should be used;

D is the percentage that the use or application for taxable supplies is over the total use as determined by section 17(1), section 10(9) or section 18(4) of the Act in the 12 month period preceding the period envisaged in C, subject to this section not applying to capital goods or services under R40 000 or where the supply was deemed to fall under subsection (4) of this section, where B in the formula was less than R40 000. Where the goods are second-hand, as provided for in the definition of input tax in section 1 of the Act, the amount determined under this section will not exceed the amount paid for transfer or stamp duty (Value-Added Tax Act 89 of 1991 s18(5)).

In terms of section 18(6) of the Act, any reduction or increase in the extent of application or use in terms of sections 18(2) or 18(5) of the Act is deemed to have taken place on the last day of the year of assessment of the vendor (Value-Added Tax Act 89 of 1991 s18(6)).

According to section 18(7) of the Act, the extent of the application or use of the goods under subsections (2) and (5) will be based on the use during the 12 month period preceding the date provided for in subsection (6) as being the increase date. Where a supply is deemed to have been made in terms of subsection (4), the extent of the application will be based
on the period beginning on the date the goods or services were deemed to have been supplied to the vendor and ending on the last day of the year of assessment (Value-Added Tax Act 89 of 1991 s18(7)).

Typical situations will now be sketched to illustrate the application of VAT, based on the provisions of the Act as discussed in this chapter.

3.10 APPLICATION WITH REGARD TO DEVELOPERS REGISTERED FOR VAT PURPOSES

3.10.1 Speculative developments intended for resale

3.10.1.1 Intention unchanged

Example 1

A developer of properties, registered for VAT purposes, acquired a residential stand from a township developer, registered for VAT purposes, for R75 000. The developer's intention in acquiring the stand was to develop it and sell the developed property at a profit. He constructed a house on the property and determined a selling price of R280 000.

Prior to the completion of the house, the developer was fortunate enough to sell the house for R275 000.
As the stand was purchased from a registered township developer, the developer of the property would, in terms of section 16(3) of the Act (see paragraph 3.4), have claimed an input tax credit on the cost of the stand, namely $\frac{14}{114} \times R75\ 000$.

During the period of construction of the house, the developer would, in terms of section 16(3) of the Act (see paragraph 3.4), have claimed an input tax credit in respect of all VAT paid by him on goods or services supplied to him for the construction of the house.

In terms of section 7(1) of the Act (see paragraph 3.7), the developer should have paid output tax (see paragraph 3.4) on the selling price of the house, namely $\frac{14}{114} \times R275\ 000$.

Example 2

A developer of properties, registered for VAT purposes, acquired a residential stand from a private person, who was not registered for VAT purposes, for R50 000. The market value of the property was R50 000. The developer's intention in acquiring the stand was to develop it and sell the developed property at a profit. He constructed a house on the property and determined a selling price of R240 000.

Prior to completion of the house, the developer was fortunate enough to sell the house for R240 000.
As the stand was purchased from a private person, who was not registered for VAT purposes, in terms of the Transfer Duty Act, transfer duty was payable by the developer on transfer of the stand to him (Du Plessis 1995:243).

Assuming that the developer is carrying on the enterprise as a company, the transfer duty that he would have paid on the transfer of the stand would have amounted to 10% of R50 000, therefore R5 000.

According to the Taxation Laws Amendment Act 20 of 1994, which amended the principal Act, the definition of input tax (see paragraph 3.3) now limits the notional input tax allowed as an input tax credit to the transfer duty paid, in this case R5 000 (Du Plessis 1995:243).

During the period of construction of the house, the developer would, in terms of section 16(3) of the Act (see paragraph 3.4), have claimed an input tax credit in respect of all VAT paid by him on goods or services supplied to him for the construction of the house.

In terms of section 7(1) of the Act (see paragraph 3.7), the developer should have paid output tax (see paragraph 3.3) on the selling price of the house, namely $14/114 \times R240\ 000$. 
3.9.1.2 Intention changed to letting, owing to circumstances

Example 3

A developer of properties, registered for VAT purposes, acquired a residential stand from a township developer, registered for VAT purposes, for R75 000. The developer's intention in acquiring the stand was to develop it and sell the developed property at a profit. He constructed a house on the property and determined a selling price of R280 000. Owing to poor market conditions, the developer was unable to sell the property that he had developed and was forced to let the property.

The problem that has now arisen is that, as the stand was purchased from a township developer, registered for VAT purposes, the developer of the property would, in terms of section 16(3) of the Act (see paragraph 3.4), have claimed an input tax credit on the cost of the stand.

In addition to this, during the period of construction of the house, the developer would, in terms of section 16(3) of the Act (see paragraph 3.4), have claimed an input tax credit in respect of all VAT paid by him on goods or services supplied to him for the construction of the house.

In terms of section 7(1) of the Act (see paragraph 3.7), the developer should have paid output tax (see paragraph 3.3) on
the selling price of the house, namely \( \frac{14}{114} \times R280\,000 \), but now he is unable to sell it, owing to circumstances beyond his control.

The developer has therefore claimed input tax, but has not paid over output tax. Letting is an exempt supply, therefore no output tax will be paid and no input tax should have been allowed.

In order to make the necessary adjustments, the provisions of section 18(1) of the Act (see paragraph 3.9) state that the developer should make a deemed supply, in other words output tax should be accounted for on the value of the deemed supply.

The value of the deemed supply is, in terms of section 10(7) of the Act (see paragraph 3.7), the open market value of the supply.

In terms of section 18(6) of the Act (see paragraph 3.9), the developer should, in the period that the property was used wholly for purposes of letting, account for the output tax on the last day of the year of assessment of the developer.

**Example 4**

A developer of properties, registered for VAT purposes, acquired a residential stand from a private person, not registered for VAT purposes, for R50 000. The market value of the property was R50 000. The developer's intention in
acquiring the stand was to develop it and sell the developed property at a profit. He constructed a house on the property and determined a selling price of R240 000.

Owing to poor market conditions, the developer was unable to sell the property that he had developed and was forced to let the property.

As the stand was purchased from a private person, not registered for VAT purposes, in terms of the Transfer Duty Act, transfer duty was payable by the developer on transfer of the stand to him (Du Plessis 1995:243).

Assuming that the developer is carrying on the enterprise as a company, the transfer duty that he would have paid on the transfer of the stand would have amounted to 10% of R50 000, therefore R5 000.

According to the Taxation Laws Amendment Act 20 of 1994, which amended the principal Act, the definition of input tax (see paragraph 3.3) now limits the notional input tax allowed as an input tax credit to the transfer duty paid, in this case R5 000 (Du Plessis 1995:243).

During the period of construction of the house, the developer would, in terms of section 16(3) of the Act (see paragraph 3.4), have claimed an input tax credit in respect of all VAT paid by him on goods or services supplied to him for the construction of the house.
In terms of section 7(1) of the Act (see paragraph 3.7), the developer should have paid output tax (see paragraph 3.3) on the selling price of the house, namely $14/114 \times R240\,000$ but now he is unable to sell it, owing to circumstances beyond his control.

The developer has therefore claimed input tax, but has not paid over output tax. Letting is an exempt supply, therefore no output tax will be paid and no input tax should have been allowed.

In order to make the necessary adjustments, the provisions of section 18(1) of the Act (see paragraph 3.9) state that the developer should make a deemed supply, in other words output tax should be accounted for on the value of the deemed supply.

The value of the deemed supply is, in terms of section 10(7) of the Act (see paragraph 3.7), the open market value of the supply.

In terms of section 18(6) of the Act (see paragraph 3.9), the developer should, in the period for which the property was used wholly for letting purposes, account for the output tax on the last day of the year of assessment of the developer.
3.10.1.3 Intention of selling, but only after an initial period of letting

Example 5

A developer of property, registered for VAT purposes, acquired a piece of land on which he had planned to develop a residential townhouse complex. It was estimated that the development of the whole townhouse complex would take approximately three years.

The developer was, at that stage, of the opinion that he would realise higher selling prices for the townhouses if he had completed the whole complex and then commenced marketing the townhouses.

In order to generate cash flow during the construction period of the townhouse complex and for security reasons, he had decided to let the townhouses in phases, as the phases were completed.

The intention of the developer appears to be the central issue in this example. The intention of the developer was to sell the townhouses, thereby making taxable supplies in the course of or for the furtherance of the enterprise. The intention of the developer was therefore in line with the requirements for a supply as set out in section 7(1) of the Act (see paragraph 3.7).
It is important to note that there is no stipulation regarding the matching of input and output tax in periods (Kruger & Bennet 2001:1-2-2). The fact that the sale of the townhouses, in other words the taxable supply, will only take place in three years' time, did not, until 1 July 2000, appear to affect the fact that input tax is being incurred between the commencement date of the construction of the townhouse complex and the completion date.

According to the March 2000 edition of Vat-News, a newsletter prepared by the South African Revenue Services to keep vendors informed, a concession that was previously made to property developers has been withdrawn with effect from 1 July 2000. Developers are now required to pay output tax on the market value of the residential units that they are temporarily letting, in the tax period during which the units are let.

The developer of the townhouse complex would therefore claim input tax credits, in terms of section 16(3) of the Act (see paragraph 3.4), as VAT is charged by suppliers of goods or services over the period of construction, and pay over the output credit, in terms of section 7(1) of the Act (see paragraph 3.7), when the taxable supply is made, that is when the townhouses are temporarily let. When the townhouses are sold at a later stage, output tax will be payable on the selling price of the townhouses, but the output tax paid at the time of letting can be claimed back.

Owing to the fact that the letting of long-term residential accommodation is, in terms of section 12 of the Act (see
3.10.2 Contractual developments

3.10.2.1 Development on buyer's property

Example 6

A developer of properties, registered for VAT purposes, was asked to do a contractual development for residential purposes.

A contract price of R150 000 was agreed upon and an escalation clause was built into the terms of the contract. On completion of the contract, an amount of R5 000 was determined as being owing for escalation.

The person who had entered into the agreement with the developer for the building of the house had already acquired the stand on which the house was to be built, directly from a township developer, at a cost of R60 000.

The buyer was not registered for VAT purposes in terms of section 23(1) of the Act (see paragraph 3.8) and could therefore not claim an input tax credit (see paragraph 3.3) on the cost of the stand.

During the period of construction of the house, the developer would, in terms of section 16(3) of the Act (see paragraph
3.4), have claimed an input tax credit in respect of all VAT paid by him on goods or services supplied to him for the construction of the house.

In terms of section 7(1) of the Act (see paragraph 3.7), the developer should have paid output tax (see paragraph 3.3) on the contract price of the house of R150 000 as well as on the escalation amount (De la Rey 1991:6) of R5 000, namely 14/114 x R155 000.

3.10.2.2 Development on developer's property

Example 7

A developer of properties, registered for VAT purposes, was asked to do a contractual development for residential purposes.

The contractual house was to be built on a stand owned by the developer. The stand was acquired by the developer from a township developer, registered for VAT purposes, at a cost of R60 000.

A contract price of R150 000 was agreed upon and an escalation clause was built into the terms of the contract.

On completion of the contract, an amount of R5 000 was determined as being owing for escalation.
The total selling price, that is the value of the stand and the building contract, excluding the escalation, amounted to R210 000.

As the stand was purchased from a township developer, registered for VAT purposes, the developer of the property would, in terms of section 16(3) of the Act (see paragraph 3.4), have claimed an input tax credit (see paragraph 3.4) on the cost of the stand, namely $14/114 \times R60\,000$.

During the period of construction of the house, the developer would, in terms of section 16(3) of the Act (see paragraph 3.4), have claimed an input tax credit in respect of all VAT paid by him on goods or services supplied to him, for the construction of the house.

In terms of section 7(1) of the Act (see paragraph 3.6), the developer should have paid output tax (see paragraph 3.3) on the selling price of the house as well as on the escalation, namely $14/114 \times R215\,000$ (De la Rey 1991:6).

3.10.3 Developments intended for letting of permanent accommodation

3.10.3.1 Intention unchanged

Example 8

A developer of property, registered for VAT purposes, acquired a piece of land on which he planned to develop a
residential townhouse complex. It was estimated that the development of the whole complex would take approximately three years.

His intention in developing the residential townhouse complex was to keep the property as a long-term investment, and earn monthly rental income from it.

Owing to the fact that the letting of long-term residential accommodation is, in terms of section 12 of the Act (see paragraph 3.7.2), an exempt supply for VAT purposes, there should be no VAT implications in this regard.

The result of this is that the developer would not have claimed input tax on the cost of the land purchased or on the goods or services rendered to him in the course of construction.

Accordingly, no output tax would have been payable on rental income.

3.10.3.2 Intention changed to selling, owing to circumstances

Example 9

A developer of property, registered for VAT purposes, acquired a piece of land on which he planned to develop a residential townhouse complex. It was estimated that the development of the whole complex would take approximately three years.
His intention in developing the residential townhouse complex was to keep the property as a long-term investment, and earn monthly rental income from it.

The developer found that, as the construction of the townhouses was completed, it was impossible to let all the townhouses.

Owing to these circumstances, he changed his original intention of letting all the townhouses, to that of selling all the townhouses.

Section 18(4) of the Act (see paragraph 3.9) provides for a situation like this where goods or services were acquired wholly for making exempt supplies, resulting in no input tax being claimed and at a later date used for purposes of rendering taxable supplies.

The input tax not previously claimed would at this point be allowed in terms of section 16(3) of the Act (see paragraph 3.4).

In the above example, the deemed supply would be determined according to the formula provided for in section 18(4) of the Act (see paragraph 3.9), namely $\frac{14}{114} \times \text{the lesser of the cost or open market value} \times 100\% \times \text{the percentage of the amount paid over the total consideration}$. 
3.11 APPLICATION WITH REGARD TO DEVELOPERS NOT REGISTERED (INCIDENTAL) FOR VAT PURPOSES

In principle, the sale of fixed property by private individuals who are not registered for VAT purposes is not subject to VAT (Ernst & Young 2001:96), and does not incur input tax credits (Van den Berg 1991:629).

Despite the fact that all other requirements for an enterprise may have been met, a "one-off" transaction generally does not meet the requirement of being carried on "continuously" or "regularly" (Kruger & Bennet 2001:1-3-5).

A word of caution is however appropriate at this stage. The Act does not define "continuously" or "regularly". A single development stretching over a long period of time could be considered "continuous", thereby fulfilling the requirements for an "enterprise". A situation similar to this arose in New Zealand in Case N43 (1991) 13 NZTC 3,361 where a farmer subdivided land. In order to increase the value of the land prior to disposal, he erected two houses on the subdivided land. The New Zealand authorities claimed that the activity was "orderly and systematic" thereby making it "regular".

The activity therefore met the requirements of an "enterprise" and constituted a taxable supply (Kruger & Bennet 2001:1-3-5).

In a subsequent Court of Appeal case of Newman v CIR (1995) 17 NZTC 12,087, a small "one-off" subdivision where no
development work was done was held not to comprise a "taxable activity", or, stated otherwise, an enterprise (Kruger & Bennet 2001:1-3-6).

3.11.1 Development intended for resale

Example 10

A man acquired a stand from a township developer at a cost of R90 000.

His intention was to build two duet houses, one of the duets for his personal use, while he intended to sell the other duet and use the profit on that duet to reduce the bond on his property. He had no intention of building any houses in the future and had not built any houses in the past.

The developer applied for approval to build the duets on the property and in due course, this was granted. He commenced with the construction of the two duets, which took three months.

On completion of the duets, the developer moved into the one duet and sold the other duet for R220 000.

The question which now arises is whether he was conducting an enterprise or not. Based on the information sketched, this was a once-off development which was built within three months. The requirements for an activity to be "regular" or "continuous" appear not to have been met.
Consequently, it does not appear that this man was carrying on an enterprise.

The effect would therefore have been that he would not have been able to claim an input tax credit for VAT included in the cost of the stand or the supplies of goods or services used in the construction of the duets (see paragraph 3.4).

On the other hand, the sale of the duet would, for the same reason, not attract output tax (see paragraph 3.3). The person who acquired the duet would therefore have had to pay transfer duty (Franzsen 1993:1071) on the R220 000 selling price of the duet.

3.11.2 Contractual development for resale

Example 11

A man acquired a stand from a township developer at a cost of R90 000.

His intention was to build two duet houses, one of which was to be for his personal use, while the other one would be built contractually; the developer intended using the profit on that duet to reduce the bond on his property. He had no intention of building any houses in future and had not built any houses in the past.
The developer applied for approval to build the duets on the property and this was granted in due course. He commenced with the construction of the two duets, which took three months.

On completion of the duets, the developer moved into the one duet and gave transfer of the other duet on payment of the R220 000 contract price.

The fact that the duet was built contractually and not speculatively was irrelevant, as the treatment of the transaction would in every way have been identical to that above (see paragraph 3.11.1).

3.11.3 Development intended for letting of permanent accommodation

Owing to the fact that the letting of permanent residential accommodation is an exempt supply in terms of section 12 of the Act (see paragraph 3.7.2), the situation where the developer is not registered for VAT purposes is identical to that of a developer registered for VAT purposes (see paragraph 3.10.3.1).

3.12 SUMMARY

This chapter dealt with the specific provisions of the Value-Added Tax Act 89 of 1991, as amended.

Firstly, the provisions of the Act with regard to the VAT rate, the type of VAT system, the methods of accounting for
VAT and the bases for VAT were discussed. It was determined that VAT is charged on goods and services at a standard rate of 14%. VAT should be accounted for on an invoice basis, except where specific requirements are met, in which case permission may be granted for a payments basis to be used.

Secondly, the provisions of the Act with regard to what constitutes a supply of goods or services were determined. The definition of goods specifically includes fixed property. It was found that the definition of fixed property would include any conceivable development of fixed property.

Thirdly, it was determined that every person carrying on an enterprise with taxable supplies exceeding R300 000 in value should register for VAT purposes.

In the next section it was ascertained that no special concessions or exemptions relate to developers of residential properties or residential land and buildings.

Lastly, various possible practical applications with regard to developers of residential properties who are registered for VAT purposes as well as those who are not registered for VAT purposes were illustrated with reference to the Act.

With regard to developers registered for VAT purposes, it was found that the output is subject to VAT and all input tax paid is recoverable.

The situation is totally different where developers not registered for VAT purposes are discussed. Output is exempt from VAT and no input tax credits may be claimed.
The next chapter will look at all the above-mentioned points with regard to the United Kingdom, which will serve as a comparison with the system used in South Africa.

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## CHAPTER 4

THE APPLICATION OF VALUE-ADDED TAX TO SMALL TO MEDIUM-SIZED DEVELOPERS OF RESIDENTIAL PROPERTIES IN THE UNITED KINGDOM

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4.1 INTRODUCTION

In the previous chapter, the application of VAT to small to medium-sized developers of residential properties was examined in terms of the provisions of the South African VAT legislation.

This chapter will analyse and discuss the same topics as those covered in the preceding chapter, except that the discussion will be based on the provisions of the United Kingdom VAT legislation.

4.2 BACKGROUND ON VAT IN THE UNITED KINGDOM

VAT was introduced in the United Kingdom on 1 April 1973, after the admission of the United Kingdom to the European Union on 1 January of that year (Somers 1995:283).

For VAT purposes, England, Wales, Scotland, Northern Ireland and the Isle of Man are included in the United Kingdom (Somers 1995:283).

In the United Kingdom, VAT is governed by the Value Added Tax Act 1994 (hereafter referred to as VATA) and is administered by Her Majesty's Customs and Excise (Somers 1995:283).
VATA furnishes the framework of VAT, but the detail is contained largely in Orders made by the Treasury or Regulations made by Her Majesty's Customs and Excise (Wareham & Dolton 2001:1).

Throughout the European Community (EC), the EC directives, especially the Sixth VAT Directive, overrule any law on VAT (Wareham & Dolton 2001:1).

4.3 TERMINOLOGY RELATING TO VAT IN THE UNITED KINGDOM

According to VATA, the following definitions apply to VAT:

- "input tax" with regard to goods or services, used for the purpose of any business carried on by, and relating to a taxable person means
  - VAT on the supply of goods or services to him;
  - VAT paid on any goods acquired by him from member states; and
  - VAT paid or payable by him on the importation of goods from outside the member states (Value Added Tax Act 1994 s24(1)).

- "output tax" with regard to a taxable person means VAT on goods or services supplied by him, and the VAT on goods acquired by him from member states (Value Added Tax Act 1994 s24(2)).
"supply" includes all forms of supply done for a consideration. Where a "supply" is made which is not a supply of goods, it is a supply of services (Value Added Tax Act 1994 s5(2)).

"supply of goods or services" is in terms of the provisions of Schedule 4 (Value Added Tax Act 1994 s5(1)).

"taxable person" includes any person who is registered or is required to be registered under the VATA (Value Added Tax Act 1994 s3).

"taxable supply" is a supply of goods or services in the United Kingdom other than an exempt supply (Value Added Tax Act 1994 s4(2)).

4.4 CONCEPT OF VAT AS APPLIED IN THE UNITED KINGDOM

The VAT that has been introduced into the United Kingdom is a relatively broadly based VAT (see paragraph 3.3), as it applies to a wide range of goods and services, over and above those exempted (Wareham & Dolton 2001:1). VAT in the United Kingdom is a multi-stage tax (see paragraph 2.3) as it is levied at every stage of supply. As credits are allowed for VAT paid in previous stages (Wareham & Dolton 2001:1), it is non-cumulative (see paragraph 3.3).

In order to calculate the VAT due by him to the authorities, a taxable person should determine the output tax (see paragraph 4.3) that is payable by him. Input tax (see
paragraph 4.3) due to the taxable person should then be determined. Section 25(2) of VATA then provides that the input tax should be deducted from the output tax to determine the VAT due by the taxable person (Value Added Tax Act 1994 s25(2)).

In terms of section 25(3) of VATA, where the input tax exceeds the output tax, a "VAT credit" arises which would be paid to the taxable person by the authorities (Value Added Tax Act 1994 s25(3)).

As the output tax should be recovered from the consumer by being built into the price of the goods and services, and the input tax paid is recovered from the authorities, the overall result for a taxable person is therefore that the VAT should be carried by the final consumer and should not affect the business under consideration (Wareham & Dolton 2001:1).

4.5 VAT RATE

According to section 2(1) of VATA, a standard VAT rate of 17.5% applies to taxable supplies (see paragraph 4.7.1) in the United Kingdom.

4.6 VAT SYSTEMS, METHODS AND BASES AS APPLIED IN THE UNITED KINGDOM

4.6.1 Type of VAT system applied in the United Kingdom

A consumption type of VAT system (see paragraph 2.5.1) is being applied, as the VAT payable is based on the VAT due on
taxable supplies (Wareham & Dolton 2001:3) less the VAT paid on intermediate goods and services for business purposes, including capital expenditure (Value Added Tax Act 1994 s24(1)).

4.6.2 Methods of accounting for VAT in the United Kingdom

In terms of section 1(2) of VATA, VAT is due at the time of supply (Value Added Tax Act 1994 s1(2)).

Where the annual taxable supplies made by a taxable person do not or are not expected to exceed £600 000 (for the 2001-2002 tax year), the taxable person should, however, account and pay for VAT on the payments basis (see paragraph 2.5.2) which, in the United Kingdom, is called the Cash Accounting Scheme (Wareham & Dolton 2001:1064). In the determination of the value of annual taxable supplies, all standard and zero-rated supplies except capital assets previously used within the business should be included. Exempt supplies should be excluded (Wareham & Dolton 2001:1064).

Where a taxable person wishes to account for and pay VAT according to the Cash Accounting Scheme, he need not apply to Her Majesty's Customs and Excise prior to implementing the scheme, provided that the following conditions have been met:

- the requirements of the annual taxable supply limit discussed in the preceding paragraph have been met;
- all returns which should have been submitted have been submitted, and any amounts due have been paid or arrangements made for the payment thereof;
in the past year, no conviction with regard to VAT was taken against him, no penalty for VAT evasion due to dishonest conduct was assessed, and his entitlement to operate the scheme after having been on it was not terminated (Wareham & Dolton 2001:1064).

4.6.3 Base for VAT in the United Kingdom

Section 1 of VATA provides that goods imported into the country from member states or other countries are subject to VAT (Value Added Tax Act 1994 s1).

Subject to various conditions, goods exported beyond the member states are zero-rated (Wareham & Dolton 2001:5).

From the above, it appears that the United Kingdom uses a destination-based VAT (see paragraph 2.5.3).

4.7 SUPPLIES OF GOODS OR SERVICES

In terms of section 1(1) of VATA, VAT should be charged on the supply of goods or services in the United Kingdom as well as on imports into the United Kingdom from member states and from other countries (Value Added Tax Act 1994 s1(1)).

Section 4(1) of VATA is more specific and states that VAT should be charged on the "supply of goods or services" where the supply is a "taxable supply", made by a "taxable person" in the "course or for the furtherance of any business" carried on by him (Value Added Tax Act 1994 s4(1)).
To enable us to understand the implications of section 4(1) of VATA, the definitions of the various elements included in the definition should be examined.

The first element that should be discussed is that of "supply of goods or services" (see paragraph 4.3). As we are referred to Schedule 4 to VATA, we will now discuss the requirements of this schedule.

Schedule 4 to VATA distinguishes between a supply of goods and a supply of services. As not all the points mentioned are relevant to this study, only those that could have relevance are mentioned. According to paragraph 1(1), the following, among others, constitute a supply of goods:

- "any transfer of the whole property in goods is a supply of goods." According to McKaig (2000:1/10), this means that the person passes the "exclusive ownership" of the goods to another person;
- the transfer of goods in terms of an agreement for the sale of the goods is a supply of goods;
- in terms of an agreement, where the possession of goods passes from a supplier and ownership will pass at some future time between the times of possession and payment, the supply constitutes a supply of goods (Value Added Tax Act 1994 Schedule 4 paragraph 1).

Among others, the following supplies of services are stated:

- the transfer of an undivided share of the property is a supply of services;
- the transfer of the possession of goods is a supply of services (Value Added Tax Act 1994 Schedule 4 paragraph 1(1)).
From the above discussion, it appears that the sale of a residential property by a developer would constitute a supply of goods.

The definition of "taxable supply" (see paragraph 4.3) is the next element that should be discussed. As this definition is very widely formulated, anything that is not stated as an exemption from VAT is a taxable supply. Owing to the fact that the construction of residential properties is not included in Schedule 9 to VATA which deals with exemptions, the construction of residential property constitutes a "taxable supply", therefore satisfying this part of the definition of the "supply of goods or services".

The third element of the definition of the supply of goods or services that should be discussed is that the supply should be made by a "taxable person". According to the definition, a "taxable person" (see paragraph 4.3) is any person who is, or is required to be, registered under VATA. In paragraph 4.7 which deals with registration, it is concluded that all developers of residential properties would be obligated to register for VAT purposes. The provisions of this requirement appear to have been met as developers of residential properties are deemed to be "taxable persons".

The element in the "course or for the furtherance of any business" does not appear to be defined in VATA. According to Wareham and Dolton (2001:112), "business" means an ongoing activity, mainly concerned with making supplies for consideration. The activity must have a level of recurrence
and scale, and it should be continued over a period of time. Isolated supplies or unconnected supplies do not qualify as businesses.

The conclusion that can be drawn from the above discussion of a "business" is that a full-time developer of residential properties would meet the requirements of operating a business. On the other hand, someone who built a house once would not appear to be classified as operating a business.

According to section 1(2) of VATA, the person making the supply of goods or services is accountable for the VAT (Value Added Tax Act 1994 s1(2)).

After having determined the meaning of the terms contained in the definition of "a supply of goods or services" above, we shall now discuss the two categories of supplies of goods or services.

According to section 4(2) of VATA, supplies of goods or services are either taxable supplies or exempt supplies (Value Added Tax Act 1994 s4(2)). A discussion of taxable supplies will now follow.

4.7.1 Taxable supplies

Taxable supplies are either taxed at the standard rate, or are zero-rated (Somers 1995:287). McKaig (2000:4/1), also mentions a reduced rate on fuel and power for domestic or charity use.
According to section 2(1) of VATA, effective from 1 April 1991, a standard VAT rate of 17.5% will apply to taxable supplies (Value Added Tax Act 1994 s2(1)) and a reduced rate of 5% will apply to fuel and power for domestic or charity use (McKaig 2000:4/1).

After 11 May 2001, the following supplies are subject to VAT at a reduced rate of 5%.

(a) Services supplied in the course of
   (i) changing the number of single household dwellings in a building, e.g. converting a house to flats;
   (ii) converting a non-residential dwelling into a single or a number of single residential dwellings;
   (iii) converting a single household dwelling which forms part of multiple occupation units into a care home or other qualifying "relevant residential" use property; and
   (iv) converting a house in multiple occupation units into a single household dwelling or vice versa.

(b) Services supplied in the course of renovating a single household dwelling which has been vacant for three or more years.

(c) Building materials and certain electrical goods used by a builder supplying services provided for under (a) or (b) above (Wareham & Dolton 2001:681-682).

In terms of section 30(1) of VATA, certain taxable supplies that are specified in Schedule 8 to VATA, are zero-rated (see paragraph 3.6.1). In terms of section 30(1) of VATA, the rate of VAT that will be charged where the taxable supplies are zero-rated is nil. This section goes on to state that
the supply should, in all other respects, be treated as a taxable supply (Value Added Tax Act 1994 s30(1)).

According to Schedule 8 to VATA, the following items are included as supplies of goods or services that are zero-rated:

- bank notes
- books etcetera
- caravans and houseboats
- charities
- clothing and footwear
- construction of buildings etcetera
- drugs, medicines, aids for the handicapped etcetera
- food
- gold
- imports, exports etcetera
- international services
- protected buildings
- sewerage services and water
- talking books for the blind and handicapped and wireless sets for the blind
- tax-free shops
- transport (Value Added Tax Act 1994 Schedule 8)

Owing to the fact that only the topic dealing with "construction of buildings etcetera" is relevant to this study, only this part will be dealt with in more detail below.

In terms of Schedule 8, Group 5 to VATA, the following supplies of "construction of buildings etcetera" are zero-rated:
Item 1. The "grant" of any part, or a major interest in the building or the site on which the building is situated by a person constructing a building where
- the building is planned as a "dwelling" or a number of dwellings;
- the building is destined solely to be used for a residential or charitable purpose.

Item 2. With the exclusion of services rendered by an architect, surveyor or any person acting as a consultant or supervisor, the supply of any service in the course of construction of
- a building planned as a "dwelling" or a number of dwellings destined solely to be used for a residential or charitable purpose;
- any civil engineering work required in order to develop a permanent park for residential caravans.

In terms of Note (12) of Schedule 8 to VATA, the person to whom the supply is made must have the intention of using it for the purposes mentioned above to qualify for zero-rating.

Item 3. The supply to a person only if that person also supplies the services under the provision immediately above this one, of
- materials; or
- builders' hardware, sanitary ware, or other articles usually used by builders as fixtures.

The same requirement with regard to the intention of use mentioned in Item 2 is also valid here (Value Added Tax Act 1994 Schedule 8 Note (12)).
In terms of Note (12) to Schedule 8 to VATA, the following are not included under materials, builder's hardware, sanitary ware or other articles usually used by builders that are mentioned above:

- finished or prefabricated furniture, except fitted kitchen furniture;
- materials for the construction of fitted furniture, except fitted kitchen furniture;
- domestic electrical or gas appliances, other than those designed to provide heating of space or water or both;
- carpets or carpeting material (Value Added Tax Act 1994 Schedule 8 Note (12)).

The following notes specifying the meaning of terminology only for purposes of Schedule 8, Group 5 to VATA, have been included in the relevant schedule:

- "construction of a building" does not include the conversion, reconstruction, alteration or enlargement of an existing building (Value Added Tax Act 1994 Schedule 8 Note (9)).

- "dwelling" includes a garage constructed, the occupation of which was taken at the same time as that of the "dwelling" (Value Added Tax Act 1994 Schedule 8 Note (2)).

- "grant" includes assignment (Value Added Tax Act 1994 Schedule 8 Note (1)).
"relevant residential purpose" includes
- a home or other institution that provides residential accommodation for children or for persons requiring care as a result of old age, disablement, mental disorders or drug or alcohol dependency;
- a hospice;
- residential accommodation for students, school pupils or members of armed forces;
- a monastery, nunnery or similar concern;
- an institution which is the only or main residence of at least 90% of its residents.

A hospital, prison, hotel, inn or similar establishment is specifically excluded (Value Added Tax Act 1994 Schedule 8 Note (3)).

A certificate must, prior to the supply, be given to the supplier of the building by the person acquiring it, to confirm that the building will be used for "relevant residential purposes" (Value Added Tax Act 1994 Schedule 8 Note (6)).

In terms of Note (7) to Schedule 8 to VATA, the supply of a building which does not entitle the person to whom the supply is being made to utilise it or part of it throughout the year (e.g. time share) will not qualify for zero-rating.

After having determined above what constitutes a taxable supply, we shall now discuss exempt supplies.
4.7.2 Exempt supplies

In terms of section 31(1) of VATA, supplies of goods and services that are included in Schedule 9 to VATA are exempt as well as goods acquired from another member State (Value Added Tax Act 1994 s31(1)).

In terms of Schedule 9 to VATA, the following items are included as supplies of goods or services that are exempt from VAT:

- betting, gaming and lotteries
- burial and cremation
- education
- finance
- fund raising events by charities and other qualifying bodies
- health and welfare
- insurance
- land
- postal services
- sport, sports competitions and physical education
- trade unions and professional bodies
- works of art etc (Value Added Tax Act 1994 Schedule 9)

Owing to the fact that "land" is the only one of the above topics that could relate to this study, only this part will be dealt with in more detail below.

According to Schedule 9, Group 1 to VATA, it appears that "land" that is exempt from VAT is land intended to be used for commercial purposes (eg holiday accommodation, camping
facilities, parking facilities for vehicles, felling and removing of standing timber, etcetera) (Value Added Tax Act 1994 Schedule 9 Group 1).

As it falls beyond the scope of this study, this aspect will not be discussed in detail.

4.8 REGISTRATION

4.8.1 Developers that should register for VAT purposes

In order to determine which developers of residential properties should register for VAT purposes, section 3 of VATA refers to Schedules 1 to 3 to VATA governing the registration of taxable persons (Value Added Tax Act 1994 s3).

Schedules 2 and 3 of VATA cover registration in respect of supplies to, or acquisitions from "member states" (see paragraph 4.3). As we are dealing with developers of residential properties in the United Kingdom, registration will not be in terms of Schedules 2 and 3 to VATA, but rather in terms of goods or services supplied in the United Kingdom and dealt with in Schedule 1 to VATA. The provisions of Schedules 2 and 3 to VATA will therefore not be dealt with here.

According to Schedule 1 paragraph 1(1) to VATA, a person making taxable supplies exceeding £54 000 effective from 1 April 2001 (Wareham & Dolton 2001:954) in a year is required to register for VAT purposes. The registration
should take place at the end of the month when the limit of £54 000 has been exceeded, or at any time when there are reasonable grounds to believe that, in the thirty day period then starting, the value of taxable supplies would exceed £54 000 (Value Added Tax Act 1994 Schedule 1 paragraph 1(1)).

In the determination for registration purposes of the value of taxable supplies made by a person, supplies of capital assets of the business are excluded (Value Added Tax Act 1994 Schedule 1 paragraph 1(7)).

The limit of £54 000 set for taxable supplies, after which registration is a requirement, is extremely low when brought in line with the prices of residential property. It therefore appears, looking solely at this element, that all developers of residential properties would be required to register for VAT purposes.

4.8.2 Developers that need not register for VAT purposes

From the definition of the supply of goods or services (see paragraph 4.7), the requirement that could present problems when classification as a supply of goods or services is sought is that the supply should be "in the course or for the furtherance of the business" (see paragraph 4.7). In order to be classified as a business, the following conditions should be met, namely
- there must be an activity that is ongoing; or
- a certain scale and level of recurrence should be present; and
- the activity should be continued over a period of time.
From the above discussion, it can be concluded that where a residential property is developed as a once-off activity or on an irregular basis, it appears that a "business" is not being conducted, therefore registration for VAT purposes is not required.

4.9 SPECIFIC VAT PROVISIONS RELATING TO RESIDENTIAL LAND AND BUILDINGS

4.9.1 Change of use of a building

According to Wareham & Dolton (2001:671), where a supply that was previously treated as a zero-rated supply is used for other purposes that constitute a non-relevant supply within ten years of the building having been completed, the person who made the supply is treated as having made a taxable self-supply in the course or furtherance of a business. The VAT chargeable would, in this case, be equal to the VAT that would have been payable if the supply of the building had not been treated as zero-rated.

4.9.2 Building contracts

The treatment of contractual developments for VAT purposes is governed by Notice 708 paragraphs 10.1-10.3 of Her Majesty's Customs and Excise. Three different ways in which a house could be built have been provided for:

- "design and build contracts". Where a "design and build" package has been signed, a total price is agreed upon for the design, materials and workmanship. A
separate figure would not usually be given for the design element. In this case the total contract price would take on the nature of the building and would therefore be zero-rated. The same would apply if the total price was only split-up for the internal purposes of the two contracting parties. Where a separate supply for design and other professional services was made, these services would be standard-rated.

- "management contracts". The client acquires the services of professional designers and a management contractor to advise him. If the project goes ahead, the management contractor usually bases the consideration on the total costs of all the "works contractors" plus his fee, usually a percentage of the total anticipated costs of the project. Where the project goes ahead, the fee of the management contractor will be zero-rated, but where the project does not go ahead, the preliminary management contractor's fees will be standard-rated.

- "project / construction management contracts". The client usually appoints a construction company which plans, manages and coordinates the project. The client actually employs and pays the "works contractors". The management fee paid to the project manager would be standard-rated in this case (Wareham & Dolton 2001:697-698).
4.9.3 Refund of VAT to persons constructing new dwellings

According to section 35(1) of VATA, where VAT is chargeable on the supply of goods, or the acquisition of goods from a member state, or on the importation of goods from a place outside the member states, to a person building a dwelling that is not in the course of or for the furtherance of a business, and
- the goods are incorporated in the "dwelling" or its site;
- the supply of goods would have been zero-rated according to item 3 Group 5 Schedule 8 to VATA (see paragraph 4.7.1) if the goods had been supplied to the same person who also supplied services under item 2
the amount of VAT chargeable will be refunded to the person on receipt of a claim relevant thereto (Value Added Tax Act 1994 s35(1)).

In conclusion, section 35(1) of VATA has the effect of placing the developer of a residential property, not registered for VAT purposes (see paragraph 4.8.2), in the same position as the registered developer of residential properties (see paragraph 4.8.1).

4.9.4 Letting of long-term residential accommodation

According to Article 13B(b) of the EC Sixth VAT Directive, the letting of long-term residential accommodation is an exempt supply (Wareham & Dolton 2001:313).
4.10 APPLICATION WITH REGARD TO DEVELOPERS REGISTERED FOR VAT PURPOSES

4.10.1 Speculative developments intended for resale

As discussed earlier in this study (see paragraph 4.7.1), zero-rating applies to the supply of most goods and services used in the construction of residential properties intended for resale. The specific exclusions that are not zero-rated (see paragraph 4.7.1) would be standard-rated (Wareham & Dolton 2001:677), but these exceptions are minimal.

The effect of Note (12) of Schedule 8 to VATA with regard to the person or body to whom the supply is being made (see paragraph 4.7.1) should, however, be pointed out at this stage. Where subcontractors render services to the main contractor, the subcontractors should, in terms of this Note, standard-rate the supplies. This is because the service is rendered to the main contractor who is not going to use the premises to live in, and therefore the zero-rating cannot be applied to these services (Value added Tax Act Schedule 8 Note (12)).

It should, however, be mentioned that the above-mentioned implications of Note (12) of Schedule 8 to VATA will not increase costs of residential properties, as the main contractor will recover the input tax paid on the supplies when determining the net VAT payable on the property to the authorities (see paragraph 4.4).

The way in which residential property transactions would most likely be treated in terms of VATA will now be discussed.
4.10.1.1 Intention unchanged

Example 1

A developer of properties, registered for VAT purposes, acquired a residential stand from a township developer, registered for VAT purposes, for £75 000. The developer's intention in acquiring the stand was to develop it and sell the developed property at a profit. He constructed a house on the property and determined a selling price of £280 000.

Prior to the completion of the house, the developer was fortunate enough to sell the house for £275 000.

Wareham and Dolton (2001:759) have calculated the VAT fraction as being 7/47 (17.5/117.5) at 17.5% and 1/21 (5/105) at 5%.

As the stand was purchased from a registered township developer, the developer of the property would, in terms of section 24(1) of VATA, have claimed an input tax credit (see paragraph 4.4) on the cost of the stand, namely 7/47 x £75 000.

During the period of construction of the house, the developer would, in terms of section 24(1) of VATA, have claimed an input tax credit in respect of all VAT paid by him on goods or services supplied to him for the construction of the house, except for the following, if applicable:

- services rendered by an architect, surveyor, or any person acting as a consultant or supervisor;
- finished, prefabricated or fitted furniture except for fitted kitchen furniture;
- domestic electrical or gas appliances, except those providing heating of space and water;
- carpets or carpeting material (see paragraph 4.7.1).

In terms of Schedule 8 to VATA (see paragraph 4.7.1), the developer would not have paid output tax on the selling price of the house of £275 000 because the supply of the house was zero-rated for purposes of VAT.

Example 2

A developer of properties, registered for VAT purposes, acquired a residential stand from a private person, not registered for VAT purposes, for £50 000. The market value of the property was £50 000. The developer's intention in acquiring the stand was to develop it and sell the developed property at a profit. He constructed a house on the property and determined a selling price of £240 000.

Prior to the completion of the house, the developer was fortunate enough to sell the house for £240 000.

As the stand was purchased from a private person, who was not registered for VAT purposes, the requirements of section 4(1) with regard to a supply of goods or services (see paragraph 4.7) could not have been met. No VAT would therefore have been paid on the transaction.
During the period of construction of the house, the developer would, in terms of section 24(1) of VATA, have claimed the same categories of input tax, with the same exceptions as stated in example 1 above.

In terms of Schedule 8 to VATA (see paragraph 4.7.1), the developer would not have paid output tax on the selling price of the house of £240 000, because the supply of the house was zero-rated for purposes of VAT.

4.10.1.2 Intention changed to letting, owing to circumstances

Example 3

A developer of properties, registered for VAT purposes, acquired a residential stand from a township developer, registered for VAT purposes, for £75 000. The developer's intention in acquiring the stand was to develop it and sell the developed property at a profit. He constructed a house on the property and determined a selling price of £280 000.

Owing to poor market conditions, the developer was unable to sell the property that he had developed and was forced to let the property.

The problem that has now arisen is that, as the stand was purchased from a township developer, registered for VAT purposes, the developer of the property would, in terms of section 24(1) of VATA, have claimed an input tax credit (see paragraph 4.3) on the cost of the stand.
In addition to this, during the period of construction of the house, the developer would, in terms of section 24(1) of VATA, have claimed the same categories of input tax, with the same exceptions as stated in example 1 above.

In terms of Schedule 8 to VATA, the developer would not have paid output tax (see paragraph 4.3) on the selling price of the house as the supply would have been zero-rated, but now he is unable to sell it, owing to circumstances beyond his control.

According to the provisions regarding the change of use (see paragraph 4.9.1), this is deemed a self-supply and therefore the VAT payable would be the amount that would have been paid if the supply had not been zero-rated.

The letting of long-term residential accommodation is an exempt supply (see paragraph 4.9.4), therefore no input tax should have been claimed and no output tax should have been paid.

From the above two paragraphs, it appears that the amount of VAT that should be paid over at this stage is the value of all input tax credits claimed in the past on the building.

Example 4

A developer of properties, registered for VAT purposes, acquired a residential stand from a private person, not registered for VAT purposes, for £50 000. The market value of the property was £50 000.
The developer's intention in acquiring the stand was to develop it and sell the developed property at a profit. He constructed a house on the property and determined a selling price of £240 000.

Owing to poor market conditions, the developer was unable to sell the property that he had developed and was forced to let the property.

As the stand was purchased from a private person, who was not registered for purposes of VAT, the requirements of section 4(1) with regard to a supply of goods or services (see paragraph 4.7) could not have been met. No VAT would therefore have been paid on the transaction.

During the period of construction of the house, the developer would, in terms of section 24(1) of VATA, have claimed the same categories of input tax, with the same exceptions as stated in example 1 above.

In terms of Schedule 8 to VATA, the developer would not have paid output tax (see paragraph 4.3) on the selling price of the house as the supply would have been zero-rated, but now he is unable to sell it, owing to circumstances beyond his control.

According to the provisions regarding the change of use (see paragraph 4.9.1), this is deemed a self-supply and therefore the VAT payable would be the amount that would have been paid if the supply had not been zero-rated.
The letting of long-term residential accommodation is an exempt supply (see paragraph 4.9.4), therefore no input tax should have been claimed and no output tax should have been paid.

From the above two paragraphs it appears that the amount of VAT that should be paid over at this stage is the value of all input tax credits claimed in the past on the building.

4.10.1.3 Intention of selling, but only after an initial period of letting

Example 5

A developer of property, registered for VAT purposes, acquired a piece of land on which he had planned to develop a residential townhouse complex. It was estimated that the development of the whole townhouse complex would take approximately three years.

The developer was, at that stage, of the opinion that he would realise higher selling prices for the townhouses if he first completed the whole complex and then commenced marketing the townhouses.

In order to generate cash flow during the construction period of the townhouse complex and for security reasons, he had decided to let the townhouses in phases, as the phases were completed.
According to Buckett (1991:42), a condition of the zero-rating on residential buildings is that these buildings are used for the relevant purpose (see paragraph 4.9.1) for a period of at least 10 years. As the developer is already aware of the fact that he is going to use the building for purposes of letting, in other words an exempt supply, there is no point in claiming the input tax credits on the building during construction, as it will be deemed a self-supply on occupation of tenants letting the residential building and taxed in the same way as in example 3 above (see paragraph 4.10.1.2).

4.10.2 Contractual developments

4.10.2.1 Development on buyer's property

Example 6

A developer of properties, registered for VAT purposes, was approached to do a contractual development for residential purposes.

A contract price of £150 000 was agreed upon and an escalation clause was built into the terms of the contract. On completion of the contract, an amount of £5 000 was determined as being owing for escalation.

The person who had entered into the agreement with the developer for the building of the house had already acquired
the stand on which the house was to be built, directly from a township developer, registered for VAT purposes, at a cost of £60 000.

As the stand was purchased from a township developer, registered for VAT purposes and in terms of section 35(1) of VATA (see paragraph 4.9.3), the VAT paid on the purchase of the stand could be claimed back, and would amount to 7/47 x £60 000.

During the period of construction of the house, the developer would, in terms of section 24(1) of VATA, have claimed an input tax credit in respect of all VAT paid by him on goods or services supplied to him, for the construction of the house.

As far as the output tax is concerned, the contract for the construction of the house appears to be in accordance with "design and build contracts" (see paragraph 4.9.2). In terms of this type of building contract, the supply, including the design element, would be zero-rated (see paragraph 4.7.1). No output tax would therefore be payable on the total contract price of £155 000.

4.10.2.2 Development on developer's property

Example 7

A developer of properties, registered for VAT purposes, was approached to do a contractual development for residential purposes.
The contractual house was to be built on a stand owned by the developer. The stand was acquired by the developer from a township developer, registered for VAT purposes, at a cost of £60 000.

A contract price of £150 000 was agreed upon and an escalation clause was built into the terms of the contract.

On completion of the contract, an amount of £5 000 was determined as being owing for escalation.

The total selling price, that is, the value of the stand and the building contract, excluding the escalation, amounted to £210 000.

As the stand was purchased from a township developer, registered for VAT purposes, the developer of the property would, in terms of section 24(1) of VATA, have claimed an input tax credit on the cost of the stand, namely \( \frac{7}{47} \times £60 000 \).

During the period of construction of the house, the developer would, in terms of section 24(1) of VATA, have claimed an input tax credit in respect of all VAT paid by him on goods or services supplied to him, for the construction of the house.

With regard to the output tax, it would be treated in the same manner as in paragraph 4.10.2.1., namely as a "design and build contract" which is zero-rated. No output tax would therefore be payable on the total price of £210 000.
4.10.3 Developments intended for letting of permanent accommodation

4.10.3.1 Intention unchanged

**Example 8**

A developer of property, registered for VAT purposes, acquired a piece of land on which he planned to develop a residential townhouse complex. It was estimated that the development of the whole complex would take approximately three years.

His intention in developing the residential townhouse complex was to keep the property as a long-term investment, and earn monthly rental income from it.

Owing to the fact that the letting of long-term residential accommodation is an exempt supply for VAT purposes (see paragraph 4.9.4), there should be no VAT implications in this regard.

The result of this is that the developer would not have claimed input tax on the cost of the land purchased or on the goods or services rendered to him in the course of construction.

Accordingly, no output tax would have been payable on rental income.
4.10.3.2 Intention changed to selling, owing to circumstances

Example 9

A developer of property, registered for VAT purposes, acquired a piece of land on which he planned to develop a residential townhouse complex. It was estimated that the development of the whole complex would take approximately three years.

The developer found that, as the construction of the townhouses was completed, it was impossible to let all the townhouses.

Owing to the circumstances, he changed his original intention of letting all the townhouses, to selling all the townhouses.

There does not appear to be a time limit on the claiming of input tax credits, therefore in terms of section 24(1) of VATA, all input tax credits would, at this stage, be claimed.

As the developer is now planning to sell the townhouses, it appears that the supply would be taxed in the same manner as if he had intended selling the townhouses from the word go.

It therefore appears that the supply would be zero-rated. No output tax would therefore be payable on the total sales value of the townhouses.
4.11 APPLICATION WITH REGARD TO DEVELOPERS NOT REGISTERED (INCIDENTAL) FOR VAT PURPOSES

As discussed in paragraph 4.8.2, the developer of residential properties who is not registered, is, in terms of section 35(1) of VATA, placed in the same position as the developer registered for VAT purposes. This results in this section becoming superfluous, as the application would be identical to that under paragraph 4.10.

4.12 SUMMARY

This chapter discussed the specific provisions of the Value Added Tax Act 1994 (VATA) of the United Kingdom, as amended. As VATA furnishes the framework of VAT and the specific provisions are found in Orders made by the Treasury or Regulations made by Her Majesty's Customs and Excise, information could not merely be taken from VATA.

The same points that were dealt with in the previous chapter with regard to South African legislation were examined with regard to the situation in the United Kingdom, namely the background to the VAT legislation in the United Kingdom was studied, and this was followed by a discussion of the terminology used in VATA.

The concept of VAT, the VAT rate and the VAT systems, methods and bases as applied in the United Kingdom, were then discussed. A standard VAT rate of 17,5% applies to taxable supplies.
VAT is due at the time of the supply, but where annual taxable supplies do not exceed £600,000, VAT should be accounted for on the Cash Accounting Scheme.

Further, the supply of goods or services was discussed and it was found that the supply of new permanent residential accommodation is generally zero-rated in terms of Schedule 8 to VATA. Zero-rating means that no output tax is payable on the supply, but at the same time, all input tax paid may be recovered. In terms of Note (12) to Schedule 8 to VATA, no input tax credit is allowed on certain items of which carpeting and stoves appear to be items which would be included in most residential dwellings.

VATA provides for a special concession relating to persons constructing new dwellings that are not in the course of or for the furtherance of the business. In terms of this concession, VAT paid will be refunded to the person concerned. The developer not registered for VAT purposes is therefore placed in the same position as the developer registered for VAT purposes.

Where a person makes taxable supplies exceeding £54,000 per year, registration is required.

The four sets of specific VAT provisions relating to residential land and buildings were then covered. This was followed by the most likely application of all the regulations and legislation in practical examples.
4.13 BIBLIOGRAPHY

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Acts

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CHAPTER 5

THE APPLICATION OF VALUE-ADDED TAX TO SMALL TO MEDIUM-SIZED DEVELOPERS OF RESIDENTIAL PROPERTIES IN CANADA

5.1 INTRODUCTION

In the previous two chapters we discussed the application of VAT in South Africa and the United Kingdom and now we will do the same for Canada based on the Canadian legislation.

The application of VAT (GST) to the small to medium-sized developer of residential properties will then be illustrated by means of examples.

5.2 BACKGROUND ON GST IN CANADA

VAT was introduced into Canada on 1 January 1991 on a federal level and is known as the Goods and Services Tax (GST) (Somers 1995:507).

The GST is administered by Revenue Canada and is governed by Part IX of the Excise Tax Act (hereafter referred to as the ETA) (Somers 1995:507). Schedules V, VI, VII and VIII of the ETA dealing with "Exempt Supplies", "Zero-Rated Supplies", "Non-Taxable Importations" and "Participating Provinces and Applicable Tax Rates" are referred to in part IX of the ETA and relate to GST (Excise Tax Act s123).
5.3 TERMINOLOGY RELATING TO GST IN CANADA

According to section 123 of the ETA, the following definitions apply to Part IX and Schedules V, VI and VII of the ETA:

- "amount" means money or the value in money of property or a service.

- "builder" of a residential complex or of an addition to a multiple unit residential complex means a person who
  (a) while he has an interest in the property on which the complex is situated, employs another person to
    - construct an addition to a multiple unit residential complex where an addition is required;
    - construct a residential condominium unit in a condominium complex; or
    - construct or substantially renovate a complex;
  (b) acquires an interest in a multiple unit residential complex while it is under construction or any other complex while it is under construction or being substantially renovated;
  (c) makes a supply of a mobile or floating home before the home has been occupied by an individual as a place of residence;
  (d) acquires an interest in a residential condominium unit before it is registered as a condominium or before it has been occupied as a place of residence by an individual, for the primary
purpose of selling the complex or part thereof, or
supplying it by way of lease or licence with the
exception of an individual who has purchased it
for personal use;
(e) anyone deemed according to section 190(1) to be a
builder;
(f) excludes anyone purchasing under (a), (b) and (c)
above for personal use;
(g) excludes anyone making a supply of a mobile or
floating home other than in the course of
business; and
(h) excludes any person identified in (a) to (c) above
who only has a right to purchase the complex or
part thereof from the builder.

"business" includes a "profession, calling, trade,
manufacture or undertaking", irrespective of which type.
"Business" also includes any activity that is embarked
on, on a regular or continuous basis which entails the
supply of property by way of lease, licence or
comparable agreement. An office or employment is
excluded from this definition.

"commercial activity" of a person means
(a) a "business" carried on by that person but
excluding exempt supplies;
(b) an "adventure or concern" of the person in the
nature of trade, excluding the extent to which it
involves the making of exempt supplies,
excluding a business carried on without a fair expectation of earning a profit, by an individual, a personal trust or a partnership where the members are all individuals,
(c) the making of, or anything in the course of, or in connection with, the making of a supply of real property, but excluding an exempt supply.

- "common-law partner" means a person who is the common-law partner of the individual at that time for purposes of the Income Tax Act.

- "condominium complex" refers to a residential complex containing more than one residential condominium unit.

- "consideration" includes any amount that is payable for a supply in terms of a law.

- "exempt supply" means a supply included in Schedule V.

- "improvement" with regard to capital property means any goods or services supplied to the owner with a view to increasing the value of the capital property to result in an adjusted capital base of the said property for purposes of the Income Tax Act.

- "individual" is defined as meaning a natural person.

- "multiple unit residential complex" means a residential complex containing more than one residential unit, but excludes a "condominium complex".
- "person" includes an individual, a partnership, a corporation, a trust, an estate, a body that is a society, union, club, association, commission or other organisation of any kind.

- "property" means any property, real or personal, tangible or intangible, movable or immovable, corporeal or incorporeal and includes a share, right or interest of any kind. Money is however excluded.

- "real property" includes land and buildings as well as a leasehold interest therein. Real property does not include mortgages or liens which are considered to be "financial instruments" for GST purposes.

- "recipient" of a supply of property or a service where consideration is payable, means the person liable to pay that consideration either in terms of an agreement or otherwise. "Recipient" of a supply of property or a service where no consideration is payable, in the case of a sale means the person who the property is delivered or made available to, or where a supply is made other than a sale, the person to whom the service is rendered or the person who took possession or use of the property.

- "residential complex" is defined as including owner-occupied single family homes, semi-detached homes, mobile homes, condominiums and multi-unit apartment buildings with the land and common areas found at
buildings like this. Hotels, motels or similar concerns that provide all or substantially all accommodation for less than 60 days are excluded.

- **residential condominium unit** means a certain space in a building defined as a separate unit on a plan registered in terms of the laws of a province and includes any claim to land relating to ownership of the unit.

- **residential unit** means a detached house, semi-detached house, rowhouse unit, condominium unit, mobile home, floating home or apartment. A room or suite in a hotel, motel, inn, boarding house and lodging house as well as a residence for students, seniors, disabled or other individuals is also included in the definition. The "residential unit" must be occupied or leased by an "individual" for residential or lodging purposes. Where the "residential unit" is vacant, it should last have been occupied by "individuals" for residential or lodging purposes. Where the "residential unit" has never been occupied, it should be intended to be used for purposes of residence or lodging by "individuals".

- **sale** with regard to property includes any transfer of ownership or possession of the property under an agreement to transfer ownership thereof.
"tax" means tax payable under this part, being 7% in terms of section 165(1) of the ETA or zero-rated in terms of section 165(3) of the ETA.

"taxable supply" means a supply that is made in the course of a commercial activity.

"tax rate" means the rate set by the province in Schedule VIII, namely 8% for all participating provinces, namely Nova Scotia, New Brunswick and Newfoundland.

"zero-rated supply" means a supply included in Schedule VI. (Excise Tax Act s123).

5.4 CONCEPT OF GST AS APPLIED IN CANADA

The GST that has been introduced in Canada includes the supply of a broad range of "services" and "property" (see paragraph 5.3). The GST differs from traditional value-added taxes in that it is aimed at the "recipient" (see paragraph 5.3) of goods and services (Somers 1995:507).

In terms of section 221(1) of the ETA, the GST is a multi-stage tax (see paragraph 2.3) as all persons making taxable supplies of property and services are required to collect the GST on the supplies.
In terms of section 169(1) of the ETA, where property or a service is supplied to or imported by a registrant, GST is paid by the registrant on the supply of property or importations to him (Excise Tax Act s169(1)).

The GST is non-cumulative (see paragraph 2.4) as, in terms of section 225(1) to (3) of the ETA, an input tax credit would be allowed in respect of the GST paid previously, before being sold to the end consumer (Excise Tax Act s225(1) to (3)).

At this stage, we should determine in which circumstances an input tax credit would be allowed.

According to section 169(1) of the ETA, the input tax credit would be determined by the following formula:

\[ A \times B \]

where

A is the total GST that has become payable or that is paid without having become payable, in respect of the supply or importation; and

B is the extent to which the person acquired or imported the supply for use or supply in the course of commercial activities of the person, expressed as a percentage (Excise Tax Act s169(1)).

After having determined the input tax credit, the next step would be to determine the net GST due or refundable to the registrant.
According to section 225(1) to (3) of the ETA, the net tax of a person for a specific period could be either a positive or negative amount and is determined by the formula:

\[ A - B \]

where

A is the total of
- all amounts that have been collected or are collectible with regard to Division II of the ETA, being the division dealing with Goods and Services and
- all amounts that are required to be added in terms of Division V of the ETA, being the Collection and Remittance of Division II Tax.

B is the total of
- all amounts being input tax credits with regard to the person submitting the return under Division V of the ETA and relating to the specific reporting period or a preceding period, if not previously claimed and
- all amounts which may, in terms of Division V of the ETA be deducted in determining the net tax of the person for the specific reporting period if not previously deducted (Excise Tax Act s 225(1) to (3)).

According to section 225(4) of the ETA, a limit is placed on an input tax credit in that
- where the person is a "specified person" (see section 225(4.1) below), the input tax must generally, with two exceptions that will not be discussed here, be claimed within two years of the fiscal year that included the period in which the return should have been filed;
where the person is not a specified person the input tax must be claimed within four years after the end of the period in which the tax became payable (Excise Tax Act s225(4)).

In terms of section 225(4.1) of the ETA, a "specified person" is a financial institution, or a person where the threshold amount exceeded C$6 million in the current and previous fiscal years, unless all or substantially all the supplies were taxable supplies or the person is a charity (Excise Tax Act s225(4.1)).

Another restriction is placed on the claiming of an input tax credit in certain circumstances. In terms of section 225(5) of the ETA, where a registrant has made an exempt supply of real property in terms of Schedule V (see paragraph 5.7.2), a precondition of which is that no input tax credits may be claimed in respect of the acquisition preceding the current acquisition of the property, the input tax credit may not be claimed at a later stage (Excise Tax Act s225(5)).

5.5 GST RATE

In terms of section 165(1) of the ETA, taxable supplies made in Canada are subject to VAT on a federal level at the current standard rate of 7%.

In addition to the federal VAT mentioned above, a provincial sales tax of 8% in terms of section 165(2) and Schedule VIII
of the ETA applies in three participating provinces. The sum of the federal sales tax and the provincial sales tax amounts to 15% and is called the harmonious sales tax (HST).

All provinces other than the three applying HST apply a provincial sales tax (PST) varying between 6% and 10% over and above the federal VAT.

5.6 VAT SYSTEMS, METHODS AND BASES AS APPLIED IN CANADA

5.6.1 Type of VAT system applied in Canada

Canada, like South Africa, applies a consumption type (see paragraph 2.5.1 and 3.6.1) of VAT as, in terms of section 225(1) to (3) of the ETA, GST is based on the tax on supplies of property and services less the tax on purchases and any acquisitions of a capital nature (Excise Tax Act s225(1) to (3)).

5.6.2 Methods of accounting for GST in Canada

In terms of section 225(1) of the ETA, registrants are required to include all GST collected or collectible, plus any other amounts that need to be added to net tax, such as a refund of tax from a supplier. On the other hand, registrants are allowed to claim the input tax for all supplies paid or payable, as well as any amounts that may be written off, such as bad debts.
From the above provisions of section 225(1) of the ETA, it appears that Canada applies the invoice basis (see paragraph 2.5.2) for accounting for GST.

In section 227 of the ETA, an alternative method of accounting for GST, known as the streamlined accounting method, was introduced. This method was introduced to simplify accounting for GST. It is aimed at small retailers who do not have sophisticated cash registers enabling them to record the provincial sales tax and the GST, especially where they provide taxable and zero-rated supplies (Wood vol 3 2000:431-432).

In Canada, section 227 of the ETA provides for circumstances where, having followed the procedures laid down in this section of the ETA, certain registrants may elect a prescribed method of determining their net tax. This elected method is in terms of the prescribed Part of the Streamlined Accounting (GST) Regulations (Excise Tax Act s227).

According to the Goods and Services Tax Technical Paper, registrants that have elected to use the streamlined accounting method will not have to differentiate between taxable and zero-rated goods at the cash register, but may use an estimate of the GST collected in the determination of the net tax for purposes of section 225(1) of the ETA (Wood vol 3 2000:431-432).
The streamlined accounting method is available to independent retailers selling both taxable supplies and zero-rated groceries where sales do not exceed C$2 million annually (Wood Volume 3 2000:431-432).

5.6.3 Base for GST in Canada

Canada cannot be classified as applying a destination-based or origin-based VAT (see paragraph 2.5.3). This is due to the fact that, according to section 218(1) of the ETA, most imports are subject to GST, but numerous exceptions are stated in Schedule VII to the ETA which deals with "Non-Taxable Importations". Exports are, in terms of Schedule VI, Part V to the ETA, exempted from GST (Excise Tax Act s218(1), Schedule VI, Part V and Schedule VII).

5.7 SUPPLIES OF PROPERTY OR SERVICES

In terms of section 123 of the ETA, the definition of "supply" (see paragraph 5.3) is a very broad definition and includes the provision of "property" or a "service" in any form imaginable. It therefore appears that any provision of property or a service would be deemed to be a "supply".

The meaning of "property" is the next element that should be looked at. As with the definition of "supply" discussed above, "property" (see paragraph 5.3) is defined very broadly and appears to include anything that could change ownership, except money, which is specifically excluded in the above-mentioned definition.
The last element of the "supply" of "property" and "services" that should be looked at is that of "services". In section 123 of the ETA, "service" (see paragraph 5.3) is defined as anything except property, money and services rendered to an employer by an employee with regard to the post that he holds. The definition of "service" therefore makes it virtually impossible to avoid GST on the grounds that the commodity supplied is neither goods nor services.

At this point in the discussion, it should be mentioned that, according to section 133 of the ETA, where an agreement for the supply of property or services is entered into, the supply is deemed to be made at the time when the agreement is entered into. GST would therefore apply to any partial payment or prepayment, irrespective of whether the property had been transferred (Excise Tax Act s133).

After having determined the meaning of all the terms encompassed in the definition of "supplies", "property" and "service", the various categories of supplies will now be discussed, the first one being taxable supplies.

5.7.1 Taxable supplies

According to section 123 of the ETA, a supply made in the course of a "commercial activity" is a "taxable supply" (see paragraph 5.3) (Excise Tax Act s123).

In order to determine whether a taxable supply has been made, the definition of "commercial activity" (see paragraph 5.3) should be examined. From this definition, it can be seen
that a "business" or an "adventure or concern" in the nature of trade with a reasonable expectation of profit, should be carried on, or a supply of real property should be made. These elements which constitute a "commercial activity", will now be discussed in more detail.

The first element of the definition of a "commercial activity", namely, that a "business" should be carried on, will now be discussed.

The definition of "business" (see paragraph 5.3) is formulated very broadly and includes practically any type of undertaking possible, irrespective of whether a profit is anticipated. The definition of "business" also includes any activity performed on a regular or continuous basis involving the supply of property by leasing or the licensing thereof (Excise Tax Act s123).

A "business" run by individuals (see paragraph 5.3), a personal trust, or a partnership made up of individuals without a fair expectation of earning a profit and exempt supplies are specifically excluded from the definition of "commercial activity" (Excise Tax Act s123).

The second element of the definition of "commercial activity" refers to any "adventure or concern" in the nature of trade, which is not specifically defined in the ETA. The same exclusions as those for a "business" are stated.

Thirdly, the making of a "supply" of "real property" (see paragraph 5.3), excluding any exempt supplies, is specifically included in the definition of "commercial
activity". According to section 123 of the ETA, land and buildings and any leasehold interest would be included in "real property". This would in effect include any supply of land and buildings by developers, except for the exempt supply of real property dealt with in Schedule V, Part 1 (see paragraph 5.7.2).

From the above discussion of taxable supplies, we have determined that all supplies of real property, other than exempt supplies, would be deemed taxable supplies for GST purposes.

The next step is to determine the rate at which these supplies would be taxed.

In terms of section 165(1) of the ETA, taxable supplies made in Canada are taxed at the current standard rate of 7% on the consideration (Excise Tax Act s165(1)).

According to section 165(2) of the ETA, all recipients of taxable supplies in participating provinces shall, in addition to the tax imposed in terms of section 165(1), pay tax calculated at the rate stipulated for that province, on the value of the consideration (Excise Tax Act s165(2)). Presently, a rate of 8% applies to all participating provinces, namely Nova Scotia, New Brunswick, and Newfoundland (Excise Tax Act Schedule VIII). According to Wood (vol 1 2000:12-13), the harmonised sales tax (HST) was implemented in 1997, and comprises a blend of a provincial component of 8% and a federal component of 7%. All provinces other than the three mentioned above apply their own PST on varying bases, at varying rates. The rates of PST vary
between 6% and 10%, which are quite close to the 8% provincial component of the HST. At present, no other provinces are prepared to harmonise the provisional sales tax (PST) and the GST. As the HST already applies to three provinces, and it appears to be the direction that is being aimed at for future taxes, this study will deal with the GST and the HST. All PST will be ignored.

Section 165(3) determines that where a supply is zero-rated, (see paragraph 3.5.1), the rate of tax is 0% (Excise Tax Act s165(3)).

After having determined the rate of GST, the "person" responsible for collecting it should be ascertained.

In terms of section 221(1) of the ETA every "person" who makes a "taxable supply" is compelled to collect the tax as an agent for Her Majesty in Canada (Excise Tax Act s221(1)).

However, section 221(2) of the ETA stipulates exceptions where the "person" making the supply is not required to collect GST as an agent for Her Majesty. These exceptions are:

- sales by non-residents;
- sales of non-residential property made to persons registered for GST purposes;
- sales of residential property to persons other than individuals who are registered for GST purposes; or
- sales to persons who are required to be registered for GST purposes (see paragraph 5.8.1)
In the circumstances mentioned above, the "recipient" (see paragraph 5.3) is, in terms of section 228(4) of the ETA, required to pay any GST payable directly to the Receiver General and not to the supplier of the service or property (Excise Tax Act s221(2) and s228(4)).

From the above, it was determined that in many cases it is the responsibility of the recipient of the supply to pay over the relevant GST. Section 223 of the ETA states two requirements, namely that the "recipient" must be aware that the supply is taxable and must have sufficient information with regard to GST on the supply to enable him to support a claim for an input tax credit. Two alternatives for meeting this requirement are stated in section 223(1) of the ETA relating to taxable supplies, other than zero-rated supplies, as follows:

- Invoices or receipts should clearly indicate the consideration paid or payable for the property or services supplied, as well as the relevant GST.
- Where prices on invoices or receipts include GST, this fact should be clearly indicated thereon (Excise Tax Act s223(1)). An example of a regulation that has been prescribed is that signs should be conspicuously displayed in a supplier's place of business that will indicate to consumers that tax has been included in the amount paid for the goods and services (Wood vol 3 2000:406).

In order to determine whether the developer of residential properties would be responsible for collecting GST as an agent for the Crown, one would have to look at who acquires the property.
Where an individual who is not registered for GST purposes acquires the property, as would be the case in the majority of transactions, the developer would, in terms of section 221(1) of the ETA, be required to collect GST and pay it over to the authorities (Excise Tax Act s221(1)).

On the other hand, where a person who is not an individual or a person who is registered for GST acquires the property, the developer need not, in terms of section 228(4) of the ETA, collect GST on behalf of the authorities. The recipient is, in this case, required to pay over GST directly (Excise Tax Act s228(4)).

After having ascertained, as described above, what would constitute a "taxable supply" and having determined what the position of the developer of residential properties would be with regard to a taxable supply, the supplies that have been zero-rated should be discussed.

The following is a broad outline of certain goods and services that have, in terms of Schedule VI to the ETA, been zero-rated in Canada:
- prescription drugs and biologicals
- specified medical devices
- basic groceries
- agricultural and fishing supplies
- exports
- certain travel services
- certain transportation services
- supplies to international organisations and officials
- certain financial services
- the collection of customs duties (Excise Tax Act Schedule VI).

After having discussed what constitutes a taxable supply, we shall now discuss exempt supplies.

5.7.2 Exempt supplies

The definition of an exempt supply in section 123 refers to Schedule V of the ETA. The following is a list of items included in this schedule:
- real property
- health care services
- educational services
- child and personal care services
- legal aid services
- public sector bodies
- financial services
- ferry, road and bridge tolls (Excise Tax Act Schedule V).

Owing to the fact that only the real property relates to the topic under discussion, only the sections of Part 1 relevant to the study will be discussed in more detail.

According to section 2 of Part 1 of Schedule V to the ETA, the following supplies by way of sale are exempt from GST,
provided that the sale was not made by the builder and no input tax credit was claimed at the last acquisition or on any "improvements" (see paragraph 5.3) made thereto
- a "residential complex" (see paragraph 5.3); and
- an addition to a "multiple unit residential complex" (see paragraph 5.3).

Section 3 of Part 1 of Schedule V to the ETA provides that where an individual who built a residential complex or made additions to a multiple unit residential complex sells the residential complex
- where on completion of the construction or substantial renovation the complex was used primarily as a place of residence by the individual, a relation of his or former spouse, or common-law partner and
- where the complex was not used for any other purpose
the supply would be exempt, except where the individual claimed an input tax credit with regard to the last acquisition of the property.

According to Wood (vol 3 2000:691), when deciding whether a supply of a self-built home is exempt or not, the determining factor is whether an input tax credit has been claimed on the last acquisition. Where an input tax credit has not been claimed, the supply of the self-built home would be exempt.

In terms of section 4 of Part 1 of Schedule V to the ETA, a supply of a single unit residential complex or a residential condominium unit by a builder would be exempt where
(a) a residential condominium unit, previously part of a multiple unit residential complex (see paragraph 5.3), has been converted by the builder into a condominium
complex (see paragraph 5.3) and the builder has received an exempt supply of the residential complex on the last acquisition, or there has been a deemed supply in terms of section 191(3) of the ETA (see paragraph 5.9.6); or 

(b) in any circumstances, the builder has been the recipient of an exempt supply of the single unit residential complex or the residential condominium unit or has been, in terms of section 191(1) or (2) of the ETA deemed to have made a taxable supply by way of sale and that supply was the last supply of the single unit residential complex or residential condominium unit.

The above-mentioned supplies would not be exempt if the builder or someone appointed by him carried on substantial repairs subsequent to the last acquisition of the property or if the builder claimed an input tax credit in respect of the last acquisition or any subsequent improvements (Excise Tax Act Schedule V Part 1 s4).

According to Wood (vol 3 2000:692), an example of a case where the builder would be the recipient of an exempt supply is where, after completion of construction, the builder makes a taxable supply by way of sale of the property and later acquires it as a used residential property which is exempt.

An example of a deemed sale in terms of section 191(3) is considered to be where a builder, on completion of construction, makes an exempt supply by way of a lease of the residential property, resulting in the self-supply rules of section 191 of the ETA being applicable (see paragraph 5.9.6).
Section 5 of Schedule V to the ETA states that a supply by way of sale of a multiple unit residential complex by a person who is the builder of the complex or of an addition to the complex would be exempt where

(a) the builder of the complex received an exempt supply by way of sale or was, in terms of section 191(3) of the ETA, deemed to have received a taxable supply of the multiple unit residential complex and that supply was the last supply of the residential property to the builder; and

(b) the builder of the addition received an exempt supply by way of sale or was deemed, in terms of section 191(4) of the ETA, to have received a taxable supply of the addition by way of sale and that supply was the last supply of the addition to the builder.

The above-mentioned exemptions would not apply where the person carried on, or contracted someone to carry on, substantial renovations subsequent to the last supply, or an input tax credit was claimed by the person with regard to the last acquisition of, or any subsequent improvements to, the multiple unit residential complex (Excise Tax Act Schedule V Part 1 s5).

From the above provisions of sections 4 and 5 of Part 1 of Schedule V to the ETA, it can be seen that the supply by way of sale of a used single unit residential complex, a residential condominium unit, a multiple unit residential complex or an addition to a multiple unit residential complex are all given the same status with regard to being exempt supplies under certain conditions.
Section 5.1 of Part 1 of Schedule V to the ETA deals with the sale of a building containing one or more residential units situated on land that is being leased. In terms of this section, the sale of the building, a part thereof or an interest therein, to the lessee of the land is exempt where immediately before and after ownership or possession is transferred to the recipient of the supply in terms of the sales agreement, the building should form part of a residential complex; and the lease of the land should be exempt in terms of subparagraph 7(a)(i) of Part 1 of Schedule V to the ETA (Excise Tax Act Schedule V Part 1 s5.1).

Section 5.2 of Part 1 of Schedule V to the ETA provides for the sale of land that was previously leased and that forms part of a residential complex. In terms of this section, the sale of the land would be exempt if the land and buildings were sold as a unit, the sale would have been an exempt sale of a used residential complex in terms of any of sections 2 to 5 of Part 1 of Schedule V to the ETA; and where, immediately before the sale, the land was subject to an exempt lease in terms of paragraph 7(a) of Part 1 of Schedule V to the ETA, being the lease of the land and a residential unit attached to it for a period of at least one month.

According to section 5.3 of Part 1 of Schedule V to the ETA, the supply of land that has been acquired as a residential trailer park is exempt. This exemption is valid, provided that the supplier of the trailer park has not claimed an input tax credit (Excise Tax Act Schedule V Part 1 s5.3).
In terms of section 6 of Part 1 of Schedule V to the ETA, the supply of
- a residential complex or a residential unit in a residential complex by way of a lease is exempt from GST where it has been occupied by an individual as a residence for at least a month; and
- a residential unit by way of lease is exempt from GST where it has been occupied by an individual as a residence provided that the consideration for the supply does not exceed C$20 per day (Excise Tax Act Schedule V Part 1 s6).

Section 6.1 of Part 1 of Schedule V to the ETA exempts the supply by way of lease, licence or similar arrangement of land, a building, or that part of a building consisting solely of residential units to a particular person where he in turn leases the property as an exempt supply in terms of section 6 or 7 or this section (Excise Tax Act Schedule V Part 1 s6.1).

In terms of section 7 of Part 1 of Schedule V to the ETA, the supply
(a) by way of lease of land, excluding a site in a residential trailer park is exempt from GST where the period of the lease is at least one month and the supply is made to
- the owner, lessee or person occupying a residential unit that was built, or is to be built as a place of residence; or
- a person who is gaining possession of the land in order to construct a residential complex on it in the course of a commercial activity;
- "service" includes anything except property, money and anything supplied to an employer by an employee in the course of or relating to the position of employment of that person.

- "short-term accommodation" means a place of residence for an "individual" in terms of a lease, licence or similar provision whereby the same "individual occupies the place of residence for less than a month", but excludes supplies under timeshare arrangements and tour packages.

- "single unit residential complex" means a "residential complex containing only one unit and excludes a "residential condominium unit"."

- "small supplier" is a person classified at that time as a "small supplier" in terms of section 148 or section 148.1 of the ETA.

- "substantial renovation" of a residential complex means the removal or replacement of all or essentially all of the building, excluding the foundations, external walls, supporting interior walls, floors, roof and staircases. After completion of the building, it should form part of a residential complex.

- "supply" means the provision of a service or property in any manner including the sale, exchange, barter, lease, licence, rental, transfer, gift or disposal thereof, subject to section 133 and section 134 of the ETA.
(b) of a site in a residential trailer park by way of lease for at least a month and made to the owner, lessee, or the person occupying a mobile home, travel trailer, motor home or similar vehicle or trailer situated or to be situated on the site (Excise Tax Act Schedule V Part 1 s7).

According to section 9 of Part 1 of Schedule V to the ETA, the supply by way of sale of real property made by an individual or a trust where all the beneficiaries are individuals is exempt, except in the following cases:

(a) property that immediately prior to the transfer of ownership or possession was capital property, used primarily in a business of the individual or trust;

(b) a supply of real property made
   - in the course of a business of the individual or the trust; or
   - in the course of an adventure or a concern in the nature of the business of the individual or the trust where an election has been filed with the Minister;

(c) a supply of a parcel of land that has been subdivided into parts, except
   - where the land was subdivided into two parts, but not by the individual, trust or settlor; or
   - where the recipient of the land is an individual who is related to or is a former spouse or common-law partner of the individual or settlor and is acquiring it for personal use and enjoyment;
(d) a supply deemed to have been made in terms of sections 206 or 207 dealing with capital real property; or
(e) a supply of a residential complex (Excise Tax Act Schedule V Part 1 s9).

According to Wood (vol 3 2000:705-706), the above section exempts individuals selling country homes kept for personal use, non-business land and non-commercial hobby farms. The supply of residential complexes is excluded from this section, as it is dealt with in sections 2 to 5 of Part 1 of Schedule V.

Section 14 of Part 1 of Schedule V to the ETA states that, for purposes of sections 4, 5, 5.2 and 5.3 of this part, it should be deemed that section 190(4) and (5) dealing with supplies of sites in residential trailer parks and section 191 of the ETA dealing with self-supply provisions had been in force at all times (Excise Tax Act Schedule V Part 1 s14).

Wood (vol 3 2000:708) states that, when looking at the effect of section 14 of Part 1 of Schedule V to the ETA, it would be deemed that the self-supply rules had been in force at all times before 1991. The effect of this section is that a residential complex that was constructed and occupied before 1991 would generally be exempt when sold after 1990. Another example is given where a builder constructed an apartment block in 1990 and leased it to tenants. In 1991, he sold it and would, in terms of section 191 have been deemed to have self-supplied the apartment block in 1990, thereby making an exempt supply. Owing to the fact that the self-supply took place before 1 January 1991, no GST would have been paid on the self-supply.
5.8 REGISTRATION

5.8.1 Developers that should register for GST purposes

In order to determine which developers of residential properties should register for GST purposes, the provisions of section 240(1) of the ETA governing registration should be ascertained.

According to section 240(1) of the ETA, every "person" making a "taxable supply" in Canada, in the advancement of a "commercial activity" entered into in Canada, is required to be registered under Part IX of the ETA for GST purposes.

The various elements of section 240(1) of the ETA will now be considered.

The first element of the above-mentioned section refers to a "person" (see paragraph 5.3). The definition of a "person" is extremely broad, encompassing all forms of enterprises.

Looking only at this element, all developers of residential properties would have to register for GST purposes.

The second element of section 240(1) of the ETA that should be considered is whether a "taxable supply" (see paragraph 5.3) has been made. It appears that developers of residential properties meet this requirement as the supply would be made in the course of a "commercial activity".
Therefore, on the basis of this element alone, it appears that developers of residential properties would be required to register for purposes of GST.

Where a person is required to be registered for purposes of GST, the application for registration must be made within 30 days of making the first taxable supply (Excise Tax Act s240(2.1)).

5.8.2 Developers that need not register for GST purposes

Where a developer does not meet the requirements set by section 240(1) of the ETA (see paragraph 5.8.1), he is not required to register for GST purposes.

According to section 240(1) of the ETA, registration is not required in the following instances:
- where the "person" is a "small supplier";
- where the "person" supplies "real property" other than in the course of "business" and this supply is the only "commercial activity" of the person; or
- where the person does not carry on any business in, and is not a resident in Canada (Excise Tax Act s240(1)).

In order to determine which developers of residential properties, if any, need not register for GST purposes, the above-mentioned exceptions to section 240(1) should be looked at in more detail.

The first exception that should be discussed is that of a "person" who is a "small supplier".
In paragraph 5.8.1, it was determined that, owing to the broad definition of "person", all developers of residential properties would be included in the definition.

Section 148 of the ETA details provisions of persons who could be considered to be "small suppliers", thereby negating the need to register for GST purposes (Excise Tax Act s148).

Section 148 of the ETA will not be dealt with in detail. This is due to the fact that, in terms of section 166 of the ETA, sales by small suppliers of "real property" (see paragraph 5.3) are excluded from being classified under the small supplier status (Excise Tax Act s166). As "real property" includes land and buildings, no small developers of residential properties would be able to claim non-registration in terms of section 166 of the ETA.

With regard to the second exception, it has not yet been established whether the supply would have been made other than in the course of "business" (see paragraph 5.3). In the discussion in paragraph 5.7.1, it was determined that for a supply to be made in the course of business, it would have to be made on a regular or continuous basis. In a case where a person developed a residential property as a once-off occurrence, it would appear that a business was not being conducted as the supply was neither regular nor continuous.

In these circumstances, registration for GST would not appear to be necessary. This is confirmed by Wood (vol 1 2000:810).
With regard to the third exception, it is unlikely that a person who was not living in Canada and who did not carry on a business there would become a developer of residential properties. As it does not appear that this exception could relate to the topic under discussion, a detailed discussion will not be conducted in this regard.

5.9 SPECIFIC GST PROVISIONS RELATING TO NEW RESIDENTIAL PROPERTIES

5.9.1 New housing rebate on land and buildings

Section 254(1) of the ETA contains the following definitions that relate to section 254 of the ETA:

- "relation" includes a former spouse or common-law partner or any person related to a certain individual.

- "single unit residential complex" includes a multiple unit residential complex provided that the complex does not contain more than two residential units.

(Excise Tax Act s254(1))

After the definitions have been established, the provisions with regard to the rebate on new housing should be determined.

Section 254(2) of the ETA sets out the circumstances under which the new housing rebate would be applicable, as well as the amount that would be allowed as a rebate.
In terms of section 254(2) of the ETA, the new housing rebate would be granted where a builder of a single unit residential complex or a residential condominium unit sells the complex or a unit to a particular individual, thereby making a taxable supply (Excise Tax Act s254(2)).

The following requirements should, however, be met in order for "individuals" to qualify for the new housing rebate in terms of section 254(2):
- when the particular individual becomes liable in terms of the contract between himself and the "builder" he should have the intention of using the single unit residential complex or residential condominium unit purchased as a primary place of residence for himself or a "relation";
- the total amount payable in terms of the above-mentioned contract should not exceed C$450 000;
- all GST payable on the above-mentioned supply, has been paid;
- after the construction or substantial renovation (see paragraph 5.3) has substantially been completed, ownership is transferred to the particular individual;
- after the construction or substantial renovation has substantially been completed, and before possession of the single unit residential complex or residential condominium unit is given to the particular individual under the contract;
- with regard to a single unit residential complex (see paragraph 5.9.1), it was not previously occupied as a place of residence by any individual and the first person to occupy it on completion, is the particular individual or a relation of his,
or where the particular individual makes an exempt supply by way of sale of the single unit residential complex, where ownership is transferred to the recipient of the supply before the single unit residential complex is occupied; with regard to a residential condominium unit (see paragraph 5.3), the residential condominium unit was not occupied as a place of residence or the first person to occupy it was an individual who is the purchaser or a relation of his in terms of the purchase contract or where an exempt supply by way of sale of the residential condominium unit is made by the individual, ownership is transferred to the recipient of the supply before the residential condominium unit is occupied (Excise Tax Act s254(2)).

Where the requirements stated above are met, and the application for a rebate has been submitted within the two-year period allowed by section 254(3), the following rebates will be paid to the individual:

- where the total consideration does not exceed C$350 000, an amount equal to the lesser of C$8 750 and 36% of the GST paid by the individual;
- where the total consideration exceeds C$350 000 but is lesser than C$450 000, the following formula applies:

\[
A \times \left( \frac{(C$450 \ 000 - B)}{C$100 \ 000} \right)
\]

where

\(A\) is the lesser of C$8 750 and 36% of the total GST paid by the individual, and
B is the total consideration (Excise Tax Act s254(2) and (3)).

As we have determined the amount of the rebate and the period within which it should be claimed, the next step is to determine how it should be claimed.

In terms of section 254(4), the builder may pay to or credit the individual with the amount of the rebate where the following provisions have been met:

- where the builder has made a taxable supply in the form of a sale to the individual and transferred ownership of the single unit residential complex or residential condominium unit;
- the GST has been or is payable by the individual with regard to the supply;
- the individual has submitted an application to the builder on the prescribed form, containing all the prescribed information, within the prescribed time;
- the builder agrees to credit or pay the individual any rebate in respect of the single unit residential complex; and
- at the time that the individual submits the application to the builder, the tax payable has not yet been paid, or where the tax has been paid by the individual, the rebate would be payable to the individual (Excise Tax Act s254(4)).

After having paid or allowed credit to the individual in respect of the new housing rebate as discussed above, section 254(5) of the ETA stipulates that the builder should submit
the rebate application with his GST return for the period in which the rebate was paid or credited (Excise Tax Act s254(5)).

According to Wood (vol 3 2000:510), it is important to note that section 254 of the ETA deals with the supply of the land and buildings as a single transaction. Further, it should be noted that the definition of "builder" (see paragraph 5.3) includes a person who buys new houses that are not occupied with the object of reselling these houses. The purchaser of a house like this may claim the new housing rebate, even though the person he purchased the house from did not construct the house.

5.9.2 New housing rebate for building only

Section 254.1 of the ETA states the following definitions that are relevant to this section of the ETA:

- "long term lease" with regard to land means a lease, licence, or similar arrangement with an option to purchase the land or a lease that has at least a 20 year term.

- "relation" see paragraph 5.8.1.

- "single unit residential complex" see paragraph 5.8.1.

Section 254.1(2)(a) of the ETA deals with a situation where an individual and a builder have an agreement whereby the land on which a single unit residential complex is situated
is supplied by the builder to the individual by way of a long term lease and the builder supplies the house thereon by way of sale to the individual (Excise Tax Act s254.1(2)(a)).

According to section 254.1(2) of the ETA, a new housing rebate will be granted to a particular individual where all requirements in terms of section 254.1 of the ETA have been met.

The following provisions should be met in terms of section 254.1(2)(b) to (g) of the ETA:
- at the time that the individual became liable under the agreement, his intention should have been to use the single unit residential complex as a primary place of residence for himself or a relation;
- the fair market value of the single unit residential complex should not have exceeded C$481 500 at the time possession was given;
- the builder should have been deemed to have made a supply of the single unit residential complex in terms of section 191(1) or (3) of the ETA (see paragraph 5.9.6) as a result of having given possession of the property to the particular individual in terms of the agreement;
- the possession of the single unit residential complex should have been given to the individual or a relation of his by the builder, subsequent to the completion of construction or substantial renovation thereof and either
  - no other individual should have occupied it as a place of residence; or
the particular individual should have sold his full interest in the single unit residential complex by means of an exempt supply and should have transferred possession thereof to the recipient of the supply before it had been occupied by any individual as a place of residence (Excise Tax Act s254.1(2)(b) to (g)).

Section 254.1(2)(h) and (i) of the ETA sets out the housing rebate that would be granted to the particular individual, where the above-mentioned provisions had been met and the required application had been made in terms of section 254.1(3) of the ETA:

- where the fair market value does not exceed C$374 500 valid at 29 June 2000, a rebate amounting to the lesser of C$8 750 (valid at 29 June 2000) and 2.34% of the total consideration would be granted to the individual; and
- where the fair market value exceeds C$374 500, but does not exceed C$481 500, the following formula would apply:

\[ A \times \left\{ \frac{(C$481 500 - B)}{C$107 000} \right\} \]

where

\( A \) is the lesser of C$8 750 and 2.34% of the total consideration, and

\( B \) is the fair market value of the single unit residential complex at the time that possession is transferred.

The total consideration mentioned above would be determined by totalling all amounts payable by the
individual to the builder for the sale of the single unit residential complex. The total consideration excludes any rent with regard to the land or any consideration for the option to purchase that land (Wood vol 3 2000:515-516).

In terms of section 254.1(3) to (5) of the ETA, an individual should file an application for a new housing rebate for building with the builder involved, within two years of taking possession of the single unit residential complex. The builder submits the application with his GST return of the period when the rebate was paid or credited to the individual (Excise Tax Act s254.1(3) to (5)).

5.9.3 Rebate for owner-built homes

Section 256(1) of the ETA provides two definitions that apply to this section:

- "relation" see paragraph 5.9.1

- "single unit residential complex" see paragraph 5.9.1

According to section 256(2) of the ETA, a new housing rebate for owner-built homes will be granted, provided that the following provisions have been met:

- the particular individual should construct or contract someone else to construct or substantially renovate a single unit residential complex or a residential condominium unit for purposes of becoming the primary residence of the particular individual or a relation of his;
the fair market value of the complex on the completion of construction or substantial renovation thereof should not exceed $450,000 at 29 June 2000;
the particular individual has paid the GST applicable to the supply of the land forming part of the complex, as well as on the construction or substantial renovation thereof;
either
- the particular individual or a relation of his is the first individual to occupy the complex subsequent to the completion of construction or substantial renovation thereof; or
- the particular individual makes an exempt supply by way of sale of the complex and the ownership is transferred to the recipient of the supply before it is occupied by any individual as a place of residence.

Where all the above-mentioned provisions have been met, the rebate that would be granted, subject to the provisions of section 256(3) of the ETA, is as follows:
- where the fair market value does not exceed $350,000, at 29 June 2000, the rebate would be the lesser of $8,750 (at 29 June 2000) and 36% of the GST paid by the individual; and
- where the fair market value exceeds $350,000, but is less than $450,000, the following formula would apply:

$$A \times \left\{ \frac{(C$450,000 - B)}{C$100,000} \right\}$$

where
A is the lesser of C$8 750 and 36% of the total GST paid by the particular individual before the application for the rebate had been filed.
B is the fair market value of the complex (Excise Tax Act s256(2)).

Before the above-mentioned rebate would be allowed, the particular individual would have to meet the provisions regarding application for the rebate stated in section 256(3) of the ETA (Excise Tax Act s256(3)).

Section 256(3) of the ETA provides that an application for a rebate should be submitted within two years of the earlier date of transfer of ownership, occupation or substantial completion of the single unit residential complex (Excise Tax Act s256(3)).

5.9.4 Rebate to owner of land leased for residential purposes

In terms of section 256.1 of the ETA, a rebate would under certain circumstances be paid to the owner of land leased. The land should have been supplied to the lessee as an exempt supply in terms of section 6.1 of Schedule V to the ETA. The lessee should be acquiring the land for the purpose of making a supply of property that includes the land or of a lease, licence or similar arrangement - that is an exempt supply in terms of sections 6(a) or 7 of Schedule V to the ETA other than section 7(a)(ii) (see paragraph 5.7.2); and
that would result in the lessee being deemed under section 190(3) to (5) and section 191 to have made a supply of the property (Excise Tax Act s256.1(1)).

The rebate that would be paid where the above requirements have been met is as follows:

\[
A - B
\]

where

A is the total GST that was or would but for section 167 of the ETA have been payable in respect of the last acquisition of the land by the landlord and the GST that was payable on any subsequent improvements; and

B is the sum of all other rebates and input tax credits that the landlord is allowed to claim in respect of amounts included in A (Excise Tax Act s256.1(1)).

According to section 256.1(2), the application for the rebate should be made within two years of the supply of the property (Excise Tax Act s256.1(2)).

According to Wood (vol 3 2000:525), owing to the fact that the lease is exempt, input tax credits may not be claimed by the owner or lessor of the land. The lessee would, however, in most cases be required to self-supply the land in terms of section 190 which deals with the conversion of real property to property for residential use or section 191 (see paragraph 5.9.6) of the ETA. Owing to the fact that the supply to the lessee is exempt, the lessee may not claim any input tax credits in terms of section 193 dealing with the sale of real
property or section 257 (see paragraph 5.9.5) of the ETA. Section 256.1 of the ETA therefore provides for a rebate to the owner or any lessor of the land.

5.9.5 Non-registrant sale of real property

According to section 257(1) of the ETA, a rebate would be paid to a non-registrant who makes a taxable supply by disposing of real property by way of sale as the lesser of
- the basic tax content of the property at that particular time; and
- the tax that is payable or would have been payable if section 167 of the ETA dealing with the supply of assets of the business had not applied to the taxable supply (Excise Tax Act s167, s257 and s259).

An application for the rebate in terms of section 257(2) of the ETA would only be paid where the prescribed application is submitted within two years of the consideration becoming due or being paid without having become due (Excise Tax Act s257(2)).

According to Wood (vol 3 2000:527), section 257 of the ETA was introduced to prevent double taxation. Where a non-registrant, for example a doctor, uses a property solely for making exempt supplies, he would be required to pay GST on the acquisition of the real property. As the property purchased would be used for rendering exempt supplies, therefore not for a commercial activity, he would not be allowed to claim an input tax credit in terms of section 193 of the ETA. The doctor would, however, be required to charge
GST on the resale of the property. The rebate allowed in terms of this section of the ETA merely eliminates the double GST on the purchase and sale of the property.

5.9.6 Self-supply of real property

Section 191(1) of the ETA provides for situations where the construction or substantial renovation of a single unit residential complex or a residential condominium unit have substantially been completed and the supply is to be made by way of a lease or the supply of the building by way of sale and the land on which the building is situated, by way of lease (Excise Tax Act s191(1)).

The provisions of section 191(1) of the ETA would be applied:
(a) where the builder gives possession of a single unit residential complex to an individual under a lease, licence or similar arrangement for residential purposes. A period of occupational rental while awaiting transfer in terms of a sales agreement is specifically excluded in terms of these provisions;
(b) where the builder gives possession of the single unit residential complex under an agreement for
- the supply by way of sale of the building or part thereof where the residential unit (see paragraph 5.3) constitutes part of the single unit residential complex; and
- the supply by way of lease of the land on which the building is situated excluding the supply of a mobile home and the site in a residential trailer park for the home; and
(c) where the builder is an individual and he occupies the single unit residential complex as a residence; and
(d) subsequent to the substantial completion of the construction or renovation, the single unit residential complex is occupied as a place of residence by the builder, the particular person or an individual who is the tenant.

Where section 191(1) of the ETA applies, the builder is deemed to have:
- made and received a taxable supply by way of sale of the single unit residential complex. The supply would be deemed to have taken place at the later of the time when the construction or substantial renovation is substantially complete and the time the possession of the complex is given to the occupant; and
- paid as a recipient and to have collected as a supplier the GST on the fair market value of the single unit residential complex (Excise Tax Act s191(1)).

Section 191(2) of the ETA deals with the situation where the builder supplies by way of sale a residential condominium unit to a "particular person" when the condominium complex in which this unit is situated is not registered as a condominium.

The provisions of section 191(2) of the ETA apply where
- the construction or substantial renovation of the residential condominium unit has been substantially completed; and
the builder gives possession of the residential condominium unit to the "particular person" or an individual who is a tenant of his to be occupied for the first time as a place of residence; and
- the sales agreement is cancelled and another sales agreement is not entered into at that time.

Where section 191(2) of the ETA applies, the builder is deemed
- at the time that the sales agreement was cancelled to have made and received a taxable supply by way of sale of the unit;
- to have paid as a recipient and collected as a supplier the GST based on the fair market value of the residential condominium unit at the time of cancellation of the sale, excluding transactions where possession of the residential condominium unit was transferred to the "particular person" before 1991 (Excise Tax Act s191(2)).

Section 191(3) of the ETA provides for a situation where
(a) the construction or substantial renovation of a multiple unit residential complex is substantially completed;
(b) the builder of the complex
(i) gives possession, under a lease, of any residential unit in the complex to a "particular person" who is not a purchaser in terms of an agreement of purchase and sale, for the purpose of occupancy as a residence;
(ii) gives possession of any residential unit in the complex to a particular person under an agreement for the sale of the building or part thereof and the supply in terms of the lease of the land, forming part of the complex; or

(iii) where the builder, being an individual, takes occupancy of any residential unit for his own use;

and

c) the builder, the particular person or a person who is a tenant is the first person to occupy a residential unit for the first time after substantial renovation or completion thereof,

the builder is deemed

d) to have made and received a taxable supply by way of sale at the later of substantial completion or possession of the multiple unit residential complex; and

e) to have paid as a recipient and collected as a supplier, tax on the supply, at the later time of the substantial completion or renovation and the time the unit is occupied, based on the fair market value of the multiple unit residential complex (Excise Tax Act s191(3)).

Section 191(4) of the ETA provides for the situation where an addition is made to a multiple unit residential complex. The provisions of this section are identical to those in section 191(3), except for the fact that it is the addition which is dealt with and not the construction or substantial renovation. The effect of this section is therefore that where a self-supply of an addition has been made, the builder would be deemed
to have made and received a taxable supply by way of sale of the addition at the later of the time when the construction of the addition is substantially completed and the time of possession; and

- to have paid as a recipient and to have collected as a supplier, the GST calculated on the fair market value of the addition (Excise Tax Act s191(4)).

Section 191(5) of the ETA excludes from the provisions of section 191(1) to (4) of the ETA a builder who is an individual and occupies the residential complex immediately after completion of construction or the addition as a place of residence for himself, a former spouse, a common-law partner or a relation of his. This exclusion would apply provided that the builder has not claimed an input tax credit in respect of the purchase or any improvement to the residential complex (Excise Tax Act s191(5)).

Section 191(6) of the ETA states that the provisions of section 191(1) to (4) do not apply where the builder is a university, public college or school authority and the construction or addition has primarily been carried out to provide a place of residence for students or scholars attending the relevant institution (Excise Tax Act s191(6)).

In terms of section 191(9) of the ETA, the construction or substantial renovation of a multiple unit residential complex or a condominium complex or the construction of an addition to a multiple unit residential complex would be deemed to be completed not later than when all the residential units have been occupied (Excise Tax Act s191(9)).
Section 191(10) of the ETA provides for cases where the builder makes a supply by way of lease, licence or a similar arrangement where the supply is exempt in terms of section 6.1 of Part 1 of Schedule V to the ETA. The supply could include a residential complex, or an addition to a multiple unit residential complex. The recipient of the supply would be purchasing the residential complex or the residential unit in order to make exempt supplies in terms of section 6 of Part 1 of Schedule V to the ETA. When the builder gives possession of the residential complex or unit to the recipient for purposes of residence, he would at that time be deemed to have made a supply by way of a lease (Excise Tax Act s191(10)).

According to Wood (vol 3 2000:322), the builder would therefore be deemed to have made a supply in terms of section 191(1), (3) or (4) of the ETA. He would therefore be deemed to have made a taxable supply of the residential complex or unit and to have collected and paid the GST on the fair market value of the property in question.

5.9.7 Input tax credits on the sale of real property

Over and above the provisions of section 169(1) (see paragraph 5.4) that relate to all persons, the ETA contains a section dealing specifically with the claiming of input tax credits not previously allowed on the sale of real property by registrants, namely section 193.
Only the provisions of section 193(1) of the ETA will now be looked at as section 193(2) relates to sales by public sector bodies.

In terms of section 193(1), where a registrant (see paragraph 5.8.1) makes a taxable supply of "real property" (see paragraph 5.3), the registrant may, in the period that the tax has been deemed to have been collected or becomes payable, claim an input tax credit determined as follows:

\[ A \times B \]

where

A is the lesser of
- the basic GST content of the property at the particular time; and
- the GST that is or would but for section 167 of the ETA, dealing with the supply of business assets, be payable in respect of the taxable supply;

B is the percentage of the total use of the property for purposes other than for commercial activities.

After having examined the specific provisions of the ETA relating to residential properties, we will now look at the practical application of these provisions.
5.10 APPLICATION WITH REGARD TO DEVELOPERS REGISTERED FOR GST PURPOSES

5.10.1 Speculative developments intended for resale

5.10.1.1 Intention unchanged

Example 1

A property developer, registered for GST purposes, acquired a residential stand from a township developer, registered for GST purposes, for C$75 000 including GST. The developer's intention in acquiring the stand was to develop it and sell the developed property at a profit. He constructed a house on the property and determined a selling price of C$280 000.

Prior to the completion of the house, the developer was fortunate in being able to sell the house at C$275 000.

As the developer of the property is registered for GST purposes, he would, in terms of sections 221(2) and 228(4) of the ETA (see paragraph 5.7.1) as the "recipient", be required to pay GST on the purchase price of the stand to the authorities and not to the township developer. The amount of GST payable to the authorities in terms of section 165 of the ETA (see paragraph 5.7.1) would be approximately 7/107 x C$75 000 = C$4 907. The balance of C$70 093 (C$75 000 - C$4 907) would be paid to the township developer. In the provinces where HST applies, the amount of HST payable to the authorities would be approximately 15/115 x C$75 000 = C$9 783.
During the period of construction of the house, the developer would have claimed an input tax credit in terms of section 169(1) of the ETA (see paragraph 5.4) in respect of all GST paid by him on property or services supplied to him for the construction of the house. In terms of the formula provided in section 169(1), the value of A would be all GST paid or payable in respect of the construction of the house and the value of B would be 100%, as all GST related to the commercial activity, namely, the construction of the house.

In terms of section 221(1) of the ETA (see paragraph 5.7.1), the developer should have collected GST due on the sale, from the "recipient" (see paragraph 5.3) of the property or service. In this case the "recipient" is the buyer of the house. The output tax that should be collected from the buyer of the house by the developer is \( \frac{7}{107} \times C$275,000 = C$17,991 \). In the provinces where HST is applied, the output tax that should be collected from the buyer of the house by the developer is \( \frac{15}{115} \times C$275,000 = C$35,870 \).

The provisions of section 254 of the ETA (see paragraph 5.9.1) should now be examined in order to determine whether the new house rebate would be relevant to the sale of the house.

A house falls within the definition of a "single unit residential complex", therefore section 254 of the ETA could apply to the sale of the house provided that the other requirements laid down by this section have been met.
The house was purchased as a unit, that is the land and the house thereon, therefore it falls within the provisions of section 254 of the ETA.

The house was purchased from a developer that would fall under the definition of a "builder" thereby meeting another requirement of section 254 of the ETA.

Provided that the other requirements of section 254 have been met, for example the application for the rebate has been submitted to the builder on the prescribed forms within the prescribed period of two years, the new housing rebate would be applied to the supply of the house.

The rebate will, in terms of section 254(2) of the ETA, (see paragraph 5.9.1), be calculated as follows:
- the lesser of C$8 750; and
- 36% of the GST paid, namely C$17 991 = C$6 477.

Therefore C$6 477 would be allowed as a new housing rebate, as it is lower than C$8 750.

The net effect of the GST paid on the selling price after deducting the new housing rebate in terms of section 254 of the ETA would therefore be C$17 991 - C$6 477 = C$11 514. This is in effect approximately 4.37% on the selling price of the house {C$11 514 / (C$275 000 - C$11 514) % = 4.37%}. (HST C$35 870 - C$6 477 = C$29 393, which is approximately 12%) {C$29 393 / (C$275 000 - C$29 393) % = 12%}. 
Example 2

A property developer, registered for GST purposes, acquired a residential stand from a private person, not registered for GST purposes, for C$50,000. The market value of the property was C$50,000. The developer's intention in acquiring the stand was to develop it and sell the developed property at a profit. He constructed a house on the property and determined a selling price of C$240,000.

Prior to the completion of the house, the developer was fortunate in being able to sell the house for C$240,000.

As the stand was purchased from a private person, who was therefore not registered for GST purposes, the supply would in terms of section 9 of Part 1 of Schedule V to the ETA (see paragraph 5.7.2), be exempt. As no GST was payable on the transaction, no input tax credit could be claimed by the developer.

During the period of construction of the house, the developer would have claimed an input tax credit in terms of section 169(1) of the ETA (see paragraph 5.4) in respect of all GST paid by him on property or services supplied to him for the construction of the house. In terms of the formula provided in section 169(1), the value of A would be all the GST paid or payable in respect of the construction of the house and the value of B would be 100%, as all GST related to the commercial activity, namely, the construction of the house.
In terms of section 221(1) of the ETA (see paragraph 5.7.1), the developer should have collected the GST due on the sale, from the "recipient" (see paragraph 5.3) of the property or service. In this case the "recipient" is the buyer of the house. In terms of section 165 of the ETA (see paragraph 5.7.1), the output tax that should be collected from the buyer of the house by the developer is $7/107 \times C$240,000 = C$15,701. (HST $15/115 \times C$240,000 = C$31,304).

The provisions of section 254 of the ETA (see paragraph 5.9.1) should now be examined in order to determine whether the new house rebate would be relevant to the sale of the house.

A house falls within the definition of a "single unit residential complex", therefore section 254 of the ETA could apply to the sale of the house provided that the other requirements laid down by this section have been met.

The house was purchased as a unit, that is the land and the house thereon, therefore falling within the provisions of section 254 of the ETA.

The house was purchased from a developer that would fall within the definition of a "builder", thereby meeting another requirement of section 254 of the ETA.

Provided that the other requirements of section 254 have been met, for example that the application for the rebate has been
submitted to the builder on the prescribed forms within the
prescribed period of two years, the new housing rebate would
be applied to the supply of the house.

The rebate will, in terms of section 254(2) (see paragraph 5.9.1) of the ETA, be calculated as follows:
the lesser of C$8 750
and
36% of the GST paid, namely C$15 701 = C$5 652.

Therefore C$5 652 would be allowed as a new housing rebate, as it is lower than C$8 750.

The net effect of the GST paid on the selling price after
deducting the new housing rebate in terms of section 254 of
the ETA would therefore be C$15 701 - C$5 652 = C$10 049.
This is in effect approximately 4.37% on the selling price of
the house \( \frac{C$10 049}{C$240 000 - C$10 049} \times 100 \approx 4.37\% \).
(HST C$31 304 - C$5 652 = C$25 652, which is approximately 12%) \( \frac{C$25 652}{C$240 000 - C$25 652} \times 100 = 12\% \)

5.10.1.2 Intention changed to letting, owing to circumstances

Example 3

A property developer, registered for GST purposes, acquired
a residential stand from a township developer, registered for
GST purposes, for C$75 000 including the GST. The
developer's intention in acquiring the stand was to develop
it and sell the developed property at a profit. He constructed a house on the property and determined a selling price of C$280 000.

Owing to poor market conditions, the developer was unable to sell the property that he had developed and was forced to let the property.

The problem that has now arisen is that, as the stand was purchased from a township developer, registered for GST purposes, the developer of the property would have claimed an input tax credit (see paragraph 5.4) on the cost of the stand.

In addition to this, during the period of construction of the house, the developer would have claimed an input tax credit in respect of all GST moneys paid by him on goods and services supplied to him for the construction of the house.

In terms of section 221(1) of the ETA, the developer should have collected the GST due on the sale of the house from the "recipient" of the property or service, but owing to circumstances beyond his control, he is unable to sell the house.

Section 191(1) of the ETA (see paragraph 5.9.6) provides for a situation like this. In terms of this section, the builder is deemed to have made a taxable supply by way of sale of the house. In this example, as the house has already been completed, it appears that the taxable supply would be deemed
to have been made at the time possession was given. The taxable amount would in terms of this section be based on the fair market value of the house.

Example 4

A property developer, registered for GST purposes, acquired a residential stand from a private person, not registered for GST purposes, for C$50 000. The market value of the property was C$50 000. The developer's intention in acquiring the stand was to develop it and sell the developed property at a profit. He constructed a house on the property and determined a selling price of C$240 000.

Owing to poor market conditions, the developer was unable to sell the property that he had developed and was forced to let the property.

As the stand was purchased from a private person, who was therefore not registered for GST purposes, the supply would be exempt in terms of section 9 of Part 1 to Schedule V to the ETA (see paragraph 5.7.2). As no GST was payable on the transaction, no input tax credit could be claimed by the developer.

During the period of construction of the house, the developer would have claimed an input tax credit in terms of section 169(1) of the ETA (see paragraph 5.4) in respect of all the GST paid by him on property or services supplied to him for the construction of the house. In terms of the formula provided in section 169(1), the value of A would be all the
GST paid or payable in respect of the construction of the house and the value of B would be 100%, as all GST related to the commercial activity, namely, the construction of the house.

In terms of section 221(1) of the ETA, the developer should have collected GST due on the sale of the house from the "recipient" of the property or service, but owing to circumstances beyond his control, he is unable to sell the house.

Section 191(1) of the ETA (see paragraph 5.9.6) provides for a situation like this. In terms of this section, the builder is deemed to have made a taxable supply by way of sale of the house. In this example, as the house has already been completed, it appears that the taxable supply would be deemed to have been made at the time possession is given. The taxable amount would in terms of this section be based on the fair market value of the house.

5.10.1.3 Intention of selling, but only after an initial period of letting

Example 5

A property developer, registered for GST purposes, acquired a piece of land on which he had planned to develop a residential townhouse complex. It was estimated that the development of the whole townhouse complex would take approximately three years.
The developer was, at that stage, of the opinion that he would realise higher selling prices for the townhouses if he completed the whole complex and then commenced marketing the townhouses.

In order to generate cash flow during the construction period of the townhouse complex and for security reasons, he had decided to let the townhouses in phases, as the phases were completed.

The townhouse complex falls within the definition given in section 123 of the ETA (see paragraph 5.3) of a multiple unit residential complex.

The supply by the builder of this multiple unit residential complex by way of a lease for residential purposes appears to meet the requirements of section 191(3) of the ETA (see paragraph 5.9.6) relating to a self-supply of real property.

In terms of section 191(3) of the ETA, the builder is deemed to have made a taxable supply of the multiple unit residential complex. He is deemed to have collected the GST on the fair market value of the multiple unit residential complex. According to Wood (vol 3 2000:318), where units in the multiple unit residential complex are let before the complex is substantially complete, the self-supply rule will come into effect at the time of substantial completion. In this example, it appears that the townhouse complex would be deemed to be substantially complete when all the townhouses in the complex have been constructed.
The GST on the self-supply, based on the market value of the townhouse complex, would therefore be payable on completion of the construction of the complex.

Owing to the fact that no mention is made of self-supply rules in section 254 of the ETA (see paragraph 5.9.1), it appears that the new housing rebate would not apply in a situation like this.

As the supply by way of leasing of the townhouse complex is taxable in terms of section 191(3) of the ETA, the developer would be allowed to claim input tax credits in terms of section 169(1) of the ETA (see paragraph 5.4) in respect of GST charged by suppliers, over the period of construction.

In terms of section 6 of Part 1 of Schedule V to the ETA (see paragraph 5.7.2), the letting of a long-term residential unit is exempt from GST. As a result of this, there would be no GST implications with regard to the income from the leases.

5.10.2 Contractual developments

5.10.2.1 Development on buyer's property

Example 6

A property developer, registered for GST purposes, was requested to do a contractual development for residential purposes.
A contract price of C$150,000 was agreed upon and an escalation clause was built into the terms of the contract.

On completion of the contract, an amount of C$5,000 was determined as being owing for escalation.

The person who had entered into the agreement with the developer for the building of the house had already acquired the stand that the house was to be built on, directly from a township developer, at a cost of C$60,000.

In terms of section 169(1) of the ETA (see paragraph 5.4), only registrants may claim input tax credits in respect of GST paid on the acquisition of property and services. The effect would therefore have been that the buyer would not be eligible to claim an input tax credit for GST included in the cost of the stand.

During the period of construction of the house, the developer that was contracted to build the house would have claimed an input tax credit in terms of section 169(1) of the ETA (see paragraph 5.4) in respect of all the GST paid by him on property or services supplied to him for the construction of the house. In terms of the formula provided in section 169(1), the value of A would be all the GST paid or payable in respect of the construction of the house and the value of B would be 100%, as all GST related to the commercial activity, namely, the construction of the house.

In terms of section 221(1) of the ETA (see paragraph 5.7.1), the developer should have collected GST due on the sale from
the "recipient" (see paragraph 5.3) of the property or service. In this case the "recipient" is the person that contracted the developer to build the house on his behalf. In terms of section 165 of the ETA (see paragraph 5.7.1), the GST that should be collected from the buyer of the house by the developer is \( \frac{7}{107} \times C\$(150 000 + 5 000) = C\$10 140 \). (HST \( \frac{15}{115} \times C\$(150 000 + 5 000) = C\$20 217 \)).

The provisions of section 256 of the ETA (see paragraph 5.9.3) should now be examined in order to determine if the owner of the house would qualify for a rebate on the home.

The first provision of section 256 of the ETA (see paragraph 5.9.3) appears to have been met, as a house falls within the definition of a single unit residential complex, the owner has the intention of using the house as a primary place of residence and he has contracted someone else to construct the house on his behalf.

The second requirement would have been met as the fair market value of the house should be considerably lower than C\$450 000 (see paragraph 5.9.3), given in this example, a stand value of C\$60 000 and construction costs of C\$155 000.

The third requirement could have been met as the GST was included in the purchase price of the stand, and the GST on the contract price and escalation would, in terms of section 165 of the ETA (see paragraph 5.7.1) be payable on completion of the house, namely \( \frac{7}{107} \times C\$(60 000 + 155 000) = C\$14 065 \). (HST \( \frac{15}{115} \times C\$(60 000 + 155 000) = C\$28 043 \).
Lastly, the owner would occupy the house on completion thereof, meeting that requirement.

The owner-built home rebate would therefore in terms of section 256 of the ETA be allowed and would be calculated as follows:
the lesser of C$8 750
and
36% of the GST paid, namely C$14 065 = C$5 063.

Therefore C$5 063 would be allowed as a new housing rebate, as it is lower than C$8 750.

5.10.2.2 Development on developer's property

A property developer, registered for GST purposes, was requested to do a contractual development for residential purposes.

The contractual house was to be built on a stand owned by the developer. The stand was acquired by the developer from a registered township developer at a cost of C$60 000, including GST.

A contract price of C$150 000 was agreed upon and an escalation clause was built into the terms of the contract.

On completion of the contract, an amount of C$5 000 was determined as being owing for escalation.
The total selling price, that is, the value of the stand and the building contract, excluding the escalation, amounted to C$210 000.

As the developer of the property is registered for GST purposes, he would, in terms of sections 221(2) and 228(4) of the ETA (see paragraph 5.7.1) as the "recipient", be required to pay GST on the purchase price of the stand to the authorities and not to the township developer. In terms of section 165 of the ETA (see paragraph 5.7.1), the amount of GST payable to the authorities would be approximately 7/107 x C$60 000 = C$3 925. The balance of C$56 075 (C$60 000 - C$3 925) would be paid to the township developer. (HST 15/115 x C$60 000 = C$7 826. Therefore C$52 174 (C$60 000 - C$7 826) would be paid to the township developer).

During the period of construction of the house, the developer would have claimed an input tax credit in terms of section 169(1) of the ETA (see paragraph 5.4) in respect of all the GST paid by him on property or services supplied to him for the construction of the house. In terms of the formula provided in section 169(1) of the ETA, the value of A would be all GST paid or payable in respect of the construction of the house and the value of B would be 100%, as all GST related to the commercial activity, namely, the construction of the house.

In terms of section 221(1) of the ETA (see paragraph 5.7.1), the developer should have collected the GST due on the sale from the "recipient" (see paragraph 5.3) of the property or
service. In this case the "recipient" is the buyer of the house. In terms of section 165 of the ETA (see paragraph 5.7.1), the GST that should be collected from the buyer of the house by the developer is \( \frac{7}{107} \times C$(210 000 + 5 000) = C$14 065 \). (HST \( \frac{15}{115} \times C$(210 000 + 5 000) = C$28 043 \).

The provisions of section 254 of the ETA (see paragraph 5.9.1) should now be looked at in order to determine if the new house rebate would be relevant to the sale of the house.

A house falls within the definition of a "single unit residential complex", therefore section 254 of the ETA could apply to the sale of the house provided that the other requirements laid down by this section have been met.

Even though the stand and a contract for the building of the house could appear to be two different supplies, the information in the example indicates a total value of the supply of the sale of the house and the stand as a unit. The house was therefore purchased as a unit, that is the land and the house thereon, falling within the provisions of section 254 of the ETA.

The house was purchased from a developer that would fall within the definition of a "builder", thereby meeting another requirement of section 254 of the ETA.

Provided that the other requirements of section 254 of the ETA have been met, for example that the application for the
rebate is submitted to the builder on the prescribed forms within the prescribed period of four years, the new housing rebate would be applied to the supply of the house.

The rebate will, in terms of section 254(2) of the ETA (see paragraph 5.9.1) be calculated as follows:
the lesser of C$8 750
and
36% of the GST paid, namely C$14 065 = C$5 063.

Therefore C$5 063 would be allowed as a new housing rebate, as it is lower than C$8 750.

The net effect of the GST paid on the selling price after deducting the new housing rebate in terms of section 254 of the ETA would therefore be C$14 065 - C$5 063 = C$9 002. This is in effect approximately 4.37% on the selling price of the house (C$9 002 / (C$215 000 - C$9 002) % = 4.37%).

(HST C$28 043 - C$5 063 = C$22 980 which is approximately 11.96% on the selling price of the house, calculated as follows C$22 980 / C$(215 000 - 22 980) = 11.96%)

From the above it can be seen that a supply of a contract house built on the property of the developer where the house and land are sold as a unit is treated in the same manner as a speculative development of a house on land, that is then sold.
5.10.3 Developments intended for letting of permanent accommodation

5.10.3.1 Intention unchanged

Example 8

A property developer, registered for GST purposes, acquired a piece of land on which he planned to develop a residential townhouse complex. It was estimated that the development of the whole complex would take approximately three years.

His intention in developing the residential townhouse complex was to keep the property as a long-term investment, and earn monthly rental income from it.

The townhouse complex falls within the definition given in section 123 of the ETA (see paragraph 5.3) of a multiple unit residential complex.

In terms of section 6 of Part 1 of Schedule V to the ETA (see paragraph 5.7.2), the letting of a long-term residential unit is exempt from GST. As a result of this, there would be no GST implications with regard to income from the leases.

In terms of section 2 of Part 1 of Schedule V to the ETA, supplies included in this section are only exempt provided that no input tax credits have been claimed on the last acquisition. The effect of this is that the developer would not have claimed input tax on the cost of the land purchased nor on the goods or property rendered to him in the course of construction.
Example 9

A property developer, registered for GST purposes, acquired a piece of land on which he planned to develop a residential townhouse complex. It was estimated that the development of the whole complex would take approximately three years.

His intention in developing the residential townhouse complex was to keep the property as a long term investment, and earn monthly rental income from it.

The developer found that, as the construction of the townhouses was completed, it was impossible to let all the townhouses.

Owing to these circumstances, he changed his original intention of letting all the townhouses to that of selling all the townhouses.

In determining which sections of the ETA apply to example 12, the treatment, for GST purposes, of the acquisition of the stand, the construction of the townhouse complex and the subsequent letting of the townhouses should be examined.

At the time of acquisition of the land and the construction of the townhouses, it is unlikely that the developer of the complex would have jeopardised the exempt status of the future letting income by claiming input tax credits. This is
due to the provisions of section 2 of Part 1 of Schedule V to the ETA, which state that the supply by way of leasing would only be exempt provided that no input tax credits had been claimed on the last acquisition. We could therefore accept that the developer would not have claimed input tax on the cost of the land purchased nor on the goods or property rendered to him in the course of construction.

Owing to the fact that the townhouse complex will now be sold, it should firstly be determined if this proposed sale is taxable or not. Owing to the fact that the supply by way of sale subsequent to a change of use does not appear to be included in exempt supplies (see paragraph 5.7.2), it would, in terms of the conclusion drawn in the discussion of taxable supplies (see paragraph 5.7.1) be classified as a taxable supply.

The supply by way of sale would therefore, in terms of section 165 of the ETA (see paragraph 5.7.1), be subject to GST at the standard rate of 7%. (HST 15%)

The problem therefore arises that the supply by way of sale is subject to GST, but that no input tax credits have been claimed. Section 193(1) of the ETA (see paragraph 5.9.7) provides for the claiming of input tax credits not previously allowed, on the sale of real property.

In terms of section 193(1) of the ETA, an input tax credit based on the following formula would be allowed at this stage:
A x B

where
A is the lesser of
the basic tax content of the property at the particular time; and
the tax that is payable or would be, but for section 167 which deals with an acquisition of a major part of a business
B is the percentage use of the property, immediately before
the change of use, other than for commercial purposes.

5.11 APPLICATION WITH REGARD TO DEVELOPERS NOT REGISTERED
(INCIDENTAL) FOR GST PURPOSES

5.11.1 Development intended for resale

Example 10

A man acquired a stand from a township developer at a cost of
C$90 000.

His intention was to build two duet houses, one of the duets
for his personal use, while he intended to sell the other
duet and use the profit on that duet to reduce the bond on
his property. He had no intention of building any houses in
the future and had not built any houses in the past.

The developer applied for approval for building the duets on
the property and in due course this was granted. He
commenced with the construction of the two duets, which took
three months.
On completion of the duets, the developer moved into the one duet and sold the other duet for C$220 000.

When looking at this example, it should firstly be determined whether the once-off developer would be required to register for GST purposes or not. One of the exceptions of section 240(1) (see paragraph 5.8.2) where registration would not be required is where the supply was not in the course of "business". In order for a supply to be in the course of "business", it would have to be done on a regular and continuous basis. In this example the supply is not on a regular or continuous basis, therefore a "business" is not being conducted and as a result registration is not required.

In terms of section 169(1) of the ETA (see paragraph 5.4), only registrants may claim input tax credits in respect of GST paid on the acquisition of property and services. The effect would therefore have been that the person building the duets would not be eligible to claim input tax credits for the GST included in the cost of the stand or the supply of goods or property used in the construction of the duets.

On the other hand, the sale of the duet would, in terms of section 3 of Part 1 of Schedule V to the ETA (see paragraph 5.7.2), be exempt from any GST.
5.11.2 Contractual development for resale

Example 11

A man acquired a stand from a township developer at a cost of C$90 000.

His intention was to build two duet houses, one of the duets for his personal use, while he built the other duet contractually and intended using the profit on that duet to reduce the bond on his property. He had no intention of building any houses in the future and had not built any houses in the past.

The developer applied for approval for building the duets on the property and in due course this was granted. He commenced with the construction of the two duets, which took three months.

On completion of the duets, the developer moved into the one duet and gave transfer of the other duet on payment of the C$220 000 contract price.

The fact that the duet was built contractually and not speculatively was irrelevant, as the treatment of the transaction would in every way have been identical to that described above. Confirmation of this statement could be found in the section dealing with developers that are registered for GST purposes (see paragraph 5.10.2.2).
5.11.3 Development intended for letting of permanent accommodation

Owing to the fact that the letting of permanent residential accommodation is an exempt supply (see paragraph 5.7.2), the situation where the developer is not registered for GST purposes is identical to that of a developer registered for GST purposes (see paragraph 5.10.3.1).

5.12 SUMMARY

This chapter dealt with the specific provisions of Part IX of the Excise Tax Act. It was established that the VAT applied in Canada is known as the goods and services tax (GST).

It was determined that GST is a federal tax which is charged at a standard rate of 7%. In addition to the federal GST, a provincial sales tax (PST) is payable at the rate stipulated for that province, which varies between 6% and 10%. To date, three provinces in Canada have agreed to a standardised PST of 8%. The combination of the GST component of 7% and the standardised PST of 8% is known as the harmonious sales tax (HST).

Next, it was established that Canada applies an invoice basis for accounting for GST.

The definition of supplies of property and services was found to be very broad, encompassing everything except money that has been excluded.
No registration limit has been set. In terms of the definition of registration every person making a taxable supply in the advancement of a commercial activity in Canada is required to register. Registration is, however, not required where the person is a small supplier. Real property is specifically excluded from the definition of a small supplier. Supplies made by persons other than in the course of the business are also excluded.

As can be seen from the content of the chapter, the Canadian legislation was found to be extremely detailed and complex, with seven different provisions relating specifically to residential real property. These provisions cover a broad spectrum of rebates or concessions on, among others, land and buildings, buildings and owner-built homes.

An example of one of these special provisions, is a new housing rebate which applies to new residential properties developed by developers registered for GST purposes. A rebate of 36% of the output tax payable, limited to C$8 750 for properties valued up to C$350 000 is provided for. Where the property is valued at between C$350 000 and C$450 000, a formula applies which reduces the limit of C$8 750. The input tax paid on the supply of goods and services may be claimed back, as is the case in South Africa.

With regard to developers of residential properties not registered for GST purposes, the same applies as in South Africa. The output is exempt from GST and no input tax paid may be claimed back.
The next chapter will deal with the same points as this chapter and the preceding two chapters, but with reference to the relevant Australian legislation.

5.13 BIBLIOGRAPHY

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CHAPTER 6

THE APPLICATION OF VALUE-ADDED TAX TO SMALL TO MEDIUM-SIZED DEVELOPERS OF RESIDENTIAL PROPERTIES IN AUSTRALIA

6.1 INTRODUCTION

In this chapter, the application of VAT in Australia will be discussed from the same perspective as the previous chapters dealing with South Africa, the United Kingdom and Canada. This will form a basis for comparison between the various countries.

Australia applies a VAT known as the goods and services tax (GST).

6.2 BACKGROUND ON GST IN AUSTRALIA

In Australia, the GST is governed by four different acts. This is due to the fact that all Commonwealth tax legislation makes a distinction between the assessing Act and the rating Act. A constitutional requirement exists to the effect that only one subject of taxation is dealt with in each tax law. This requirement has resulted in three rating Acts being used (O’Brien 2000:vii).

The assessing Act is the A New Tax System (Goods and Services Tax) Act 1999, hereafter called the GST Act 1999 which is supported by the A New Tax System (Goods and Services Tax) Regulations 1999 (O’Brien 2000:vii).

The GST applies to all taxable supplies made on or after 1 July 2000 (O'Brien 2000:vii).

The GST is administered by the Commissioner of Taxation, through the Australian Taxation Office (ATO) (Somers 1995:627).

6.3 TERMINOLOGY RELATING TO GST IN AUSTRALIA

According to section 195-1 of the GST Act 1999, the following definitions apply:

- "account on a cash basis" applies when a choice has been made in terms of section 29-40 of the GST Act (see paragraph 6.6.2 which states that the annual turnover may not exceed A$1 million), or permission has been granted by the Commissioner in terms of section 29-45 of the GST Act.

- "account on the same basis" signifies that two or more companies are accounting on a cash basis or none of the companies is accounting on a cash basis.
"acquisition" has the meaning attributed by section 11-10 of the GST Act, which defines acquisition as any form of acquisition whatsoever (GST Act 1999 s11-10).

"amount" includes a nil amount.

"annual turnover" means:
(a) with regard to meeting a turnover threshold, as provided for in section 188-10(1) of the GST Act; and
(b) with regard to not exceeding a turnover threshold, as provided for in section 188-10(2) of the GST Act.

"business" includes any profession, trade, employment, vocation or calling, but does not include occupation as an employee.

"carrying on" an enterprise includes anything done in the commencement or termination of the enterprise.

"cash accounting turnover threshold" has the meaning attributed by section 29-40(3), being A$1 000 000 or a higher amount as stipulated by the regulations (GST Act 1999 s29-40).

"commercial residential premises" means
(a) a hotel, motel, inn, hostel or boarding house; or
(b) premises used for school accommodation; or
(c) a ship which is let out in the normal course of business; or
(d) a ship used for entertainment or transport; or
(e) a caravan park or camping ground; or
(f) any residential premises similar to (a) to (e) above.

"commissioner" means the Commissioner of Taxation.

"company" means a body corporate or any other unincorporated association or body of persons, excluding a partnership or a non-entity joint venture.

"connected with Australia" with regard to a supply has the meaning attributed by sections 9-25 and 85-5 of the GST Act. Section 9-25(4) of the GST Act states that a supply of real property is "connected with Australia" if the real property or the land to which it relates is in Australia (GST Act 1999 s9-25(4)). Section 85-5 of the GST Act deals with telecommunication supplies connected with Australia, therefore it is irrelevant to this study.

"consideration", according to section 9-15(1) of the GST Act, includes:

(a) any payment, or any act or avoidance, in connection with a supply of anything; and
(b) any payment, or any act or avoidance, in response to or for the incitement of a supply of anything.

(2) It is irrelevant whether the payment, act or avoidance was voluntary, or whether it was by the recipient of the supply.
(2A) It is irrelevant whether the payment, act or avoidance was in compliance with a court order, or settlement relating to proceedings before a court or any other body authorised to make orders.

(2B) Where the supplier is an entity that only supplies to its members, or where this specific supply is to a member, the payment is still deemed to be a consideration (GST Act 1999 s9-15).

- "corrected GST amount" has the meaning attributed by section 19-40(c), which states that as a result of an adjustment, the GST previously calculated no longer reflects the GST on the supply (GST Act 1999 s19-40(c).

- "creditable acquisition" has the meaning attributed by section 11-5, which states that a creditable acquisition is made by someone who is registered, or required to be registered where something is acquired for a creditable purpose, which forms part of a taxable supply, and consideration is supplied for the supply (GST Act 1999 s11-5).

- "enterprise" has the meaning attributed by section 9-20 of the GST Act. Section 9-20(1) of the GST Act defines enterprise as an activity or series of activities carried out:
  (a) in the form of a business; or
  (b) in the form of an adventure or concern as part of trade; or
  (c) in the form of a lease, licence or other interest in property on a regular or continuous basis; or
(d) by a trustee of a fund covered by section 30-B of the Income Tax Assessment Act 1997 to which deductible gifts can be made; or
(e) by a trustee or person managing a superannuation fund; or
(e) by a charitable institution or trustee of a charitable fund; or
(f) by a religious institution; or
(g) by the Commonwealth, a State or a Territory, or a body corporate or a corporation sole established for a public purpose.

According to section 9-20(2) of the GST Act, enterprise does not include an activity, or series of activities carried out by a person as an employee, as a private hobby or recreational pursuit, by an individual without a reasonable expectation of profit, or as a member of a local governing body.

"entity" means any of the following, according to section 184-1(1) of the GST Act:
(1) (a) an individual;
   (b) a body corporate;
   (c) a corporation sole;
   (d) a body politic;
   (e) a partnership;
   (f) any unincorporated association or body of persons;
   (g) a trust, excluding a non-equity; and
   (h) a superannuation fund;
(2) The trustee of a trust or a superannuation fund is considered to be an entity consisting of the person or persons who are the trustees.

(3) Each capacity in which a legal person operates is deemed to be a different entity.

(4) Where a provision refers to an entity of a certain kind, it refers only to an entity in that specific capacity (GST Act 1999 s184-1).

- "financial year" means a period of 12 months beginning on 1 July.

- "floating home" means a floating platform with a permanently affixed structure designed for residential purposes, which is not, and cannot easily be adapted to be self-propelled.

- "goods" means any form of tangible property.

- "GST" means tax payable in terms of the GST law which is imposed by any of the following acts:
  (a) A New Tax System (Goods and Services Tax Imposition - General) Act 1999; or
  (b) A New Tax System (Goods and Services Tax Imposition - Customs) Act 1999; or

- "GST exclusive market value" in relation to a supply or an acquisition is:
(a) on everything other than luxury cars, 10/11 of the market value including GST;
(b) on luxury cars, 10/11 of the market value including GST, excluding luxury car tax that is or would be payable on the supply of that car.

"GST exclusive value" in relation to an acquisition means:
(a) for acquisitions other than luxury cars, 10/11 of the price of the acquisition; or
(b) for luxury cars, 10/11 of the price of the car, excluding luxury car tax payable on the supply; or
(c) the value of a taxable importation; or
(d) for an importation which is not taxable, the value that the importation would have had if it had been taxable.

"GST-free" has the meaning as stated in section 9-30(1) and Division 38 and is known as a zero-rated supply in South African legislation. According to section 9-30(1), a GST-free supply is where the supply or a right to receive a supply is free of GST in terms of either Division 38 or another Act (GST Act 1999 s9-30(1)). Division 38 is discussed in paragraph 6.7.1, therefore no detailed discussion will be provided at this stage.

"GST inclusive market value" of an object or consideration is the market value thereof, without any discount for GST or luxury car tax payable on the supply.
- "individual" means a natural person.

- "input tax credit" means an entitlement in terms of sections 11-20 or 15-15 of the GST Act. These sections provide for entitlement to the input tax credit for any creditable acquisition or creditable importation made (GST Act 1999 s11-20 and s15-15).

- "input taxed" has the meaning attributed for in section 9-30(2) or Division 40 and is known as an exempt supply in most other VAT legislation. According to section 9-30(2), an input taxed supply is where the supply or a right to receive a supply is input taxed in terms of either Division 40 or another Act (GST Act 1999 s9-30(2)). Division 40 is discussed in paragraph 6.7.2, therefore no detailed discussion will be entered into at this stage.

- "invoice" means a document stating a duty to make a payment.


- "long-term accommodation" has the meaning as stated by section 87-20(1) of the GST Act. In terms of section 87-20(1) of the GST Act, long-term accommodation is commercial accommodation provided for a continuous period of 28 days or more in the same premises (GST Act 1999 s87-20(1)).
"margin" with regard to a taxable supply of real property has the meaning as stated in section 75-10(2) of the GST Act. According to section 75-10(2) of the GST Act, the margin is the difference between the consideration of the supply and the consideration of the acquisition thereof (GST Act 1999 s75-10(2)).

"margin scheme" applies where a choice has been made according to section 75-5 of the GST Act to use this scheme to calculate the amount of GST on the taxable supply of real property. Section 75-5 of the GST Act states that the margin scheme can be used where a taxable supply of the following real property is made:
(a) selling a freehold interest in land; or
(b) selling a stratum unit; or
(c) granting or selling a long-term lease,
but this facility is only available where the acquisition of this property was based on the margin scheme (GST Act 1999 s75-5). According to section 75-10 of the GST Act, where a taxable supply of real property is made in terms of the margin scheme, the GST is 1/11 of the "margin" for the supply. This "margin" is defined as the amount by which the consideration for the supply exceeds the consideration for the acquisition.

In terms of section 75-20 of the GST Act, an acquisition of a freehold interest in land, a stratum unit or a long-term lease is not a creditable acquisition if the supply was a taxable supply under the margin scheme (GST Act 1999 s75-10 and s75-20).
- "net amounts" has the meaning as provided for in section 17-5 of the GST Act, which states that GST less input tax credits amount to the "net amount" payable. The GST is defined as being the sum of all the GST on the taxable supplies during the tax period. The input tax credits is the sum of all the input tax credits on acquisitions and importations during the tax period (GST Act 1999 s17-5). It is also stated in section 7-10 of the GST Act 1999 that "net amounts" are determined by setting off amounts of goods and services tax and input tax credits against one another (GST Act 1999 s7-10).

- "new residential premises" means residential premises that:
  (a) have not previously been the subject of a long-term lease or have not been sold as residential premises; or
  (b) have come into being as a result of substantial renovations; or
  (c) have been built on land to replace demolished premises which were on the same land.

- "person" includes a company.

- "real property" includes:
  (a) any interest in or right over land; or
  (b) a personal right to be granted or to call for an interest in or a right over land; or
  (c) a licence or contractual right to occupy land.
"recipient" in relation to a supply, is the entity to which the supply was made.

"registered" means registered in terms of part 2-5. Part 2-5 deals with registration.

"required to be registered" has the meaning given by sections 23-5, 57-20, 144-5 and 147-5 of the GST Act. Section 23-5 of the GST Act is dealt with in paragraph 6.8. Sections 57-20, 144-5 and 147-5 of the GST Act are irrelevant to this study and will therefore not be discussed.

"residential premises" means land or a building that is occupied or is intended to be occupied as a residence and includes a floating home.

"retailer" means an entity that sells goods to people for private or domestic use in the course or furtherance of carrying on its enterprise.

"supply" has the meaning attributed by section 9-10 of the GST Act. According to section 9-10 of the GST Act 1999, supply is defined very broadly as including any of the following:

(1) A supply is any form of supply.

(2) Without limiting the meaning of "supply", supply includes:
   (a) a supply of goods;
   (b) a supply of services;
   (c) a provision of advice or information;
(d) a grant, assignment or surrender of real property;
(e) a creation, grant, transfer, assignment or surrender of any right;
(f) a financial supply;
(g) an entry into or a release from an obligation:
   (i) to do anything; or
   (ii) to refrain from an act; or
   (iii) to tolerate an act or situation;
(h) any combination of any two or more of the points referred to in paragraphs (a) to (g).
(3) It is irrelevant whether the acts included in section 9-10(2)(g) of the GST Act 1999 are legal or not.
(4) The supply of money is excluded, except where money is provided as consideration for a supply, which is a supply of money.

"taxable supply" has the meaning attributed by sections 9-5, 78-50, 84-5 and 105-5 (GST Act 1999 s195-1). According to section 9-5 of the GST Act 1999, a taxable supply is made where:
(a) a supply is made for consideration; and
(b) the supply is made in the course or furtherance of an enterprise which is being carried on; and
(c) the supply is connected with Australia; and
(d) the supplier is registered or required to be registered.
The supply is not a taxable supply to the extent that it is GST-free or input taxed (GST Act 1999 s9-5).
Sections 78-50, 84-5 and 105-5 of the GST Act do not relate to the topic under discussion, therefore the details will not be discussed here.

"tax periods" relates to every entity registered or required to be registered according to section 7-10 of the GST Act 1999.

6.4 CONCEPT OF GST AS APPLIED IN AUSTRALIA

The Australian GST is a broadly based indirect tax introduced to replace the wholesale sales tax and a number of other indirect taxes (O'Brien 2000:76).

The GST is a multi-stage tax (see paragraph 2.3) as tax is imposed on supplies made by enterprises registered for GST, but they are allowed to offset input tax credits against the GST payable to the authorities. The GST is therefore borne by the consumer as this is the final point at which input tax credits can no longer be claimed back (O'Brien 2000:76-77).

In terms of section 7-1 of the GST Act, GST is payable on taxable supplies and taxable importations and persons are entitled to input tax credits on creditable acquisitions and creditable importations (GST Act 1999 s7-1). This is also provided for in section 11-20 of the GST Act, which states that persons are entitled to input tax credits on any creditable acquisition (GST Act 1999 s11-20). Similarly, in terms of section 15-15 of the GST Act, input tax credits are available for creditable importations (GST Act 1999 s15-15).
According to section 66-1 of the GST Act, division 66 of the GST Act allows, in certain circumstances, for input tax credits to be claimed on acquisitions of second-hand goods, even though GST was not payable on the supply to the business (GST Act 1999 s66-1). Section 66-5(1) of the GST Act states that where you acquire second-hand goods to resell or exchange, but not for manufacture, in the ordinary course of business, the supply of goods to you will be a creditable acquisition. According to section 66-5(3) of the GST Act, this section overrides section 11-5 of the GST Act (GST Act 1999 s66-5(1) and (3)).

Section 11-5 of the GST Act (see paragraph 6.3) defines a creditable acquisition as being something acquired for a creditable purpose which forms part of a taxable supply (GST Act 1999 s11-5).

In terms of section 66-5(2) of the GST Act, this section does not apply where the supply to you was a taxable supply or a GST-free supply, or the goods were imported by you, or the supply of the goods to you was by way of hire or the supply of the goods by you is not a taxable supply (GST Act 1999 s66-5(2)).

Section 66-10(1) of the GST Act provides for the amount of input tax credits allowed on creditable acquisitions of second-hand goods exceeding A$300 as the lesser of 1/11 of the consideration provided for the acquisition or the GST payable on the taxable supply. The input tax credit for
creditable acquisitions of goods with a consideration of less than A$300 is, according to section 66-10(1A), 1/11 of the consideration provided or to be provided (GST Act 1999 s66-10).

According to section 7-5 of the GST Act, the GST payable and the input tax credits are set off against one another to arrive at the net amount of tax for the period. Section 17-5 also provides for a net amount to be calculated according to the following formula:

\[
\text{Net amount} = \text{GST} - \text{input tax credits}
\]

where:
- "GST" is the sum of all the GST payable on the taxable supplies made for the tax period.
- "Input tax credits" is the sum of all input tax credits on creditable acquisitions (see paragraph 6.3) and importations for the period (GST Act 1999 s7-5 and 17-5).

The "net amount" may be increased or decreased by any adjustments for the tax period (GST Act 1999 s7-5 and s17-5). According to section 7-15 of the GST Act, the net amount is either the net amount for a tax period that an entity must pay to the Commonwealth, or that the Commonwealth must refund to the entity (GST Act 1999 s7-15).

In terms of section 33-5 of the GST Act, the net amount must be paid by the 21st day of the month following the end of the tax period to which the amount relates (GST Act 1999 s33-5). According to Krever (2000:153), section 35 of the Taxation
Administration Act states that a net amount ceases to be payable four years after the time that it became payable under section 33-5 of the GST Act.

It appears from the above that a developer of residential properties would have a duty with regard to registering for, collecting, and paying over GST on the sale of residential properties.

6.5 GST RATE

In terms of section 9-70 of the GST Act, the GST rate is 10% of the value of the taxable supply.

6.6 VAT SYSTEMS, METHODS AND BASES AS APPLIED IN AUSTRALIA

6.6.1 Type of VAT system applied in Australia

The GST applied in Australia, as in South Africa, is a consumption type of VAT (see paragraphs 2.5.1 and 3.6.1), as it taxes the consumption of most goods and services in Australia, and includes imports. The GST will not apply to consumption outside Australia, therefore exports are exempted (O'Brien 2000:76).

6.6.2 Methods of accounting for GST in Australia

According to Krever (2000:132), ordinary taxpayers are those paying on the accrual basis. Krever (2000:138) states that all GST payers are subject to the accrual basis rules unless they choose to account on a cash basis.
In terms of section 29-40 of the GST Act, you may choose to account on a cash basis, provided that:

(a) your annual turnover does not exceed the cash accounting turnover threshold of A$1 000 000 or a higher amount determined by the regulations; or

(b) you account for your income for income tax purposes by using the receipts method; or

(c) each of the enterprises that you carry on is of the type in respect of which the Commissioner has determined that a choice may be made to account on a cash basis.

Section 29-5(1) of the GST Act provides that the GST payable on a taxable supply is attributable to the tax period which is the earlier of either the period when the consideration for the supply is received, or the period when an invoice is issued (GST Act s29-5(1)). This applies to ordinary taxpayers, namely those paying on the accrual basis.

According to section 29-5(2) of the GST Act, when accounting is done on a cash basis, the GST on the supply is directly linked to the amount of consideration received. This means that if the full consideration is received, the full GST on the supply is attributable to the period. If only part of the consideration is received, only that part of the GST on the supply will be attributable to that period and if none of the consideration is received, none of the GST on the supply will be attributed to that period (GST Act 1999 s29-5(2)).
6.6.3 Base for GST in Australia

Australia applies a destination based VAT (see paragraph 2.5.3), as imports are taxable, in terms of section 13-5 of the GST Act, if they are imported for use in or application in Australia. In terms of division 38-E exports are GST-free, or zero-rated, subject to certain conditions as set out in section 38-185 of the GST Act (GST Act 1999 s13-5 and s138-185).

6.7 SUPPLIES OF GOODS OR SERVICES

Supplies of goods or services are defined very broadly in section 9-10 of the GST Act (see paragraph 6.3) as including any form of supply and including, among others, services, advice, information and surrender of real property.

Real property is defined very broadly (see paragraph 6.3) as including, among others, any right over land.

From the above, it can be seen that a supply of property will be deemed a supply in terms of section 9-10 of the GST Act.

6.7.1 Taxable supplies

According to Krever (2000:41), the criteria under section 9-5 of the GST Act must be met before a supply under section 7-1 of the GST Act can become a taxable supply.

According to section 9-5 of the GST Act (see paragraph 6.3), a supply must be made for "consideration", "in the course or
furtherance" of an "enterprise" being "carried on". In addition to this, the supply must be "connected with Australia" and the supplier must be registered or required to be registered (GST Act 1999 s9-5).

To enable us to understand the implications of section 9-5 of the GST Act dealing with taxable supplies, the definitions of the various elements included in the provisions of this section should be discussed.

Firstly, the definition of "consideration" (see paragraph 6.3) should be discussed. A consideration is defined as any payment, act or avoidance that can be linked to a supply, irrespective of the reason behind or the person making the consideration. Where a developer sells a property, there will certainly be a consideration, therefore this part of the definition of taxable supply will be complied with.

The next part of the definition of a taxable supply that should be discussed is "in the course or furtherance" of an enterprise being "carried on". This term is not defined in the GST Act, but it is linked to "carrying on" an enterprise, which is defined as anything done in the course of the commencement or termination of the enterprise. Developing and selling residential properties would meet this criterion, thereby contributing to a taxable supply being made.

"Enterprise" is the next term that should be discussed. In the GST Act, enterprise is partly defined (see paragraph 6.3) as an activity or series of activities carried out in the form of a business, or a concern in the nature of trade or an
adventure. This broad definition certainly includes any possible sale of residential properties, therefore it appears, based solely on this element, that the sale of residential properties would be a taxable supply.

From the above, it appears that GST would be payable by developers registered for GST purposes on the value of the supply and input tax credits could be claimed, provided that the margin scheme (see paragraph 6.3) has not been used.

In terms of section 75-5 of the GST Act, the margin scheme can be chosen to calculate the amount of GST payable on the supply of real property. Where the margin scheme (see paragraph 6.3) is used, 1/11 of the margin or profit is taxed and not the total value of the supply (GST Act 1999 s75-10). At the same time, no input tax credits may be claimed (GST Act 1999 s75-20). According to Krever (2000:315), the scheme is usually used for sales of property to private consumers.

Section 9-5 of the GST Act (see paragraph 6.3) specifically states that a supply is not a taxable supply if it is GST-free, similar to a zero-rated supply or if it is input taxed, also known as an exempt supply (GST Act 1999 s9-5).

From the discussion of taxable supplies, we have determined that all supplies of real property made by developers registered for GST purposes, other than GST-free or input-taxed supplies, also known as exempt, are deemed to be taxable supplies for GST purposes.
The next step is to determine the rate at which these supplies would be taxed where the margin scheme has not been chosen.

According to section 9-70 of the GST Act, the GST is 10% of the value of a taxable supply. Section 9-75 of the GST Act defines the value of a taxable supply as:

\[
\text{Price} \times \frac{10}{11}
\]

where:
"price" is the sum of:
- where the consideration is expressed in money, the amount of money; and
- where the consideration is not expressed in money, the GST inclusive market value of the consideration (GST Act 1999 s9-75).

According to Krever (2000:59), the above formula removes the value from the final price. The value plus 10% will always equal the price. The price of a supply will therefore always be treated as a GST-inclusive amount.

After having determined the rate of GST, the person responsible for paying the GST should be determined. Section 9-40 of the GST Act states that you are responsible for paying the GST on a taxable supply made by you (GST Act 1999 s9-40). In my opinion, this is not totally clear. Krever (2000:59) clarifies this by stating that the liability to pay
the GST rests with the supplier of a taxable supply. This is confirmed by O'Brien (2000:89), who states that where the GST Act refers to "you", it is generally referring to the entity.

From the above, it has been determined that it is the responsibility of the developer, as the supplier of a taxable supply, to pay the GST on the sale of residential properties.

After having discussed what constitutes a "taxable supply", and how it applies to developers of residential properties, the GST-free supplies, also known as zero-rated supplies, should be ascertained.

6.7.2 GST-free supplies

In terms of section 38-1 of the GST Act 1999, Division 38 sets out all supplies that are "GST-free". When a supply is GST-free, no GST is payable on the supply, but an input tax credit can be claimed. This is similar to zero rating in South African VAT legislation.

The subdivisions of division 38 dealing with supplies that are either GST-free, or GST-free subject to certain conditions, are as follows:

38-A food
38-B health
38-C education
38-D child care
38-E exports and other supplies for consumption outside Australia
38-F religious services
As none of the above subdivisions relate to the topic under discussion, no detailed discussion of the GST-free supplies will be provided.

After having discussed what constitutes a taxable supply and a GST-free supply, the meaning of an "exempt supply", known as an "input taxed supply" in Australia, will now be discussed.

6.7.3 Input taxed (exempt) supplies

Division 40 of the GST Act deals with input taxed supplies. According to section 40-1 of the GST Act, an input taxed supply is when no GST is payable on the supply, but at the
same time no input tax credit will be allowed with regard to the supply. This is comparable to an exempt supply under South African VAT legislation.

The subdivisions of Division 40 of the GST Act dealing with input taxed supplies are as follows:

40-A financial supplies
40-B residential rent
40-C residential premises
40-D precious metals
40-E school tuckshops and canteens
40-F fund-raising events conducted by charitable institutions etc.

Only subdivisions 40-B and 40-C of the GST Act, namely residential rent and residential premises, could have a bearing on the topic under discussion, therefore only these two subdivisions will be discussed in more detail.

Subdivision 40-B of the GST Act deals with residential rent and consists of section 40-35. In terms of section 40-35(1) of the GST Act, a supply of premises by means of a lease, hire or licence is input-taxed, that is exempt from GST where:

(a) the supply is a supply of residential premises; or
(b) the supply is in terms of section 87-25 of the GST Act, dealing with commercial residential premises that are for long-term accommodation. Commercial residential premises are defined in section 195-1 (see paragraph 6.3) as including short-term holiday accommodation and school boarding houses.
Section 40-35(2) of the GST Act limits the supply that will be subject to input tax to:

(a) the extent to which the premises are used mainly for residential accommodation; and

(b) a lease, hire or licence that is not of a long term nature. "Long-term" is defined in section 195-1 of the GST Act as being for at least 50 years.

Subdivision 40-C of the GST Act deals with residential premises and consists of section 40-65, which provides for sales of residential premises, and section 40-70, which deals with supplies of residential premises by way of a long-term lease.

According to section 40-65(1) of the GST Act, a sale of real property is input-taxed to the extent that the property is a residential property used mainly for residential accommodation. Section 40-65(2) of the GST Act, states, however, that a sale of residential premises is not input-taxed where the premises are residential commercial premises or new residential premises other than those premises used for residential accommodation before 2 December 1998.

According to Krever (2000:214), section 40-65 of the GST Act clearly states that the sale of used residential premises will be input taxed, whereas new residential premises will be an ordinary taxable supply.

Section 40-70 of the GST Act deals with the supply of residential premises by way of a long-term lease. In terms of section 40-70(1) of the GST Act, a supply is input-taxed provided that:
(a) the supply is of real property, only in as far as the property is residential premises used mainly for residential accommodation; and
(b) the supply is by way of a long-term lease.

In terms of section 40-70(2) of the GST Act, a supply by way of a long-term lease is not input-taxed where the residential premises are commercial residential premises or new residential premises other than those used for residential accommodation before 2 December 1998.

According to Krever (2000:215), section 40-70 of the GST Act differs from section 40-35 of the GST Act in that it does not apply to a supply of new residential premises. The long-term lease is deemed to be the same as a sale of property and consequently treated the same. By excluding the long-term leases of new property in section 40-70 of the GST Act, long-term leasing is being dealt with in a comparable manner to the sale of new property, which is excluded from section 40-65 of the GST Act. Long-term leases of new residential premises would therefore be an ordinary taxable supply and GST would be payable on the value of the supply and input tax credits would be claimed.

From the above paragraph, it can be seen that developers would be responsible for paying GST on the sale of new residential properties, as they are excluded from the provision with regard to properties that are input-taxed or, stated otherwise, exempt from GST.
6.8 REGISTRATION

6.8.1 Developers that should register for GST purposes

In terms of section 23-5 of the GST Act, you are required to be registered for GST purposes if you are "carrying on" (see paragraph 6.3) an "enterprise" (see paragraph 6.3) and the annual turnover meets the registration turnover threshold (GST Act 1999 s23-5).

According to section 23-15 of the GST Act, the registration turnover threshold for a non-profit body is A$100 000 or a higher amount specified by the regulations, and that of any other body is A$50 000 or a higher amount specified (GST Act 1999 s23-15).

In order to determine if a developer should register for GST purposes, it should be determined whether he is "carrying on" an "enterprise" as the registration limit of A$50 000 provided for in section 23-5 of the GST Act will most certainly require registration.

In paragraph 6.7.1, it was determined that a developer of residential premises would be deemed to be "carrying on" an "enterprise", therefore all developers would be required to register for GST purposes.
6.8.2 Developers that need not register for GST purposes

Where a developer does not meet the requirements of section 23-5 of the GST Act (see paragraph 6.8.1), he is not required to register for GST purposes.

The requirements of section 23-5 of the GST Act are usually not satisfied owing to the fact that "once-off" transactions do not appear to meet the criteria of "carrying on" (see paragraph 6.3) an enterprise. As "carrying on" includes anything done in the commencement or termination of the enterprise, a continuous operation appears to be implied. It therefore appears that entities performing "once-off" transactions would not be required to register for GST purposes.

6.9 APPLICATION WITH REGARD TO DEVELOPERS REGISTERED FOR GST PURPOSES

6.9.1 Speculative developments intended for resale

6.9.1.1 Intention unchanged

Example 1

A developer of properties, registered for GST purposes, acquired a residential stand from a township developer registered for GST purposes for A$75 000. The developer's intention in acquiring the stand was to develop it and sell the developed property at a profit. He constructed a house on the property and determined a selling price of A$280 000.
Prior to the completion of the house, the developer was fortunate enough to sell the house to a private consumer at A$275 000.

As the house is being sold to a consumer, the developer of the property would most likely be registered under the margin scheme as provided for in section 75-5 of the GST Act (see paragraphs 6.3 and 6.7.1). In terms of section 75-10 of the GST Act, the developer would only pay 1/11 of the margin (see paragraph 6.3) on the house. For purposes of illustration, assume a total construction cost of A$175 000. The GST payable on the sale of the property would therefore be 1/11 of (A$275 000 - A$75 000 - A$175 000) = A$25 000. The GST payable would therefore be A$2 273. The provisions of section 75-5 of the GST Act override the provisions of section 11-20 of the GST Act which provides for the claiming of input tax credits on creditable acquisitions. The developer would therefore not be able to claim back input tax credits on the creditable acquisitions of A$75 000 and A$175 000, namely the purchase of the stand and the cost of construction, but at the same time, he would not pay GST on the taxable supply of A$275 000 in terms of section 7-1 of the GST Act.

Example 2

A developer of properties, registered for GST purposes, acquired a residential stand from a private person, who was not registered for GST purposes, for A$50 000. The market value of the property was A$50 000. The developer's
intention in acquiring the stand was to develop it and sell the developed property at a profit. He constructed a house on the property and determined a selling price of A$240 000.

Prior to completion of the house, the developer was fortunate enough to sell the house for A$240 000.

As the stand was purchased from a private person, who was not registered for GST purposes, no GST would be payable on the acquisition of the stand by the developer.

As the house is being sold to a consumer, the developer of the property would most likely be registered under the margin scheme as provided for in section 75-5 of the GST Act (see paragraphs 6.3 and 6.6.1). In terms of section 75-10 of the GST Act, the developer would only pay 1/11 of the margin (see paragraph 6.3) on the house. For purposes of illustration, assume a total construction cost of A$165 000. The GST payable on the sale of the property would therefore be 1/11 of (A$240 000 - A$50 000 - A$165 000) = A$25 000. The GST payable would therefore be A$2 273.

The provisions of section 75-5 of the GST Act override the provisions of section 66-5(1) of the GST Act which provides for creditable acquisitions on second-hand goods. The developer would therefore not be able to claim back input tax credits on the creditable acquisitions of A$50 000 and A$165 000, namely the purchase of the stand and the cost of construction and he would not pay GST on the taxable supply
of A$240,000 in terms of section 7-1 of the GST Act. The A$2,273 would be the total GST payable on the sale of the property.

6.9.1.2 Intention changed to letting, owing to circumstances

Example 3

A developer of properties, registered for GST purposes, acquired a residential stand from a township developer, registered for GST purposes, for A$75,000. The developer's intention acquiring the stand was to develop it and sell the developed property at a profit. He constructed a house on the property and determined a selling price of A$280,000.

Owing to poor market conditions, the developer was unable to sell the property that he had developed and was forced to let the property.

As in examples 1 and 2 above, the margin scheme would most likely have been used, therefore no GST complications exist as section 75-5 of the GST Act overrides sections 7-1 and 11-20 of the GST Act, dealing with taxable supplies and input tax credits. In terms of section 75-10 of the GST Act, GST would be payable on the margin (see paragraph 6.3) earned on the house. As the house cannot be sold at this stage, it appears that the payment of the GST on the margin would be postponed until the house was sold.
Residential rental of properties is input taxed (exempt) in terms of section 40-35 of the GST Act, therefore no GST implications exist on the rental of the premises.

Example 4

A developer of properties, registered for GST purposes, acquired a residential stand from a private person, not registered for GST purposes, for A$50 000. The market value of the property was A$50 000. The developer's intention in acquiring the stand was to develop it and sell the developed property at a profit. He constructed a house on the property and determined a selling price of A$240 000.

Owing to poor market conditions, the developer was unable to sell the property that he had developed and was forced to let the property.

Once more, the margin scheme would most likely be used by the developer of the property. It appears that this example would therefore be treated in the manner outlined in example 3 above.

6.9.1.3 Intention of selling, but only after an initial period of letting

Example 5

A developer of property, registered for GST purposes, acquired a piece of land on which he had planned to develop
a residential townhouse complex. It was estimated that the development of the whole townhouse complex would take approximately three years.

At that stage, the developer was of the opinion that he would realise higher selling prices for the townhouses if he first completed the whole complex and then commenced marketing the townhouses.

In order to generate cash flow during the construction period of the townhouse complex and for security reasons, he had decided to let the townhouses in phases, as the phases were completed.

Once more, the margin scheme would most likely be used by the developer of the property. It appears that this example would therefore be treated in the manner outlined in example 3 above. This is confirmed by Krever (2000:214), who stated that where new residential premises are first let, and then sold at a later stage, the first sale, whenever it takes place, will be a taxable supply. As we are assuming that the margin scheme would most likely apply, section 75-10 of the GST Act would apply at the time of the first sale.

Owing to the fact that in terms of section 40-35 of the GST Act (see paragraph 6.7.3), the letting of residential accommodation is an input-taxed (exempt) supply for GST purposes, there will be no GST implications regarding the income from the letting of the townhouses.
6.9.2 Contractual developments

6.9.2.1 Development on buyer's property

Example 6

A developer of properties, registered for GST purposes, was approached to do a contractual development for residential purposes.

A contract price of A$150,000 was agreed upon and an escalation clause was incorporated into the terms of the contract.

On completion of the contract, an amount of A$5,000 was determined as being owing for escalation.

The person who had entered into the agreement with the developer for the building of the house had already acquired the stand that the house was to be built on, directly from a township developer, at a cost of A$60,000.

The buyer was not registered for GST purposes, in terms of section 23-5 of the GST Act (see paragraph 6.8.1), and could therefore not claim an input tax credit (see paragraph 6.3) on the cost of the stand.

As the house is being built for a consumer, the developer of the property would most likely be registered under the margin scheme as provided for in section 75-5 of the GST Act (see paragraphs 6.3 and 6.7.1). In terms of section 75-10 of the
GST Act, the developer would only pay 1/11 of the margin (see paragraph 6.3) on the house. For purposes of illustration, assume a total construction cost of A$140 000. The GST payable on the sale of the property would therefore be 1/11 of A$15 000 ($155 000 - A$140 000). The GST payable would therefore be A$1 364.

The provisions of section 75-5 of the GST Act override the provisions of section 11-20 of the GST Act, which provides for the claiming of input tax credits on creditable acquisitions. The developer would therefore not be able to claim back input tax credits on the creditable acquisitions of A$140 000, namely the construction cost and he would not pay GST on the taxable supply of A$155 000 in terms of section 7-1 of the GST Act. The A$1 364 would be the total GST payable on the sale of the property.

6.9.2.2 Development on developer's property

As the margin scheme would most likely be applied as illustrated in the above examples, a contractual development on the buyer's property would be treated in the same way as a contractual development on the developer's property. GST would be payable at 1/11 of the margin (see paragraph 6.3) on the sale of the property, therefore the detailed example will not be illustrated.
6.9.3 Developments intended for letting of permanent accommodation

6.9.3.1 Intention unchanged

Example 7

A developer of property, registered for GST purposes, acquired a piece of land on which he planned to develop a residential townhouse complex. It was estimated that the development of the whole complex would take approximately three years.

His intention developing the residential townhouse complex was to keep the property as a long-term investment, and earn monthly rental income from it. The townhouses were to be rented out according to an initial six months' rental agreement, whereafter the period would be from month to month.

Section 195-1 of the GST Act defines "long-term" as being for a period of at least 50 years. The intended letting of the townhouses is therefore not classified as long term in terms of the GST Act. Owing to the fact that the letting of residential accommodation which is not long term is, in terms of section 40-35 of the GST Act (see paragraph 6.7.3), an input-taxed (exempt) supply for GST purposes, there should be no GST implications in this regard.
The result of this is that the developer would not have claimed input tax on the cost of the land purchased or on the goods or services rendered to him in the course of construction.

Accordingly, no output tax would have been payable on rental income.

6.9.3.2 Intention changed to selling, owing to circumstances

Example 8

A developer of property, registered for GST purposes, acquired a piece of land on which he planned to develop a residential townhouse complex. It was estimated that the development of the whole complex would take approximately three years.

His intention in developing the residential townhouse complex was to keep the property as a long-term investment, and earn monthly rental income from it.

The developer found that, as the construction of the townhouses was completed, it was impossible to let all the townhouses.

Owing to these circumstances, he changed his original intention of letting all the townhouses to that of selling all the townhouses.
It does not appear that the situation sketched in this example would pose any adjustment problems, as the supply would have been deemed to be an input-taxed supply for letting purposes. No input tax credits would therefore have been claimed and no output tax would have been paid. The change of intention to selling the townhouses therefore appears to have little effect, as the margin scheme in terms of section 75-5 of the GST Act would most likely apply. GST would be payable on the margin at 1/11 thereof, as the townhouses are sold.

6.10 APPLICATION WITH REGARD TO DEVELOPERS NOT REGISTERED (INCIDENTAL) FOR GST PURPOSES

According to section 9-5 of the GST Act 1999 (see paragraphs 6.3 and 6.7.1), the supplier should either be registered or required to be registered for a taxable supply to be made. From the discussion in paragraph 6.8.2, it appears that entities doing a once-off development do not meet the registration criteria. In principle, it therefore appears that the sale of fixed property by private individuals, who are not registered for GST purposes, will not be subject to GST.

In terms of sections 11-20 and 15-15 of the GST Act, input tax credits (see paragraph 6.3) can only be claimed for creditable acquisitions (GST Act 1999 s11-20 and s15-15).

According to section 11-5 of the GST Act (see paragraphs 6.3 and 6.4), a creditable acquisition can only be made by someone who is registered or required to be registered for
GST purposes. It appears that no input tax credits can therefore be claimed by someone not registered for GST purposes.

From the above it appears that no GST would be charged and no input tax credits could be claimed back by someone not registered for GST purposes.

6.10.1 Development intended for resale

Example 9

A man acquired a stand from a township developer at a cost of A$90 000.

His intention was to build two duet houses, one of the duets for his personal use, while he intended to sell the other duet and use the profit on that duet to reduce the bond on his property. He had no intention of building any houses in the future and had not built any houses in the past.

The developer applied for approval for building the duets on the property and this was granted in due course. He commenced with the construction of the two duets, which took three months.

On completion of the duets, the developer moved into the one duet and sold the other duet for A$220 000.

The question which now arises is whether he made a taxable supply or not. Based on the information sketched, this was a once-off development which was built within three months.
From the detailed provisions of the GST Act discussed in paragraph 6.10, it appears that a taxable supply was not made and no input tax credits could be claimed.

6.10.2 Contractual development for resale

Example 10

A man acquired a stand from a township developer at a cost of A$90,000.

His intention was to build two duet houses, one of the duets for his personal use, while he built the other duet contractually and intended using the profit on that duet to reduce the bond on his property. He had no intention of building any houses in the future and had not built any houses in the past.

The developer applied for approval for building the duets on the property and this was granted in due course. He commenced with the construction of the two duets, which took three months.

On completion of the duets, the developer moved into the one duet and gave transfer of the other duet on payment of the A$220,000 contract price.

The fact that the duet was built contractually and not speculatively was irrelevant, as the treatment of the transaction would in every way have been identical to that above (see paragraph 6.10.1).
6.10.3 Development intended for letting of permanent accommodation

Owing to the fact that the letting of permanent residential accommodation is, in terms of section 40-35 of the GST Act (see paragraph 6.7.3), an input-taxed (exempt) supply, the situation where the developer is not registered for GST purposes is identical to that of a developer registered for GST purposes (see paragraph 6.9.3.1).

6.11 SUMMARY

This chapter dealt with the specific provisions of the A New Tax System (Goods and Services Tax) Act 1999.

Firstly, the provisions of the GST Act with regard to the type of GST system, the methods of accounting for GST and the bases for GST were discussed. It was found that ordinary taxpayers account for GST on the accrual basis. Taxpayers may choose to account on a cash basis, provided certain conditions are complied with. An example of a condition is that the annual turnover may not exceed A$1 million.

Secondly, the provisions of the GST Act with regard to the GST rate and what constitutes a supply of goods or services were examined. It was determined that the GST rate is 10% and a wide range of goods and services are subject to GST.

It was determined that the supply of goods or services is very broadly defined and real property is specifically included. Real property is defined as including any right over land which is also a very broad definition.
It was determined that in terms of the GST Act, a concession on real property is provided for. In terms of this concession, known as the margin scheme, developers of real property registered for GST purposes may choose to pay GST based on the margin and not the total value of the supply. The margin is defined as the difference between the considerations of the supply and acquisition. At the same time, no input tax credits may be claimed. The Australian GST legislation appears to be unique in this provision, as it was found in this study that the VAT or GST of all the other countries chosen was based on the value of the supply and not on the profit.

The supply of residential properties developed by developers not registered for GST purposes is exempt from GST. Input tax paid may not be recovered. This agrees to the legislation applied in South Africa and Canada.

Thereafter, it was determined that persons who carry on an enterprise and meet the turnover threshold of A$50 000 are required to register for GST purposes.

Lastly, various possible practical applications with regard to developers of residential properties were illustrated with reference to the GST Act.

The next chapter will look at the concept and application of transfer duty as currently applied to second-hand properties in South Africa, in order to serve as a basis of comparison with the VAT payable on new properties.
6.12 BIBLIOGRAPHY

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CHAPTER 7

THE APPLICATION OF TRANSFER DUTY AS AN ALTERNATIVE TO VALUE-ADDED TAX ON RESIDENTIAL PROPERTIES IN SOUTH AFRICA

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CHAPTER 7

THE APPLICATION OF TRANSFER DUTY AS AN ALTERNATIVE TO VALUE-ADDED TAX ON RESIDENTIAL PROPERTIES IN SOUTH AFRICA

7.1 INTRODUCTION

Chapters 3, 4, 5 and 6 discussed VAT as applied to small to medium-sized developers of residential properties in South Africa, the United Kingdom, Canada and Australia respectively. It was found that VAT is known as the goods and services tax (GST) in Canada and Australia.

Before the implementation of VAT in South Africa, transfer duty was payable by the purchaser on all residential property transactions. Since the implementation of VAT, transfer duty is payable on all second-hand property transactions and on new property transactions where the developer is not registered for VAT purposes.

With the implementation of capital gains tax in October 2001, a transitional period has been provided for whereby properties registered in trusts, close corporations or companies may be transferred from these legal entities to natural persons without transfer duty being charged. As this is only a transitional arrangement and it is probably not relevant with regard to developers of residential properties, no further discussion is warranted.

In this chapter, transfer duty, as applied in South Africa, is looked at in order to form a basis for comparison with the VAT that is currently payable by all registered vendors.
7.2 TERMINOLOGY RELATING TO TRANSFER DUTY IN SOUTH AFRICA

According to section 1 of the Transfer Duty Act 40 of 1949, the following definitions apply to the Act:

- "Commissioner" means the Commissioner for the South African Revenue Service.

- "date of acquisition" means
  (a) where a property was acquired by means of a transaction, the date on which the transaction was entered into, irrespective of whether the transaction was conditional or not, or where the property was not acquired in terms of a transaction, the date that the person became entitled to the property;
  (b) where property is acquired in terms of the Share Blocks Control Act, the date of the written request in terms of subitem 1(b) of item 8 of Schedule 1 to the Share Blocks Control Act 59 of 1980.

- "declared value" of property means the value of the property as declared in the declaration made in terms of section 14 by the person acquiring the property.

- "fair value" means the fair market value of the property at the acquisition date.

- "person" includes the estate of a deceased or insolvent person as well as any trust.
"property" means land and fixtures thereon and includes—
(a) any real right in land, excluding any right in terms of a mortgage bond or a lease, except a lease referred to in paragraphs (b) or (c);
(b) a lease or sub-lease of a property registrable in the office of Rand Townships Registrar in terms of the Registration of Mining Rights Proclamation 35 of 1902 as read with section 1 of the Mining Titles Registration Act 29 of 1908;
(c) any right to minerals including the right to mine for minerals as well as a lease or sub-lease of such right.

"registration officer" means the person who is in charge of a deeds registry.

"transaction" means an agreement whereby one party agrees to sell, grant, donate, exchange, lease or dispose of property to another or any act whereby one person gives up any interest in the use or disposal of property.

"trust" means any trust consisting of assets or cash which are administered by a person in a fiduciary capacity irrespective of whether the person was appointed under a deed of trust, by agreement or in terms of the will of the deceased (Transfer Duty Act 40 of 1949 s1).
7.3 CONCEPT OF TRANSFER DUTY AS APPLIED IN SOUTH AFRICA

In terms of section 2(1) of the Transfer Duty Act, a transfer duty is payable by a person acquiring property by means of a transaction, or in any other way, at the rate of-

(a) 10% where the person by whom or for whom the property is acquired is not a natural person; or

(b) subject to subsection (5)-

(i) 1% of the said value or amount which does not exceed R70 000; and
(ii) 5% of the said value or amount that exceeds R70 000 but does not exceed R250 000; and
(iii) 8% of the said value or amount that exceeds R250 000,

provided that the person who acquired the property is a natural person (Transfer Duty Act 40 of 1949 s2(1)).

Subsections (2), (3), (4) and (7) of section 2 of the Transfer Duty Act have been deleted.

According to section 2(5) of the Transfer Duty Act, the acquisition of an undivided share of property by a natural person, provides for the duty payable being calculated according to the following formula:

\[ y = \frac{a}{b} \times c \]

where

(a) \( y \) is the duty payable;
(b) \( a \) is the value on which the duty is leviable in terms of subsection (1);
(c) $b$ is an amount equal to the sum of—

(i) the amount represented by $a$; and

(ii) the value of the remainder of the joint property, being the total value less the value of the undivided share being "a" above, provided that the value of the remainder of the property relates to the undivided share;

(d) $c$ is the duty which would have been leviable at the rate prescribed in subsection 1 (b), based on the value of $b$, provided that it was the value on which duty was leviable under subsection (1) (Transfer Duty Act 40 of 1949 s2(5)).

Section 2(6) of the Transfer Duty Act states that section 2(5) does not apply in respect of an acquisition of an undivided share in terms of the Sectional Titles Act 95 of 1986 (Transfer Duty Act 40 of 1949 s2(6)).

In terms of section 2(8) of the Transfer Duty Act, a trustee or administrator of a trust or a person acting in a fiduciary capacity will not be deemed to be a natural person (Transfer Duty Act 40 of 1949 s2(8)).

7.4 CIRCUMSTANCES WHEN TRANSFER DUTY IS NOT PAYABLE

Section 9(1) of the Transfer Duty Act deals with acquisitions of property where no transfer duty is payable. These exemptions deal with, among others, Government and semi-government acquisitions as well as those in terms of estates
that do not relate to this study and will therefore not be
discussed here. The same applies to exemptions in terms of
section 9(2) to 9(10) of the Transfer Duty Act.

Section 9(11) deals with exemptions relating to periods of
1978, 1980, 1992 and 1993, which will not be discussed here,
as section 9(12C) will apply to any current transactions.

In terms of section 9(12C) of the Transfer Duty Act, no
transfer duty is payable by a natural person on the
acquisition of full ownership on or after 1 April 1999 in-
(a) any land with a dwelling-house thereon or a residential
apartment as well as an undivided share in common
property held under sectional title, where the value of
the property does not exceed R70 000; or
(b) any unimproved land acquired for purposes of
constructing a dwelling-house thereon, where the value
does not exceed R30 000 (Transfer Duty Act 40 of 1949
s9(12C)).

According to section 9(15) of the Transfer Duty Act, no
transfer duty is payable on a transaction relating to the
acquisition of property where the transaction is deemed a
taxable supply in terms of the Value-Added Tax Act 89 of 1991
(see paragraph 3.6.1), provided that-
(a) the transferor of the property certifies in the
prescribed declaration that the transferee has paid the
required VAT on the supply to him, or where a zero
rating applies, that the required information has been
supplied to the Commissioner;
(b) where the VAT has not yet been paid, acceptable security has been furnished to the Commissioner;

(c) the Commissioner has issued the certificate that the requirements of this subsection have been met (Transfer Duty Act 40 of 1949 s9(15)).

7.5 ENTITIES OR PERSONS RESPONSIBLE FOR PAYING TRANSFER DUTY

7.5.1 Buyers of new residential properties developed by developers not registered (incidental) for VAT purposes

In chapter 3 (see paragraph 3.7.2) it was found that where developments of residential properties were of a "once-off" nature, the requirements of section 23(1) of the Value-Added Tax Act 89 of 1991 were not met. Consequently, the developer was not required to register for VAT, thereby not charging VAT on the transaction. The exemption of section 9(15) of the Transfer Duty Act (see paragraph 7.4) would therefore not be applicable and transfer duty would be payable in terms of section 2(1) of the Transfer Duty Act, (see paragraph 7.3) (Value-Added Tax Act 89 of 1991 s23(1) and Transfer Duty Act 40 of 1949 s2(1) and s9(15)).

7.5.2 Buyers of existing residential properties that are not purchased from vendors

The majority of sellers of existing residential properties are not vendors in terms of the Value-Added Tax Act, and do therefore not qualify for any exemptions in terms of section 9 of the Transfer Duty Act. Transfer duty would therefore be
payable by the buyer of the property in terms of section 2(1) of the Transfer Duty Act (see paragraph 7.3) (Transfer Duty Act 40 of 1949 s2(1)).

7.6 APPLICATION OF TRANSFER DUTY

7.6.1 Trusts, close corporations or companies as buyers

Example 1

A man acquired a stand from a township developer at a cost of R90 000.

His intention was to build two duet houses, one of the duets being for his personal use, while he intended to sell the other duet and use the profit on that duet to reduce the mortgage bond on his property. He had no intention of building any houses in the future and had not built any houses in the past.

The developer applied for approval for building the duets on the property which was granted in due course. He commenced with the construction of the two duets, which took three months.

On completion of the duets, the developer moved into one duet and sold the other duet for R220 000 to a trust, company or close corporation.
As the developer was not found to be a vendor in terms of the Value-Added Tax Act (see paragraph 3.10.1), the buyers of the duet would be required to pay transfer duty on the purchase price of R220 000.

The buyer of the duet is a not a natural person and would therefore in terms of section 2(1)(a) of the Transfer Duty Act be liable for transfer duty of 10% on R220 000, amounting to R22 000.

7.6.2 Natural persons as buyers

Example 2

The same information as in example 1 in paragraph 7.6.1 above, except that the duet has been acquired by a natural person.

In terms of section 2(1)(b) of the Transfer Duty Act, the buyer would be required to pay the following transfer duty:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1% on the first R70 000</td>
<td>700</td>
</tr>
<tr>
<td>5% on (R220 000 - R70 000)</td>
<td>7 500</td>
</tr>
<tr>
<td>Transfer duty payable</td>
<td>8 200</td>
</tr>
</tbody>
</table>

7.7 SUMMARY

This chapter dealt with the specific provisions of the Transfer Duty Act 40 of 1949.
Firstly, the concept of transfer duty as applied to residential properties in South Africa was examined. It was found that all property transactions, except where exemptions apply, are subject to transfer duty. It was determined that land with a dwelling-house up to a value of R70 000 and unimproved land up to a value of R30 000 is exempt from transfer duty.

The rates at which the transfer duty should be paid where a natural person is the buyer differed from the rate applicable to companies, close corporations and trusts.

It was determined that the following transfer duty rates apply to buyers who are natural persons:
- 1% of the said value or amount which does not exceed R70 000; and
- 5% of the said value or amount that exceeds R70 000 but does not exceed R250 000; and
- 8% of the said value or amount that exceeds R250 000.

It was determined that a transfer duty rate of 10% applies to property transactions where properties are transferred to companies, close corporations and trusts.

Secondly, circumstances when transactions were exempt from transfer duty were determined. The main exemption that specifically relates to residential properties was found to be that a property transaction that is subject to VAT is exempt from transfer duty.
Thirdly, the entities or persons responsible for paying transfer duty were examined. In terms of the Transfer Duty Act, the buyer of the property is responsible for paying the transfer duty.

Thereafter, a short example was worked to illustrate the difference in the transfer duty payable where the buyer is a natural person as opposed to where the buyer is not a natural person, namely a trust, company or close corporation. Based on the selling price in the example, the transfer duty payable by a company, close corporation or trust is almost 2.7 times that payable by a natural person.

7.8 BIBLIOGRAPHY

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8.5 Bibliography
CHAPTER 8

EVALUATION OF THE CURRENT SITUATION, RECOMMENDATIONS AND CONCLUSION

8.1 INTRODUCTION

Chapters 3, 4, 5 and 6 dealt with the application of value-added tax to small to medium-sized developers of residential properties in South Africa, the United Kingdom, Canada and Australia respectively.

Chapter 7 discussed transfer duty as applied to incidental developers of new residential properties in South Africa as well as used properties, to serve as a basis for comparison with value-added tax charged on new residential properties.

In chapters 3 to 6, it was determined that the legislation of the various countries with regard to value-added tax on residential properties differed considerably.

This chapter aims to quantify these differences to serve as a basis for comparison between the provisions of the various value-added tax acts with regard to developers of residential properties in these countries.

The most effective way of illustrating the major differences between the value-added tax acts is to take basic examples and apply the legislation of the various countries to these examples. It is obvious that these examples cannot cover all the complexities discussed in chapters 3 to 6. This fact
is emphasised by the complex provisions relating to new residential properties in Canada which were discussed in paragraph 5.9, only one aspect of which is relevant to the examples chosen in Annexures A to F.

Transfer duty as applied in South Africa is included in the above-mentioned examples, as it forms part of the comparison with value-added tax in South Africa.

8.2 EVALUATION OF THE CURRENT SITUATION

In order to evaluate the current situation, examples are discussed in Annexures A to F which clearly illustrate the basic application of the VAT, GST or HST legislation of the chosen countries as well as the levels of exemption from and rates of transfer duty.

The figures provided in the examples in Annexures A to F have been indicated as rand values, but should be taken as being the values in terms of the currency of the specific country.

In practice in South Africa, the market value of a property sold by a developer registered for VAT purposes is generally higher than one sold by a developer not registered for VAT. This is due to the fact that the buyer of a property developed by a developer not registered for VAT purposes discounts the transfer duty that he is liable for on the purchase price, into the price he is prepared to pay for the property.
As it is very difficult to determine how much of the transfer duty will be discounted into the price and to keep examples that are comparable with one another, the total VAT and/or transfer duty payable on the development has been used as a basis.

Before discussing the effect of the application of the legislation of the various countries to the examples, it is essential to firstly summarise the basic VAT, transfer duty, GST or HST rates to provide a basis for comparison with the effective rates determined after having taken all rebates, exemptions, zero-rating or special provisions into account.

8.2.1 Basic VAT, transfer duty, GST or HST rates

Table 1, which follows, summarises the percentage VAT, transfer duty, GST or HST on the exclusive consideration for goods and services.

The applicable fractions used based on the inclusive consideration for goods and services are determined. The percentage VAT, transfer duty, GST or HST on the inclusive consideration for goods and services is then determined. This percentage is comparable to the percentage which would be included in the project cost in the various examples in Annexures A to F.

In order to provide a complete picture, transfer duty as applied in South Africa is included in table 1.
### Table 1: Summary of basic VAT, transfer duty, GST or HST rates

<table>
<thead>
<tr>
<th>% VAT, GST or HST on exclusive price of goods or services</th>
<th>South Africa VAT</th>
<th>South Africa Transfer duty - company, trust etc.</th>
<th>South Africa Transfer duty - natural person</th>
<th>United Kingdom VAT</th>
<th>Canada GST*</th>
<th>Canada HST*</th>
<th>Australia GST</th>
</tr>
</thead>
<tbody>
<tr>
<td>14%</td>
<td>-</td>
<td>-</td>
<td>17(\frac{1}{2})%</td>
<td>7%</td>
<td>15%</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>Fraction of VAT, GST or HST on inclusive price of goods or services</td>
<td>(\frac{14}{114})</td>
<td>-</td>
<td>(\frac{7}{47})</td>
<td>(\frac{7}{107})</td>
<td>(\frac{15}{115})</td>
<td>(\frac{10}{110})</td>
<td></td>
</tr>
<tr>
<td>% VAT, GST or HST on inclusive price of goods or services</td>
<td>12.28%</td>
<td>-</td>
<td>14.89%</td>
<td>6.54%</td>
<td>13.04%</td>
<td>9.09%</td>
<td></td>
</tr>
<tr>
<td>Transfer duty on developed property</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Company, CC or trust</td>
<td></td>
<td>10%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Natural person property up to value of R70 000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Natural person property over R70 000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>First R70 000</td>
<td></td>
<td></td>
<td>1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>over R70 000 - R250 000</td>
<td></td>
<td></td>
<td>5%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>above R250 000</td>
<td></td>
<td></td>
<td>8%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
According to table 1 above, the basic VAT rate applied in South Africa appears to be in line with the VAT rates in the other chosen countries. From the table, it can be seen that South Africa applies a basic VAT rate of 14%, which is the VAT charged on the exclusive consideration.

In table 1, it appears that Canada applies the lowest GST rate of 7%, but it should be borne in mind that in the provinces where only GST applies, a provincial sales tax (PST) ranging between 6% and 10% is applied in addition to the GST. Alternatively, an HST rate of 15% applies, which comprises both the GST of 7% at a federal level and a PST of 8%, and is known as the harmonious sales tax (HST).

From the above, it is clear that Australia applies the lowest GST rate (10%), and the United Kingdom the highest VAT rate ($17^{1/2}%$).

Lastly, the percentage VAT, GST or HST on the inclusive consideration of goods or services is calculated in table 1 to serve as a comparison with the rates determined in Annexures A to F. The rates were found to be 12.28% in South Africa, 14.89% in the United Kingdom, 6.54% GST in Canada or 13.04% HST in Canada and lastly, 9.09% in Australia.

In table 1, transfer duty is 10% for properties registered in the name of a company, trust or close corporation. The transfer duty on a property registered in the name of a natural person ranges between being exempt for properties up to R70 000, 1% on the first R70 000, 5% over R70 000 up to R250 000 and 8% on any value exceeding R250 000.
The next step is to determine which effective VAT, transfer duty, GST or HST rates are payable by developers of residential properties in the various countries on the inclusive consideration of goods or services.

8.2.2 Effective VAT, transfer duty, GST or HST rates

Table 2, which follows after paragraph 8.2.2.6, is a summary of the percentage effective rates of VAT, transfer duty, GST or HST which have been calculated in Annexures A to F after having applied the detailed provisions of the VAT, transfer duty, GST or HST legislation of the various countries to the examples.

As all zero-rated supplies, exemptions and rebates have been taken into account in the examples, there is a major difference between the rates stated in table 1 in paragraph 8.2.1 and those stated in table 2 which follows after this discussion.

8.2.2.1 South Africa - VAT

In table 2, it can be seen that the effective VAT rate payable by developers registered for VAT purposes in South Africa remains the same as the 12.28% VAT calculated in Table 1 in paragraph 8.2.1.

It should be noted that there is no difference in the effective VAT rates between the various value ranges of properties. It must therefore be concluded that there are no
special concessions relating to the development of residential properties by developers registered for VAT purposes in South Africa.

Further, it can be seen that where developers in South Africa are not registered for VAT purposes, the effective VAT rates range from 5.79% to 6.22%. These percentages indicate that certain concessions apply (1.1 of Annexures A-F).

At this stage it should be mentioned that where developers are not registered for VAT purposes, transfer duty is payable, and that therefore the total of the VAT and transfer duty should be compared with the VAT payable on developments by developers registered for VAT purposes.

8.2.2.2 South Africa - Transfer duty

In table 2 it can be seen that transfer duty payable on second-hand properties and properties developed by developers not registered for VAT purposes is 10% for properties which are being transferred into a trust, company or close corporation.

Where the property is transferred into the name of a natural person, the transfer duty rate ranges from 3.88% to 5.25%. These percentages indicate that exemptions apply and rates are applied on a sliding scale (1.2 of Annexures A-F).
8.2.2.3 United Kingdom - VAT

In table 1 in paragraph 8.2.1, an inclusive VAT rate in the United Kingdom of 14.89% was calculated and identified as the highest rate in any of the countries. However, when compared with the effective VAT rate as stated in table 2, which ranges from 0.30% to 0.64%, it is obvious that massive VAT concessions are made on the development of residential properties (1.3 of Annexures A-F).

In table 2, it can be seen that developers who are registered for VAT purposes and those who are not are placed in the same position, paying exactly the same VAT on residential developments.

There does not appear to be a specific trend with regard to the value of the properties and the VAT payable on the development of the properties.

8.2.2.4 Canada - GST

In table 1 in paragraph 8.2.1, an inclusive GST rate of 6.54% was determined for Canada. The effective GST rate for Canada according to table 2 in paragraph 8.2.2 ranges from 3.08% to 4.21% (1.4 of Annexures A-F). This is considerably lower than the 6.54%, which indicates that Canadian legislation allows for a special concession on the development of residential properties.
In table 2 it can be seen that there is a very small difference in the effective GST rate on properties with different values.

It is interesting to note from table 2 that developers not registered for GST purposes pay approximately 1% less GST than those that are registered.

8.2.2.5 Canada - HST

An inclusive HST rate of 13,04% for Canada was determined in table 1 in paragraph 8.2.1. In table 2, effective HST rates ranging from 6,15% to 11,29% were determined (1.4 of Annexures A-F). As with the GST in Canada, this is substantially lower than the 13,04%. It is therefore obvious that Canada applies a special concession relating to the development of residential properties.

It is interesting to note that where the developer is registered for purposes of HST, the effective rate is 8,35% for properties valued at C$70 000 and C$250 000. However, this effective rate increases to 11,29% where the value of the property is C$375 000. Therefore the concession allowed on the development of residential properties is reduced on the more expensive residential properties.

The concession for developers not registered for HST purposes is even greater than that for developers registered for HST purposes. On the lower value properties, the developer not
registered for HST purposes pays about 1.78% to 2.20% less than developers registered for HST purposes. This difference increases to 4.1% for a property with a value of R375 000.

8.2.2.6 Australia - GST

In table 1 in paragraph 8.2.1, an inclusive GST rate of 9.09% was determined. However, the effective rate in table 2 fluctuates between 4.29% and 5.07% (1.5 of Annexures A-F). It is therefore obvious that some special concessions relate to the development of residential properties.

Table 2 illustrates the fact that there is almost no difference between the effective rate of GST on properties of various values developed by developers registered for GST purposes.

According to table 2, there appears to be a very small difference of less than 1% between the effective GST rate payable on properties developed by developers registered for GST purposes and those not registered for GST purposes.

The reasons for the differences in the inclusive and effective VAT, GST and HST rates should be analysed. This will be done in an attempt to provide a basis for recommendations for the improvement in the current VAT provisions being applied to the development of residential properties in South Africa.
Table 2: Summary of effective VAT, transfer duty, GST or HST rates per examples in Annexures A to F

<table>
<thead>
<tr>
<th>Annexure</th>
<th>Value</th>
<th>Developer</th>
<th>South Africa VAT</th>
<th>South Africa Transfer duty -company, trust</th>
<th>South Africa Transfer duty -natural person</th>
<th>United Kingdom VAT</th>
<th>Canada GST</th>
<th>Canada HST</th>
<th>Australia GST</th>
</tr>
</thead>
<tbody>
<tr>
<td>A:</td>
<td>70 000</td>
<td>registered</td>
<td>12,28%</td>
<td>exempt</td>
<td>exempt</td>
<td>0,64%</td>
<td>4,19%</td>
<td>8,35%</td>
<td>5,07%</td>
</tr>
<tr>
<td>B:</td>
<td>70 000</td>
<td>not registered</td>
<td>5,79%</td>
<td>10,00%</td>
<td>exempt</td>
<td>0,64%</td>
<td>3,08%</td>
<td>6,15%</td>
<td>4,29%</td>
</tr>
<tr>
<td>C:</td>
<td>250 000</td>
<td>registered</td>
<td>12,28%</td>
<td>exempt</td>
<td>exempt</td>
<td>0,30%</td>
<td>4,19%</td>
<td>9,54%</td>
<td>4,87%</td>
</tr>
<tr>
<td>D:</td>
<td>250 000</td>
<td>not registered</td>
<td>6,19%</td>
<td>10,00%</td>
<td>3,88%</td>
<td>0,30%</td>
<td>3,30%</td>
<td>6,57%</td>
<td>4,58%</td>
</tr>
<tr>
<td>E:</td>
<td>375 000</td>
<td>registered</td>
<td>12,28%</td>
<td>exempt</td>
<td>exempt</td>
<td>0,40%</td>
<td>4,21%</td>
<td>11,29%</td>
<td>4,85%</td>
</tr>
<tr>
<td>F:</td>
<td>375 000</td>
<td>not registered</td>
<td>6,22%</td>
<td>10,00%</td>
<td>5,25%</td>
<td>0,40%</td>
<td>3,31%</td>
<td>6,61%</td>
<td>4,61%</td>
</tr>
</tbody>
</table>
8.2.3 Analysis of the effective VAT, transfer duty, GST or HST rates

Table 3, which follows after paragraph 8.2.3.7, illustrates in detail how the effective rates included in Table 2 have been determined. Table 3 is based on the detailed application of the VAT, transfer duty, GST or HST legislation of the selected countries to the examples illustrated in Annexures A to F.

8.2.3.1 South Africa - VAT

In table 3 it can be seen that there is a distinct difference in the application of VAT to developers registered for VAT purposes and those not registered for VAT purposes.

With regard to developers registered for VAT purposes, the output is subject to VAT at the full inclusive rate of 12.28% and all input tax paid is recoverable. This principle applies throughout, irrespective of the value of the property developed.

On the other hand, where developers of residential properties not registered for VAT purposes are discussed, the situation is totally different. Output is exempt from VAT and no input tax credits may be claimed. The net effect is therefore dependant on the amount of VAT included in the input tax. In the kind of situation reflected in the examples in Annexures A to F, where VAT was only payable on the cost of the stand and 50% of the construction costs, the net amount of VAT
included in the project cost expressed as a percentage of the inclusive value was found to be lower than the 12,28% and was calculated as being between 5,79% and 6,22%.

It should, however, be borne in mind that transfer duty is payable on properties developed by developers not registered for VAT purposes. The total amount of VAT and transfer duty is therefore the full amount of tax included in the project cost.

8.2.3.2 South Africa - Transfer duty

In table 3 it can be seen that where developers are registered for VAT purposes, the transactions are exempt from transfer duty.

Transfer duty is therefore applicable to developments where the developer is not registered for VAT purposes. The 10% transfer duty payable where the property is transferred in the name of a company, trust or close corporation is therefore in addition to the VAT which varies between 5,79% and 6,22%. The total tax therefore appears to be between 15,79% and 16,22%. It is therefore obvious that the VAT and transfer duty included in the project cost exceed the 12,28% VAT payable on properties developed by developers registered for VAT purposes.

Where the property is registered in the name of a natural person, the total tax is considerably lower. In this situation, the effective transfer duty payable varies between 0% and 5,25%, depending on the value of the property. The
input tax not recoverable amounts to between 5.79% and 6.22%. The total tax content therefore appears to be between 5.79% and 11.47%, which should be compared with the 12.28% applicable to developers registered for VAT purposes. It is therefore obvious that there is a great saving on the properties in the lower cost range that are developed by developers not registered for VAT purposes and transferred into the name of a natural person.

8.2.3.3 United Kingdom - VAT

Table 3 explains the drastic difference found between an inclusive rate of 14.89% in Table 1 and the effective rate of between 0.30% and 0.64% in Table 2.

It was determined in paragraph 8.2.2.3 that developers registered for VAT purposes and those not registered for VAT purposes pay the same amount of VAT.

In terms of the VAT legislation of the United Kingdom, the supply of new residential property is zero-rated. Zero-rating means that no output tax is payable on the supply, but at the same time, all input tax paid may be claimed back. In the United Kingdom legislation, there are a few exceptions to the basic zero-rating principle. The effect of these exceptions is that no input tax credit is allowed on these exceptions as they are not deemed to be part of materials, builder's hardware or articles usually used by builders. Two items that are generally included in the construction cost of residential properties that are on the exceptions list are
carpeting and stoves. The input tax on these two items therefore explains the minimal VAT included in the project cost of between 0,30% and 0,64%.

8.2.3.4 Canada - GST

In table 3, it can be seen that the effective GST rate on the output is between 4,19% and 4,21% for developers registered for GST purposes. The difference between these rates and the 6,54% in Table 1 can be explained by a new housing rebate of 36% of the output tax, limited to an amount of C$8 750. Where the value of the property exceeds C$350 000, a formula provided for in section 254 of the ETA (see paragraph 5.9.1) applies. The housing rebate is only one of many special concessions made in the Canadian GST legislation with regard to residential properties (see paragraph 5.9). As in South Africa, the input tax paid on the supply of goods or services may be claimed back.

With regard to developers of residential properties not registered for GST purposes, the same applies as in South Africa. The output is exempt from GST and no input tax paid on the supply of goods and services may be claimed back. In table 3, the effective GST rates range between 3,08% and 3,31%, depending on the value of the property. The effective GST rates where developers are not registered for GST purposes are approximately 1% lower than those where developers are registered for GST purposes. Where the effective GST and VAT rates of Canada and South Africa are compared with one another, the South African rates are approximately 3% higher than those of Canada. It should be
remembered, however, that in the provinces where HST does not apply, GST and a provincial sales tax (PST) ranging between 6% and 10% apply. The GST rate of Canada is therefore not directly comparable with the VAT rate in South Africa.

8.2.3.5 Canada - HST

In table 3, output tax payable by developers registered for HST purposes varies between 8.35% and 11.29%, depending on the value of the property.

The difference in the effective rates on the output should be explained here. Where property of C$70,000 and C$250,000 is used in the examples, the effective rate on the output is 8.35%. This figure increases to 11.29% where property with a value of C$375,000 is used in the examples. As was mentioned in the discussion in paragraph 8.2.3.4, this is owing to the new housing rebate formula applicable to properties exceeding C$350,000, which reduces the C$8,750 maximum new housing rebate on the output tax payable.

With the exception of the difference in rates, the provisions of the GST and HST legislation are identical in every respect, and will therefore not be discussed again here.

In table 3, the effective HST rates relating to developers not registered for HST purposes range between 6.15% and 6.61%. These effective rates are from 1.78% to 4.68% lower than those for developers registered for HST purposes,
depending on the value of the property. The developers not registered for HST purposes therefore have a cost advantage over those registered for HST purposes.

8.2.3.6 Australia - GST

Table 3 explains the difference between the inclusive rate of 9,09% that was determined in table 1, which differs considerably from the effective rates of between 4,29% and 5,07% in table 2.

With regard to developers of residential property registered for GST purposes, it can be seen that the GST on output varies between 1,82% and 2,08%. This reduction is due to a special provision relating to real property known as the margin scheme. In terms of the margin scheme (see paragraphs 6.3 and 6.7.1), GST is to be paid at a rate of 1/11 on the margin which is defined as being the difference between the considerations of the supply and acquisition. GST is therefore paid on the basis of the profit. According to the margin scheme, input tax paid may not be claimed back.

In Australia, the supply of goods or services relating to residential properties developed by developers not registered for GST purposes is exempt from GST. At the same time, no input tax paid may be claimed back. This agrees with the legislation of South Africa and Canada.

In table 3, the difference between the effective GST rates applicable to developers registered and not registered for GST purposes varies between 0,29% and 0,78%.
8.2.3.7 Summary of analysis of effective rates

It is clear from paragraphs 8.2.3.1 to 8.2.3.6 that South Africa is the only country which does not have special concessions or provisions regarding the supply of residential properties developed by developers registered for VAT, GST or HST purposes.

As determined above, these provisions or concessions range from zero-rating the supply in the United Kingdom, to allowing a rebate of up to 36% of the output tax payable in Canada, to paying output tax on the margin, not on the sales value in Australia.

When evaluating the differences in the way the input tax paid is dealt with, it was determined that the total input tax paid in South Africa and Canada may be claimed back. In the United Kingdom all input tax paid except for that on carpeting and stoves may be claimed back. As this is minimal in relation to the inclusive consideration, it will be disregarded. In terms of the Australian legislation no input tax credits may be claimed back where the margin scheme is being used. This is logical, as GST is not payable on the output, but only on the margin or profit.

The provisions where the developers of residential properties are not registered for VAT, GST or HST purposes should now be discussed.
In South Africa, Canada and Australia, all supplies made by developers not registered for VAT, GST or HST purposes are exempt. In the United Kingdom, these supplies are zero-rated.

Input tax paid by developers not registered for VAT, GST or HST purposes may not be claimed back in South Africa, Canada and Australia. This agrees with the definition of an exempt supply. As the supply is zero-rated in the United Kingdom, it follows that the input tax may be claimed back.

One of the objectives of this study was to determine whether the developer registered for VAT purposes is in a competitive position vis-à-vis sellers of existing houses and developers not registered (incidental) for VAT purposes.

In table 2 and the subsequent discussion in paragraph 8.2.3.2, it was determined that where a property is registered in the name of a company, close corporation or trust, the tax component consisting of input tax and transfer duty amounts to between 15.79% and 16.22% which exceeds the effective VAT rate of 12.28%. On the basis of these figures, where the survival of developers registered for VAT purposes is being examined, it does not appear that transfer duty could be considered as a replacement for VAT. Where the property is registered in the name of a natural person, the tax component varies between 5.79% and 11.47% which is lower than the effective VAT rate of 12.28%.

In determining whether a developer registered for VAT purposes is competitive with a developer not registered for
VAT purposes it is therefore obvious that it depends on the value of the property and on whether it is being registered in the name of a natural person or a legal entity. Because transfer duty does not appear to be an alternative to the current application of VAT on property developments, all discussions will focus on alternative VAT systems.

From the above, it can be seen that where developers of residential properties are not registered for VAT, GST or HST purposes, the provisions of the legislation of all the selected countries except for the United Kingdom are identical. With the exception of the United Kingdom, the difference in the effective rates illustrated in table 3 is due to the difference in the basic VAT, GST or HST rates.

Where the developers of residential properties are registered for VAT, GST or HST purposes, it was found that different methods are being applied by the various countries. It was found that all the countries except South Africa are applying concessions regarding the supply of residential properties.

The recommendations will therefore focus on residential properties developed by developers registered for VAT, GST or HST purposes.

Table 3 follows, whereafter the recommendations will be made.
Table 3: Analysis of effective VAT, transfer duty, GST or HST rates in Table 2 of paragraph 8.2.2

<table>
<thead>
<tr>
<th></th>
<th>South Africa VAT</th>
<th>South Africa Transfer duty - company etc.</th>
<th>South Africa Transfer duty - natural person</th>
<th>United Kingdom VAT</th>
<th>Canada GST</th>
<th>Canada HST</th>
<th>Australia GST</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Annexure A: Value 70 000,</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>developer registered for VAT</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>% output tax on inclusive value</td>
<td>12,28</td>
<td>exempt</td>
<td>exempt</td>
<td>zero-rated</td>
<td>4,19</td>
<td>8,35</td>
<td>2,08</td>
</tr>
<tr>
<td>Add: % input tax not recovered</td>
<td>0,00</td>
<td>not applicable</td>
<td>not applicable</td>
<td>0,64</td>
<td>0,00</td>
<td>0,00</td>
<td>2,99</td>
</tr>
<tr>
<td>% input tax paid</td>
<td>5,79</td>
<td></td>
<td></td>
<td>7,02</td>
<td>3,08</td>
<td>6,15</td>
<td>2,99</td>
</tr>
<tr>
<td>% input tax recovered</td>
<td>(5,79)</td>
<td></td>
<td></td>
<td>(6,38)</td>
<td>(3,08)</td>
<td>(6,15)</td>
<td>(6,15)</td>
</tr>
<tr>
<td><strong>Effective VAT, etc. - table 2</strong></td>
<td>12,28</td>
<td>0,00</td>
<td>0,00</td>
<td>0,64</td>
<td>4,19</td>
<td>8,35</td>
<td>5,07</td>
</tr>
</tbody>
</table>

| **Annexure B: Value 70 000,**  |                  |                                           |                                            |                   |            |            |              |
| developer not registered for VAT|                  |                                           |                                            |                   |            |            |              |
| % output tax on inclusive price | exempt           | 10,00                                     | exempt                                     | zero-rated        | exempt     | exempt     | exempt       |
| Add: % input tax not recovered | 5,79             | not applicable                            | not applicable                             | 0,64              | 3,08       | 6,15       | 4,29         |
| % input tax paid               | 5,79             |                                           |                                            | 7,02              | 3,08       | 6,15       | 4,29         |
| % input tax recovered          | -                |                                           |                                            | (6,38)            | -          | -          | -            |
| **Effective VAT, etc. - table 2** | 5,79             | 10,00                                     | 0,00                                       | 0,64              | 3,08       | 6,15       | 4,29         |
Table 3: Analysis of effective VAT, transfer duty, GST or HST rates (continued)

<table>
<thead>
<tr>
<th></th>
<th>South Africa VAT</th>
<th>South Africa Transfer duty - company etc.</th>
<th>South Africa Transfer duty - natural person</th>
<th>United Kingdom VAT</th>
<th>Canada GST</th>
<th>Canada HST</th>
<th>Australia GST</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Annexure C: Value 250 000, developer registered for VAT</strong></td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>% output tax on inclusive value</td>
<td>12,28</td>
<td>exempt</td>
<td>exempt</td>
<td>zero-rated</td>
<td>4,19</td>
<td>9,54</td>
<td>1,93</td>
</tr>
<tr>
<td>Add : % input tax not recovered</td>
<td>0,00</td>
<td>not applicable</td>
<td>not applicable</td>
<td>0,30</td>
<td>0,00</td>
<td>0,00</td>
<td>2,94</td>
</tr>
<tr>
<td>% input tax paid</td>
<td>6,19</td>
<td>(6,19)</td>
<td>7,51</td>
<td>(7,21)</td>
<td>3,30</td>
<td>(3,30)</td>
<td>6,57</td>
</tr>
<tr>
<td>% input tax recovered</td>
<td>12,28</td>
<td>0,00</td>
<td>0,00</td>
<td>0,30</td>
<td>4,19</td>
<td>9,54</td>
<td>4,87</td>
</tr>
<tr>
<td><strong>Effective VAT, etc. - table 2</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Annexure D: Value 250 000, developer not registered for VAT</strong></td>
<td>exempt</td>
<td>10,00</td>
<td>3,88</td>
<td>zero-rated</td>
<td>exempt</td>
<td>exempt</td>
<td>exempt</td>
</tr>
<tr>
<td>% output tax on inclusive price</td>
<td>6,19</td>
<td>not applicable</td>
<td>not applicable</td>
<td>0,30</td>
<td>3,30</td>
<td>6,57</td>
<td>4,58</td>
</tr>
<tr>
<td>Add: % input tax not recovered</td>
<td>10,00</td>
<td>3,88</td>
<td>0,30</td>
<td>exempt</td>
<td>exempt</td>
<td>exempt</td>
<td>exempt</td>
</tr>
<tr>
<td>% input tax paid</td>
<td>6,19</td>
<td>(6,19)</td>
<td>7,51</td>
<td>(7,21)</td>
<td>3,30</td>
<td>(3,30)</td>
<td>6,57</td>
</tr>
<tr>
<td>% input tax recovered</td>
<td>12,28</td>
<td>0,00</td>
<td>0,00</td>
<td>0,30</td>
<td>4,19</td>
<td>9,54</td>
<td>4,87</td>
</tr>
<tr>
<td><strong>Effective VAT, etc. - table 2</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Table 3: Analysis of effective VAT, transfer duty, GST or HST rates (continued)

<table>
<thead>
<tr>
<th></th>
<th>South Africa VAT</th>
<th>South Africa Transfer duty - company etc.</th>
<th>South Africa Transfer duty - natural person</th>
<th>United Kingdom VAT</th>
<th>Canada GST</th>
<th>Canada HST</th>
<th>Australia GST</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annexure E: Value 375 000, developer registered for VAT</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>% output tax on inclusive value</td>
<td>12,28</td>
<td>exempt</td>
<td>exempt</td>
<td>zero-rated</td>
<td>4,21</td>
<td>11,29</td>
<td>1,82</td>
</tr>
<tr>
<td>Add: % input tax not recovered</td>
<td>0,00</td>
<td>not applicable</td>
<td>not applicable</td>
<td>0,40</td>
<td>0,00</td>
<td>0,00</td>
<td>3,03</td>
</tr>
<tr>
<td>% input tax paid</td>
<td>6,22</td>
<td></td>
<td></td>
<td>7,55</td>
<td>3,31</td>
<td>6,61</td>
<td>3,03</td>
</tr>
<tr>
<td>% input tax recovered</td>
<td>(6,22)</td>
<td></td>
<td></td>
<td>(7,15)</td>
<td>(3,31)</td>
<td>(6,61)</td>
<td>-</td>
</tr>
<tr>
<td>Effective VAT, etc. - table 2</td>
<td>12,28</td>
<td>0,00</td>
<td>0,00</td>
<td>0,40</td>
<td>4,21</td>
<td>11,29</td>
<td>4,85</td>
</tr>
<tr>
<td>Annexure F: Value 375 000, developer not registered for VAT</td>
<td>exempt</td>
<td>10,00</td>
<td>5,25</td>
<td>zero-rated</td>
<td>exempt</td>
<td>exempt</td>
<td>exempt</td>
</tr>
<tr>
<td>% output tax on inclusive price</td>
<td>6,22</td>
<td>not applicable</td>
<td>not applicable</td>
<td>0,40</td>
<td>3,31</td>
<td>6,61</td>
<td>4,61</td>
</tr>
<tr>
<td>Add: % input tax not recovered</td>
<td>0,00</td>
<td></td>
<td></td>
<td>3,31</td>
<td>6,61</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>% input tax paid</td>
<td>6,22</td>
<td></td>
<td></td>
<td>7,55</td>
<td>3,31</td>
<td>6,61</td>
<td>4,61</td>
</tr>
<tr>
<td>% input tax recovered</td>
<td>-</td>
<td></td>
<td></td>
<td>(7,15)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Effective VAT, etc. - table 2</td>
<td>6,22</td>
<td>10,00</td>
<td>5,25</td>
<td>0,40</td>
<td>3,31</td>
<td>6,61</td>
<td>4,61</td>
</tr>
</tbody>
</table>
8.3 RECOMMENDATIONS

8.3.1 Principles of taxation

South Africa is a developing country with an immense shortage of housing and a high unemployment rate. In view of this, it appears strange that South Africa is the only country which does not have special VAT concessions regarding the supply of residential properties by developers registered for VAT purposes.

It should be borne in mind that any tax system should be measured against the principles of taxation. These principles are discussed in detail in paragraph 2.2, but only those principles deemed relevant in the choice between the concessions or special provisions of the various countries selected will briefly be discussed here to form a basis for recommendations.

8.3.1.1 Simplicity and certainty

The reasoning behind the lack of special concessions regarding the supply of residential properties in South Africa probably lies in the Report of the VATCOM (1991:7), which was discussed in paragraph 2.2.1, and which states that the VAT system introduced in South Africa aims to comply with the principle of simplicity. It further states that by using a single VAT rate and keeping exemptions to a minimum, the VAT will be applied to a very broad base. The logic behind this is to keep compliance costs to a minimum.
When compared with the standard VAT rate on residential properties in South Africa, the zero-rating used in the United Kingdom does not, in my opinion, affect simplicity, or add to compliance costs. In South Africa, output is taxed at the standard rate of 14%. In the United Kingdom, output is taxed at 0% and input is treated in precisely the same manner as in South Africa at present. In fact, applying a rate of 0% on supplies of residential properties would, in my opinion, be simpler and less time-consuming than the present system of VAT applied in South Africa.

The rebate system used in Canada would not, in my opinion, affect simplicity or compliance costs when compared with the VAT system currently being applied in South Africa. It is not a complicated nor a major administrative exercise to allow a rebate of for example 36% on the output tax payable on a residential property. This rebate was found to apply to the examples illustrated in Annexures A to F.

A word of warning is essential at this stage, however. The detailed provisions for various situations as provided for in the Canadian GST and HST legislation and discussed in paragraph 5.9 would, in my opinion, be far too complex for a developing country like South Africa and would not comply with the principle of simplicity. It would also most likely increase compliance costs.

Lastly, the system used in Australia, where the margin and not turnover is used as a basis for output tax, appears, at face value, to be more complicated than the VAT currently being applied in South Africa.
When one looks at the finer points, it becomes clear, however, that this system is not as complicated as it initially appears. In the South African VAT system, output is taxed at the standard rate and input tax credits are allowed for all input on which VAT was paid. Where the margin scheme is used, the consideration less all the acquisitions are subject to GST. This is a calculation that will have to be checked by the revenue authorities, which would probably be an obstacle to the principle of simplicity and would possibly increase compliance costs. It should be remembered that where the margin scheme is used, no input tax credits are allowed. This could simplify the system slightly and reduce compliance costs.

8.3.1.2 Efficiency and neutrality

In paragraph 2.2.3, the details of the principle of efficiency and neutrality are discussed. According to Rebhun (1982:30), neutrality can only be determined in relation to another tax. The VAT, transfer duty, GST or HST applied in the selected countries should be measured against the VAT system currently being applied in South Africa.

At this stage, the only guideline which appears to be relevant in determining whether a VAT system is neutral appears to be that the tax should be levied equally on enterprises, irrespective of whether they are profitable or not.
When assessing the provisions relating to residential properties, the principle of neutrality appears to be met with regard to the VAT in the United Kingdom and the GST or HST in Canada.

It appears that the margin scheme provided for in Australia would not meet this criterion, as it is based on a margin, which would be affected by profitability.

8.3.1.3 Fiscal adequacy

As stated in paragraph 2.2.6, this principle implies that the tax should generate the amount of revenue required by the government. As the effective VAT rate on housing in South Africa is much higher than that of any of the other countries selected, the VAT which is currently being applied certainly earns more revenue for the government than any of the other countries' provisions with regard to housing would.

It is therefore obvious that, where fiscal adequacy is being considered, the VAT currently being applied with regard to residential properties in South Africa is superior to the VAT in the United Kingdom, the GST or HST in Canada and the GST in Australia.

8.3.1.4 Political acceptability

As discussed in paragraph 2.2.7, a tax should not create political difficulties in the country in which it is applied nor in other tax jurisdictions.
It is unlikely that special VAT concessions on housing could be seen as anything but politically acceptable in South Africa. On the contrary, it would indicate a commitment from government to provide affordable housing.

If South Africa were to apply special concessions with regard to VAT on housing, it would be a case of South Africa falling in line with the provisions of the other countries selected. This could not be seen to be creating political difficulties as all the selected countries, except South Africa, already have these concessions in place.

8.3.2 Alternative to current application of VAT to developers of residential properties in South Africa

In paragraph 8.3.1, the application of VAT, GST or HST to small to medium-sized developers of residential properties in South Africa, the United Kingdom, Canada and Australia was measured against the principles of taxation.

The application of GST or HST relating to developers of residential properties in Canada was found to be the best alternative. This is because the principles of simplicity and certainty, efficiency and neutrality and political acceptability are met. Regarding the principle of fiscal adequacy, the Canadian GST or HST provisions were found to be superior to those of the other countries selected, but inferior to the South African VAT provisions. With regard to
fiscal adequacy, the Canadian GST or HST provisions relating to developers of residential properties therefore rank second to those of South Africa.

When measured against the principles of taxation, the VAT provisions relating to developers of residential properties in the United Kingdom were found to rank third, after the South African and Canadian provisions of VAT, GST or HST.

The VAT provisions in the United Kingdom were found to comply with the principles of simplicity and certainty, efficiency and neutrality, and political acceptability. Regarding the principle of fiscal adequacy, the VAT provisions relating to developers of residential properties in the United Kingdom contributed substantially lower revenues to the government than those of Canada. In table 2, the effective GST or HST rates in Canada were found to be between 3.08% and 4.21% or 6.15% and 11.29%, whereas those of the United Kingdom were found to be between 0.30% and 0.64%.

Where the Australian GST provisions relating to residential developments were measured against the principles of taxation, it is doubtful whether the principles of simplicity and certainty, and efficiency and neutrality are met. The principles of fiscal adequacy and political acceptability appear to be met.

Before an alternative can be recommended, all factors should be considered. The GST or HST provisions relating to developers of residential properties in Canada would result in substantially more revenue being earned by the government
than those of the United Kingdom would yield. This does not necessarily indicate that the Canadian alternative is the best.

It should be remembered that, unlike Canada and the United Kingdom, South Africa is a developing country with a critical shortage of housing. The government has, on numerous occasions, committed itself to the provision of housing. Special concessions with regard to residential properties as provided for in the other countries selected would, in my opinion, make housing more affordable, which would in turn result in an increase in the demand for housing, which would lead to an upswing in the building industry, which would ultimately create more job opportunities.

The projection that special concessions on housing will not earn as much VAT revenue as that presently earned in South Africa is not a valid reason to ignore the situation. A developing country should have concessions or incentives in areas where development is being encouraged. This is emphasised by the fact that all the other countries selected are deemed to be developed countries and they all have special concessions on housing.

In chapter 1, the definition of the problem established that the financial survival of the construction industry is being threatened by various factors, including the VAT payable on residential developments. It was also established that the consumers are not in a position to absorb the increase in housing costs due to VAT, and that therefore the increase has to be absorbed by the developers of properties. The
developers of properties are not in a position to absorb these costs, therefore some form of relief or rebate should be implemented, as is done in the selected countries.

The commitment of the government to provide affordable housing should be weighed up against this loss in revenue. Alternative ways should be found to compensate the government for the loss of VAT revenue owing to special concessions on housing.

The best alternative to the current application of VAT in South Africa would probably be VAT provisions somewhere between the new housing rebate allowed on output tax in Canada and the zero-rating of housing supplies in the United Kingdom. The effective VAT rate should then be somewhere between the effective rates of the United Kingdom and Canada. This rate appears to be fair, as it is approximately the effective GST rate on housing in Australia.

Table 4 summarises the examples in annexure G where possible alternatives to the current VAT provisions relating to developers of residential properties in South Africa are illustrated which would be comparable to effective VAT, GST or HST rates in the other countries selected.
### Table 4: Summary of effective VAT rates after proposed new housing rebates

<table>
<thead>
<tr>
<th>Annexure G</th>
<th>Average effective HST or VAT rate - Canada and United Kingdom</th>
<th>Effective GST rate - Australia</th>
<th>South Africa - 50% housing rebate</th>
<th>South Africa - 60% housing rebate, limited to R25 000</th>
<th>South Africa - 70% housing rebate, limited to R25 000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property value of R70 000</td>
<td>4.50%</td>
<td>5.07%</td>
<td>6.14%</td>
<td>4.91%</td>
<td>3.68%</td>
</tr>
<tr>
<td>Property value of R250 000</td>
<td>4.92%</td>
<td>4.87%</td>
<td>6.14%</td>
<td>4.91%</td>
<td>3.68%</td>
</tr>
<tr>
<td>Property value of R375 000</td>
<td>5.85%</td>
<td>4.85%</td>
<td>6.14%</td>
<td>5.61%</td>
<td>5.61%</td>
</tr>
</tbody>
</table>
In paragraph 8.3.2, it was determined that a proposed housing rebate should result in an effective VAT rate for South African developers of residential properties who are registered for VAT purposes, similar to that of Australia, where the rate applicable lies between the effective rates of Canada and the United Kingdom.

In table 4, which summarises examples in Annexure G, various proposed housing rebates are applied to the examples in an attempt to determine which rebate would result in effective VAT rates for South Africa similar to the average of the HST or VAT rates in Canada and the United Kingdom and comparable to the effective GST rates in Australia.

In table 2, for a property value of R70 000, an effective HST rate of 8.35% for Canada and an effective VAT rate of 0.64% for the United Kingdom were determined. The average rate is therefore 4.50%, whereas the effective GST rate for Australia is 5.07%.

In table 4, at a property value of R70 000 and a proposed new housing rebate of 50% of the output tax payable, an effective VAT rate of 6.14% would be payable. This is higher than the rate we are aiming for. A proposed new housing rebate of 60% of the output tax payable indicates an effective VAT rate of 4.91%. This rate is comparable to the effective rates of the selected countries and is therefore acceptable as a proposed rebate on new housing. A proposed rebate of 70% of the output tax payable on new housing results in an effective rate of 3.68%. This proposed 70% rebate could be promoted on the basis that South Africa is a developing country which
should have more benefits on housing than the developed countries. When the whole issue of effective rates was discussed, it was suggested, however, that the proposed effective VAT rates should be more or less the average of the effective HST and VAT rates of Canada and the United Kingdom. Based on this, the 70% new housing rebate will not be proposed as future policy.

In table 2, at a property value of R250 000, an effective HST rate of 9,54% for Canada and an effective VAT rate of 0,30% for the United Kingdom were determined. The average rate is therefore 4,92%, whereas the effective GST rate for Australia is 4,87%.

In table 4, at a property value of R250 000 and a proposed new housing rebate of 50% of the output tax payable, an effective VAT rate of 6,14% would be payable, as on a property of R70 000. Again, this is higher than the rate we are aiming for. A proposed new housing rebate of 60% of the output tax payable, limited to R25 000, indicates an effective VAT rate of 4,91%. This rate is comparable with the effective rates of the selected countries and is therefore acceptable as a proposed rebate on new housing. A rebate of 70% of the output tax payable, limited to R25 000, results in an effective VAT rate of 3,68% which is the same as the rate determined for a property value of R70 000. Based on the same reasoning as above, the 70% rebate will not be proposed.

In table 2, at a property value of R375 000, an effective HST rate of 11,29% for Canada and an effective VAT rate of 0,40%
for the United Kingdom were determined. The average rate is therefore 5.85%, whereas the effective GST rate for Australia is 4.85%.

Where a property value of R375 000 is discussed, a proposed new housing rebate of 50% of the output tax payable again results in an effective VAT rate of 6.14%, which is higher than the targeted effective rates of between 4.85% and 5.85%. A proposed new housing rebate of 60% of the output tax payable, limited to R25 000, would result in an effective VAT rate of 5.61%, which is within the rates that are comparable to those of the selected countries. A proposed rebate of 70% of the output tax payable, limited to R25 000, results in an effective VAT rate of 5.61%, which is identical to that of the 60% proposed new housing rebate.

It is clear from the above discussion of table 4 that a new housing rebate of 60% of the output tax payable, limited to R25 000, would result in the effective VAT rate applying to developers of residential properties who are registered for VAT purposes in South Africa being comparable to the effective VAT, GST or HST rates in the selected countries.

I therefore recommend that a new housing rebate of 60% of the output tax payable, limited to R25 000, be implemented in South Africa in respect of VAT on developers of residential properties who are registered for VAT purposes.
8.4 CONCLUSION

This study set out to determine whether an alternative exists to the current application of VAT that will firstly ensure the financial survival of the small to medium-sized developer of residential properties in South Africa and, secondly, place him in a competitive position vis-à-vis sellers of existing houses and incidental developers.

In paragraph 8.2.3.7 it was determined that where developers of residential properties are not registered for VAT purposes, the provisions of the VAT legislation of all the countries except the United Kingdom are identical. In this regard, the South African VAT legislation appears to be in line with that of the other countries discussed, therefore no further discussion was entered into in this regard.

It was determined that transfer duty was not an alternative to a system of VAT on residential properties. It was not part of this study to determine whether taxes similar to transfer duty apply to developments by developers not registered for VAT purposes in the other countries discussed.

Based on this, the recommendations focused on developers of residential properties registered for VAT purposes.

Firstly, the way VAT is applied to residential properties in the United Kingdom was established. It was ascertained that supplies relating to residential premises are zero-rated.
In paragraph 8.3, it was determined that the zero-rating applied to residential properties in the United Kingdom complied with the taxation principles of simplicity and certainty, efficiency and neutrality, and political acceptability. With regard to the principle of fiscal adequacy, it was determined that the VAT applied to residential properties in the United Kingdom satisfied this principle least of all the countries discussed.

Secondly, the application of GST or HST to residential properties in Canada was discussed. It was ascertained that various complex provisions exist relating to the development of residential properties. In the examples illustrated in Annexures A to F, a rebate on housing of 36% of the output, limited to C$8 750, applied. Where the value of the property exceeds C$350 000, a formula applies which reduces the C$8 750 rebate. This rebate was tested against the principles of taxation. It was found that the housing rebate met the principles of simplicity and certainty, efficiency and neutrality, and political acceptability. In terms of fiscal adequacy, the Canadian system was found to rank second to the South African system.

Thirdly, the application of GST with regard to developers of residential premises in Australia was discussed. It was found that a margin scheme whereby the margin is subject to GST is provided for with regard to developers of residential premises. In terms of the margin scheme, no input tax credits may be claimed.
The Australian margin scheme was tested against the principles of taxation and met the principle of political acceptability. With regard to the principles of simplicity and certainty, and efficiency and neutrality, the margin scheme does not meet this principle, as the system does not appear to be simple to enforce and all enterprises are not treated equally, regardless of profit. Regarding fiscal adequacy, it was found to be preferable to the United Kingdom, but lacking when compared to Canada.

Overall, based on the discussion of the selected countries' provisions regarding VAT, GST or HST that were measured against the principles of taxation, it was determined that Canada and the United Kingdom were the most suitable.

It was determined that not one of the countries measured up to the principle of fiscal adequacy to the same extent as the South African system, which produces the highest income from VAT on housing. The fact that South Africa is a developing country with a shortage of housing was taken into account. This, together with the fact that the survival of developers of residential properties is threatened as stated in chapter 1, indicated that a compromise had to be found between the provisions in South Africa and the other countries regarding the principal of fiscal adequacy.

It was determined that the best alternative would be provisions which were somewhere between the housing rebate in Canada and the zero-rating in the United Kingdom. This
effective VAT rate was found to be fair as it was approximately the effective GST rate on residential properties in Australia.

In table 4 and the subsequent discussion, a new housing rebate was discussed. Table 4 was based on the examples in Annexure G which tested various levels of rebates and values of properties. The effective VAT rates calculated in these examples were tested against the rates which were being aimed at, namely the average of the effective rates of Canada and the United Kingdom, which were comparable to those of Australia.

When compared with the average of the HST and VAT rates of Canada and the United Kingdom, weighed up against those of Australia, a 50% rebate on the output tax payable resulted in effective rates which were too high. On the other hand, a 70% rebate resulted in effective rates which were too low.

A 60% rebate on output tax payable, limited to R25 000, was found to result in effective rates which were between the HST rate of Canada and the VAT rate of the United Kingdom. This rate was also found to be approximately that of Australia.

In conclusion, it is proposed that a 60% rebate on the output tax payable, limited to R25 000, be implemented in South Africa in respect of VAT on residential properties developed by developers registered for VAT purposes.
8.5 BIBLIOGRAPHY

Dissertations / Theses


Acts


Reports

ANNEXURE A: IMPROVED RESIDENTIAL PROPERTY WITH A VALUE OF R70 000 - DEVELOPER REGISTERED FOR VAT OR GST PURPOSES

1 EXAMPLE 1

A property developer registered for VAT or GST purposes acquired a residential stand from a township developer registered for VAT or GST purposes for R12 000 (£12 000; C$12 000; A$12 000).

He constructed the first phase of the house on the property, at a cost of R42 000 (£42 000; C$42 000; A$42 000). During the period of construction, VAT was paid by him on 50% of the construction cost of the house, namely on R21 000 (£21 000; C$21 000; A$21 000).

On completion of the house, he sold it for R70 000 (£70 000; C$70 000; A$70 000).

In paragraphs 1.1 to 1.5 the legislation of various countries will be applied to example 1.

1.1 South Africa - Value-added tax

As the stand was purchased from a township developer registered for VAT purposes, the developer would, in terms of section 16(3) of the Act (see paragraph 3.4), have claimed an input tax credit on the cost of the stand of R12 000.
During the period of construction, the developer would, in
terms of section 16(3) of the Act, have claimed an input tax
credit for VAT paid on the goods and services of R21 000.

Output tax would, in terms of section 7(1) of the Act, be
payable on the selling price of R70 000.

The net VAT payable on the above transaction is summarised as
follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable (14/114 x R70 000)</td>
<td>R8 596</td>
</tr>
<tr>
<td>Input tax paid but not recovered</td>
<td>-</td>
</tr>
<tr>
<td>Input tax paid [14/114 x R(12 000 + 21 000)]</td>
<td>R4 053</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td>R4 053</td>
</tr>
<tr>
<td>On stand (14/114 x R12 000)</td>
<td>1 474</td>
</tr>
<tr>
<td>On construction costs (14/114 x R21 000)</td>
<td>2 579</td>
</tr>
<tr>
<td>Net VAT payable</td>
<td>R8 596</td>
</tr>
</tbody>
</table>

Based on inclusive consideration

\[- \text{% VAT payable (R8 596/R70 000)} = 12.28\%
\]
\[- \text{% input tax paid (R4 053/R70 000)} = 5.79\%
\]

\subsection*{1.2 South Africa - Transfer duty}

As the property transaction is deemed a taxable supply for
VAT purposes, the transaction is, in terms of section 9(15)
of the Transfer Duty Act (see paragraph 7.4), exempt from
transfer duty.
1.3 United Kingdom - VAT

As the stand was purchased from a township developer registered for VAT purposes, the developer would, in terms of section 24(1) of VATA (see paragraph 4.4), have claimed an input tax credit on the cost of the stand of £12 000.

During the period of construction, the developer would, in terms of section 24(1) of VATA, have claimed an input tax credit for VAT paid on most of the goods and services. Section 24(1) of VATA excludes two items that would relate to this transaction, namely carpeting and a stove. Assume that the cost of the stove and carpeting amounts to £3 000. After the deduction of these two items, the developer could claim an input tax credit on £18 000.

No output tax will, in terms of Schedule 8 of VATA, be payable on the selling price of £70 000, as the supply of the house is zero-rated.

The net VAT payable on the above development is summarised as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total output tax payable</td>
<td>-</td>
</tr>
<tr>
<td>Input tax paid, not recovered</td>
<td>447</td>
</tr>
<tr>
<td>Input tax paid [7/47 x (£12 000 + 21 000)]</td>
<td>4 915</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td>4 468</td>
</tr>
<tr>
<td>On stand (7/47 x £12 000)</td>
<td>1 787</td>
</tr>
<tr>
<td>On construction costs (7/47 x £18 000)</td>
<td>2 681</td>
</tr>
<tr>
<td>Net VAT payable</td>
<td>447</td>
</tr>
</tbody>
</table>
Based on inclusive consideration
- % VAT payable (£447/£70 000) 0,64%
- % input tax paid (£4 915/£70 000) 7,02%
- % input tax recovered (£4 468/£70 000) 6,38%

1.4 Canada - GST or HST

As the stand was purchased from a township developer registered for the purposes of the GST, the developer would, in terms of section 169(1) of the ETA (see paragraph 5.4), have claimed an input tax credit on the cost of the stand of C$12 000.

During the period of construction, the developer would, in terms of section 169(1) of the ETA (see paragraph 5.4), have claimed an input tax credit for VAT paid on the goods and services of C$21 000.

In terms of sections 165 and 221(1) of the ETA (see paragraph 5.7.1 and 5.10.1.1), output tax is payable on the selling price of C$70 000 and the developer is responsible for collecting the output tax from the recipient and paying it over. The rebate in terms of section 254 of the ETA (see paragraph 5.9.1) applicable to this transaction is whichever is the lesser of C$8 750 or 36% of the output tax.

The net federal VAT payable on the above transaction is summarised as follows:
Output tax payable \( (\frac{7}{107} \times \text{C$70 000}) \) 4 579

Less: Section 254 new housing rebate
\( (36\% \times \text{C$4 579}) \) 1 648

Net output tax payable 2 931

Input tax paid, not recovered -

Input tax paid \( (\frac{7}{107} \times \text{C$(12 000 + 21 000)}) \) 2 159

Less: Input tax claimed back
On stand \( (\frac{7}{107} \times \text{C$12 000}) \) 785
On construction cost \( (\frac{7}{107} \times \text{C$21 000}) \) 1 374

Net GST payable 2 931

Based on inclusive consideration
- % GST payable \( (\frac{\text{C$2 931}}{\text{C$70 000}}) \) 4,19%
- % input tax paid \( (\frac{\text{C$2 159}}{\text{C$70 000}}) \) 3,08%

OR

Where applicable, the net HST payable on the above transaction is summarised as follows:

Output tax payable \( (\frac{15}{115} \times \text{C$70 000}) \) 9 130

Less: Section 254 new housing rebate
\( (36\% \times \text{C$9 130}) \) 3 287

Net output tax payable 5 843

Input tax paid, not recovered -

Input tax paid \( (\frac{15}{115} \times \text{C$(12 000 + 21 000)}) \) 4 304

Less: Input tax claimed back
On stand \( (\frac{15}{115} \times \text{C$12 000}) \) 1 565
On construction \( (\frac{15}{115} \times \text{C$21 000}) \) 2 739

Net HST payable 5 843
Based on inclusive consideration
- % HST payable (C$5 843/ C$70 000) 8.35%
- % input tax paid (C$4 304/C$70 000) 6.15%

1.5 Australia - GST

In terms of section 75-5 of the GST Act, as discussed in paragraphs 6.3 and 6.7.1, property developers may choose to use the margin scheme to calculate the amount of GST on the taxable supply of real property.

According to section 75-20 of the GST Act, where the margin scheme is used, no creditable acquisitions arise on any acquisitions regarding the taxable supply. The property developer may therefore not claim any input tax credits on the cost of the stand of A$12 000 or on the cost of construction of A$21 000 on which GST was paid.

Section 75-10 of the GST Act provides for GST to be paid on the taxable supply at 1/11 of the margin provided that, in terms of section 75-5 of the GST Act, the stand was acquired according to the margin scheme. According to section 75-10(2) of the GST Act (see paragraph 6.3), the margin is defined as the difference between the considerations for the supply and acquisition. In this example, the supply is A$70 000 and the acquisitions are A$12 000 and A$42 000. The margin is therefore A$16 000. GST at 1/11 is payable on this margin, amounting to A$1 455 (A$16 000 x 1/11). Assume that the margin on the purchase of the stand was A$2 000.
The net GST payable on the above transaction is summarised as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (A$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GST payable on margin (A$16 000 x 1/11)</td>
<td>1 455</td>
</tr>
<tr>
<td>GST paid, not recovered</td>
<td>2 091</td>
</tr>
<tr>
<td>GST paid [10/110 x A$(2 000 + 21 000)]</td>
<td></td>
</tr>
<tr>
<td>Less: GST tax claimed back</td>
<td></td>
</tr>
<tr>
<td>On stand</td>
<td></td>
</tr>
<tr>
<td>On construction costs</td>
<td></td>
</tr>
<tr>
<td>Net GST included in the project cost</td>
<td>3 546</td>
</tr>
</tbody>
</table>

Based on inclusive consideration

- % GST payable (A$3 546/ A$70 000) = 5.07%
- % GST payable on margin (A$1 455/ A$70 000) = 2.08%
- % input tax paid (A$2 091/A$70 000) = 2.99%
1  EXAMPLE 2

A person not registered for VAT or GST purposes (incidental property developer) acquired a residential stand from a person not registered for VAT or GST purposes, for R12 000 (£12 000; C$12 000; A$12 000).

He constructed the first phase of the house on the property, at a cost of R42 000 (£42 000; C$42 000; A$42 000). During the period of construction, VAT was paid by him on 50% of the construction cost of the house, namely on R21 000 (£21 000; C$21 000; A$21 000).

On completion of the house, he sold it for R70 000 (£70 000; C$70 000; A$70 000).

In paragraphs 1.1 to 1.5 the legislation of the various countries will be applied to example 2.

1.1 South Africa - Value-added tax

Owing to the fact that this is a once-off development, the person is an incidental developer, who is not required in terms of 23(1) of the Act to register as a vendor.

In terms of section 1 of the Act (see paragraphs 3.3 and 3.11), as the developer is not registered for VAT purposes,
the incidental developer may not claim back an input tax
credit for the VAT on the cost of the stand or the
construction costs on which VAT was paid.

According to section 7(1)(a) of the Act (see paragraphs 3.3
and 3.11), the sale of the house would not, for the same
reason, attract output tax.

The net VAT that appears to be included in the cost of the
building project is summarised as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable</td>
<td>R</td>
</tr>
<tr>
<td>Input tax paid, not recovered</td>
<td>4 053</td>
</tr>
<tr>
<td>Input tax paid [14/114 x R(12 000 + 21 000)]</td>
<td>4 053</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td></td>
</tr>
<tr>
<td>On stand</td>
<td>-</td>
</tr>
<tr>
<td>On construction costs</td>
<td>-</td>
</tr>
<tr>
<td>Net VAT included in the project cost</td>
<td>4 053</td>
</tr>
</tbody>
</table>

Based on inclusive consideration
- % input tax paid (R4 053/R70 000) 5.79%

The incidental developer does not pay output tax, but the
purchaser of the property is liable for transfer duty, as
illustrated in 1.2 below.
1.2 South Africa - Transfer duty

1.2.1 Company, close corporation or trust

In terms of section 2(1) of the Transfer Duty Act, the transfer duty payable by the entity acquiring the property is 10% of the selling price.

Total transfer duty payable (10% x R70 000) R7 000

1.2.2 Natural person

According to section 9(12C) of the Transfer Duty Act, the first R30 000 of unimproved land and the first R70 000 of improved land that is acquired by a natural person for the purpose of constructing a dwelling-house is exempt.

On completion of the house and the subsequent sale thereof, the selling price of the house falls within the exemption limit stated above for improved land, therefore no transfer duty is payable on the sale of the completed house.

Total transfer duty payable Rnil

1.3 United Kingdom - VAT

In terms of section 35(1) of VATA (see paragraph 4.8.3), the developer not registered for VAT purposes is placed in the same position as the registered developer, therefore this application would be identical to the application in paragraph 1.3 of Annexure A, where total VAT payable amounted to £447 (0.64%).
1.4 Canada - GST or HST

An incidental developer cannot claim back input tax on the cost of the stand or the building costs, as in terms of section 169(1) of the ETA (see paragraph 5.4), only registrants may claim back input tax. In paragraph 5.8.2 it was determined that an incidental developer cannot be a registrant, as he does not meet the criteria of developing property on a regular or continuous basis.

On the other hand, the sale of the house would, in terms of section 3 of Part 1 of Schedule V to the ETA, be exempt.

The federal VAT included in the project cost of the house appears to be as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable</td>
<td>C$</td>
</tr>
<tr>
<td>Input tax paid not recovered</td>
<td>2 159</td>
</tr>
<tr>
<td>Input tax paid [7/107 \times C$(12 000 + 21 000)]</td>
<td>2 159</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td></td>
</tr>
<tr>
<td>On stand</td>
<td>-</td>
</tr>
<tr>
<td>On construction costs</td>
<td>-</td>
</tr>
<tr>
<td>Net GST included in the project cost</td>
<td>2 159</td>
</tr>
</tbody>
</table>

Based on inclusive consideration

- % input tax paid \( \frac{C$2 159}{C$70 000} \) 3.08%
Where applicable, the HST included in the project cost of the house appears to be as follows:

Output tax payable  
Input tax paid not recovered  4,304

Input tax paid \( \left[ \frac{15}{115} \times \text{C}\$(12,000 + 21,000) \right] \)  4,304

Less:  Input tax claimed back

On stand
On construction costs

Net VAT included in the project cost  4,304

Based on inclusive consideration
\[- \frac{\text{Input tax paid}}{\text{Project cost}} \times 100 = 6.15\%\]

**1.5 Australia - GST**

According to section 9-5 of the GST Act (see paragraphs 6.7.1 and 6.10), a taxable supply can only be made by a supplier registered or required to be registered for GST purposes. As the person selling the house is not registered for GST purposes, a taxable supply cannot be made. It therefore appears that no GST would be charged on the sale of the house.

In terms of sections 11-20 and 15-15 of the GST Act (see paragraph 6.3) input tax credits can only be claimed for creditable acquisitions. In terms of section 11-5 of the GST
Act (see paragraphs 6.3 and 6.4), a creditable acquisition can only be made by a registered person. It therefore appears that no input tax credits may be claimed back.

The GST included in the project cost of the house appears to be as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable</td>
<td>A$ -</td>
</tr>
<tr>
<td>Input tax paid not recovered</td>
<td>3 000</td>
</tr>
<tr>
<td>Input tax paid ( \frac{10}{110} \times \text{A$(12 000 + 21 000)} )</td>
<td>3 000</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td>-</td>
</tr>
<tr>
<td>On stand</td>
<td>-</td>
</tr>
<tr>
<td>On construction costs</td>
<td>-</td>
</tr>
<tr>
<td>Net GST included in the project cost</td>
<td>3 000</td>
</tr>
</tbody>
</table>

Based on inclusive consideration

- % input tax paid (A$3 000/A$70 000) 4.29%
ANNEXURE C: IMPROVED RESIDENTIAL PROPERTY WITH A VALUE OF R250 000 - DEVELOPER REGISTERED FOR VAT OR GST PURPOSES

1 EXAMPLE 3

A property developer registered for VAT or GST purposes acquired a residential stand from a township developer registered for VAT or GST purposes for R55 000 (£55 000; C$55 000; A$55 000).

He constructed a house on the property, at a cost of R142 000 (£142 000; C$142 000; A$142 000). During the period of construction, VAT was paid by him on 50% of the construction cost of the house, namely on R71 000 (£71 000; C$71 000; A$71 000).

On completion of the house, he sold it for R250 000 (£250 000; C$250 000; A$250 000).

In paragraphs 1.1 to 1.5 the legislation of the various countries will be applied to example 3.

1.1 South Africa - Value-added tax

As the stand was purchased from a township developer registered for VAT purposes, the developer would, in terms of section 16(3) of the Act (see paragraph 3.4), have claimed an input tax credit on the cost of the stand.
During the period of construction, the developer would, in terms of section 16(3) of the Act, have claimed an input tax credit for VAT paid on an amount of R71 000 for goods and services.

Output tax would, in terms of section 7(1) of the Act, be payable on the selling price of R250 000.

The net VAT payable on the above transaction is summarised as follows:

\[
\begin{array}{ll}
\text{Output tax payable (14/114 x R250 000)} & 30 702 \\
\text{Input tax paid, not recovered} & - \\
\text{Input tax paid [14/114 x R(55 000 + 71 000)]} & 15 473 \\
\text{Less: Input tax claimed back} & 15 473 \\
\text{On stand (14/114 x R55 000)} & 6 754 \\
\text{On construction costs (14/114 x R71 000)} & 8 719 \\
\hline
\text{Net VAT payable} & 30 702 \\
\end{array}
\]

Based on inclusive consideration

- % VAT payable (R30 702/R250 000) 12.28%
- % input tax paid (R15 473/R250 000) 6.19%

1.2 South Africa - Transfer duty

As the property transaction is deemed a taxable supply for VAT purposes, the transaction is, in terms of section 9(15) of the Transfer Duty Act (see paragraph 7.4), exempt from transfer duty.
As the stand was purchased from a township developer registered for VAT purposes, the developer would, in terms of section 24(1) of VATA (see paragraph 4.4), have claimed an input tax credit on the cost of the stand.

During the period of construction, the developer would, in terms of section 24(1) of VATA, have claimed an input tax credit for VAT paid on most of the goods and services. Section 24(1) of VATA excludes two items that would relate to this transaction, namely carpeting and a stove. Assume that the cost of the stove and carpeting amounted to £5 000. After the deduction of these two items, the developer could claim an input tax credit on £66 000.

In terms of Schedule 8 to VATA, no output tax would be payable on the selling price of £250 000 as the supply of the house is zero-rated.

The net VAT payable on the above development is summarised as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total output tax payable</td>
<td>£</td>
</tr>
<tr>
<td>Input tax paid, not recovered</td>
<td>745</td>
</tr>
<tr>
<td>Input tax paid [7/47 \times £(55 000 + 71 000)]</td>
<td>18 766</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td>18 021</td>
</tr>
<tr>
<td>On stand (7/47 \times £55 000)</td>
<td>8 191</td>
</tr>
<tr>
<td>On construction costs (7/47 \times £66 000)</td>
<td>9 830</td>
</tr>
<tr>
<td>Net VAT payable</td>
<td>745</td>
</tr>
</tbody>
</table>
Based on inclusive consideration
- % VAT payable (£745/£250 000) 0.30%
- % input tax paid (£18 766/£250 000) 7.51%
- % input tax recovered (£18 021/£250 000) 7.21%

1.4 Canada - GST or HST

As the stand was purchased from a township developer registered for GST purposes, the developer would, in terms of section 169(1) of the ETA (see paragraph 5.4), have claimed an input tax credit on the cost of the stand of C$55 000.

During the period of construction, the developer would, in terms of section 169(1) of the ETA, have claimed an input tax credit for VAT paid on an amount of C$71 000 for goods and services.

In terms of sections 165 and 221(1) of the ETA, output tax would be payable on the selling price of C$250 000 and the developer is responsible for collecting the output tax from the recipient and paying it over. The rebate in terms of section 254 of the ETA (see paragraph 5.9.1) applicable to this transaction is whichever is the lesser of C$8 750 or 36% of the output tax.
The net federal VAT payable on the above transaction is summarised as follows:

Output tax payable \( \left( \frac{7}{107} \times \text{C$250 000} \right) \) \[ \text{C$} \]

Less: Section 254 new housing rebate \( \left( 36\% \times \text{C$16 355} \right) \)

Net output tax payable \[ \text{C$} \]

Input tax paid, not recovered

Input tax paid \( \left( \frac{7}{107} \times \text{C$(55 000 + 71 000)} \right) \)

Less: Input tax claimed back

On stand \( \left( \frac{7}{107} \times \text{C$55 000} \right) \)
On construction costs \( \left( \frac{7}{107} \times \text{C$71 000} \right) \)

Net GST payable

Based on inclusive consideration

- % GST payable \( \left( \frac{\text{C$10 467}}{\text{C$250 000}} \right) \) \[ 4,19\% \]
- % input tax paid \( \left( \frac{\text{C$8 243}}{\text{C$250 000}} \right) \) \[ 3,30\% \]

OR
Where applicable, the net HST payable on the above transaction is summarised as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable (15/115 x C$250 000)</td>
<td>32 609 C$</td>
</tr>
<tr>
<td>Less: Section 254 new housing rebate (36% x C$32 609, limited to</td>
<td>8 750</td>
</tr>
<tr>
<td>Net output tax payable</td>
<td>23 859</td>
</tr>
<tr>
<td>Input tax paid, not recovered</td>
<td>-</td>
</tr>
<tr>
<td>Input tax paid [15/115 x C$(55 000 + 71 000)]</td>
<td>16 435</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td>16 435</td>
</tr>
<tr>
<td>On stand (15/115 x C$55 000)</td>
<td>7 174</td>
</tr>
<tr>
<td>On construction costs (15/115 x C$71 000)</td>
<td>9 261</td>
</tr>
<tr>
<td>Net HST payable</td>
<td>23 859</td>
</tr>
</tbody>
</table>

Based on inclusive consideration
- % HST payable (C$23 859/ C$250 000) 9.54%
- % input tax paid (C$16 435/C$250 000) 6.57%

1.5 Australia - GST

In terms of section 75-5 of the GST Act, as discussed in paragraphs 6.3 and 6.7.1, property developers may choose to use the margin scheme to calculate the amount of GST on the taxable supply of real property.

According to section 75-20 of the GST Act, where the margin scheme is used, no creditable acquisitions arise on any acquisitions regarding the taxable supply. The property developer may therefore not claim any input tax credits on
the cost of the stand of A$55 000 or on the cost of construction of A$142 000. Assume that the margin on the purchase of the stand was A$10 000.

Section 75-10 of the GST Act provides for GST to be paid on the taxable supply at 1/11 of the margin. According to section 75-10(2) of the GST Act (see paragraph 6.3), the margin is defined as the difference between the considerations of the supply and acquisition. In this example, the supply is A$250 000 and the acquisitions are A$55 000 and A$142 000. The margin is therefore A$53 000. GST at 1/11 is payable on this margin, amounting to A$4 818 (A$53 000 x 1/11).

The net GST payable on the above transaction is summarised as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>GST payable on margin (A$53 000 x 1/11)</td>
<td>A$4 818</td>
</tr>
<tr>
<td>GST paid, not recovered</td>
<td>A$7 364</td>
</tr>
<tr>
<td>GST paid [10/110 x A$(10 000 + 71 000)]</td>
<td>A$7 364</td>
</tr>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>On stand</td>
<td></td>
</tr>
<tr>
<td>On construction costs</td>
<td></td>
</tr>
<tr>
<td>Net GST included in the project cost</td>
<td>A$12 182</td>
</tr>
</tbody>
</table>

Based on inclusive consideration

- % GST payable (A$12 182/ A$250 000) 4.87%
- % GST payable on margin (A$4 818/ A$250 000) 1.93%
- % input tax paid (A$7 364/A$250 000) 2.94%
ANNEXURE D: IMPROVED RESIDENTIAL PROPERTY WITH A VALUE OF R250 000 - DEVELOPER NOT REGISTERED FOR VAT OR GST PURPOSES

1 EXAMPLE 4

A person not registered for VAT or GST purposes (incidental property developer) acquired a residential stand from a person registered for VAT or GST purposes, for R55 000 (£55 000; C$55 000; A$55 000).

He constructed the first phase of the house on the property, at a cost of R142 000 (£142 000; C$142 000; A$142 000). During the period of construction, VAT was paid by him on 50% of the construction costs of the house, namely on R71 000 (£71 000; C$71 000; A$71 000).

On completion of the house, he sold it for R250 000 (£250 000; C$250 000; A$250 000).

In paragraphs 1.1 to 1.5 the legislation of the various countries will be applied to example 4.

1.1 South Africa - Value-added tax

Owing to the fact that this is a once-off development, the person is an incidental developer, who is not required in terms of 23(1) of the Act to register as a vendor.

In terms of section 1 of the Act (see paragraph 3.3 and 3.11), as the developer is not registered for VAT purposes,
the incidental developer may not claim back an input tax credit for the VAT on the cost of the stand or the construction costs on which VAT was paid.

According to section 7(1)(a) of the Act (see paragraph 3.3 and 3.11), the sale of the house would not, for the same reason, attract output tax.

The net VAT that appears to be included the cost of the building project is summarised as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable</td>
<td>R</td>
</tr>
<tr>
<td>Input tax paid, not recovered</td>
<td>15 474</td>
</tr>
<tr>
<td>Input tax paid [14/114 \times R(55 ,000 + 71 ,000)]</td>
<td>15 474</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td></td>
</tr>
<tr>
<td>On stand</td>
<td>-</td>
</tr>
<tr>
<td>On construction costs</td>
<td>-</td>
</tr>
</tbody>
</table>

Net VAT included in project cost 15 474

Based on inclusive consideration

% input tax paid \(R15 \,474/R250 \,000\) 6,19%

The incidental developer does not pay output tax, but the purchaser of the property is liable for transfer duty, as illustrated in 1.2 below.
1.2 South Africa - Transfer duty

1.2.1 Company, close corporation or trust

In terms of section 2(1) of the Transfer Duty Act, the transfer duty payable by the entity acquiring the property is 10% of the selling price.

Total transfer duty payable (10% x R250 000) R25 000

1.2.2 Natural person

According to section 2(1) of the Transfer Duty Act, transfer duty is payable at 1% on the first R70 000 and 5% on the difference between R70 000 and R250 000 on land acquired by a natural person.

The transfer duty payable by the purchaser of the house is:
Transfer duty [(1% x R70 000) + (5% x R180 000)] R9 700

% transfer duty on value (R9 700/R250 000) 3.88%

1.3 United Kingdom - VAT

In terms of section 35(1) of VATA (see paragraph 4.8.3), the developer not registered for VAT purposes is placed in the same position as the developer registered for VAT purposes, therefore the application would be identical to the application in paragraph 1.3 of Annexure C, where total VAT payable amounted to £745 (0.30%).
1.4 Canada - GST or HST

An incidental developer cannot claim back input tax on the cost of the stand or the building cost, as in terms of section 169(1) of the ETA (see paragraph 5.4), only registrants may claim back input tax. In paragraph 5.8.2, it was determined that an incidental developer cannot be a registrant, as he does not meet the criteria of developing property on a regular or continuous basis.

On the other hand, the sale of the house would, in terms of section 3 of Part 1 of Schedule V to the ETA, be exempt.

The federal VAT included in the project cost of the house would be as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>C$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable</td>
<td></td>
</tr>
<tr>
<td>Input tax paid, not recovered</td>
<td>8 243</td>
</tr>
<tr>
<td>Input tax paid ([7/107 \times \text{C$}(55,000 + 71,000)])</td>
<td>8 243</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td></td>
</tr>
<tr>
<td>On stand</td>
<td></td>
</tr>
<tr>
<td>On construction costs</td>
<td></td>
</tr>
<tr>
<td>Net VAT included in the project cost</td>
<td>8 243</td>
</tr>
</tbody>
</table>

Based on inclusive consideration

- % input tax paid \(\frac{\text{C$}8,243}{\text{C$}250,000}\) 3,30%
Where applicable, the HST included in the project cost of the house would be as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable</td>
<td>0</td>
</tr>
<tr>
<td>Input tax paid, not recovered</td>
<td>16,435</td>
</tr>
<tr>
<td>Input tax paid ([15/115 \times C$(55,000 + 71,000)])</td>
<td>16,435</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td></td>
</tr>
<tr>
<td>On stand</td>
<td>-</td>
</tr>
<tr>
<td>On construction costs</td>
<td>-</td>
</tr>
<tr>
<td><strong>Net HST included in the project cost</strong></td>
<td><strong>16,435</strong></td>
</tr>
</tbody>
</table>

Based on inclusive consideration

- \(\%\) input tax paid \(\frac{C\$16,435}{C\$250,000}\) 6.57%

1.5 **Australia - GST**

According to section 9-5 of the GST Act (see paragraphs 6.7.1 and 6.10), a taxable supply can only be made by a supplier registered or required to be registered for GST purposes. As the person selling the house is not registered for GST purposes, a taxable supply cannot be made. It therefore appears that no GST would be charged on the sale of the house.

In terms of sections 11-20 and 15-15 of the GST Act (see paragraph 6.3), input tax credits can only be claimed for creditable acquisitions. In terms of section 11-5 of the GST Act (see paragraphs 6.3 and 6.4), a creditable acquisition can only be made by a registered person. It therefore appears that no input tax credits may be claimed back.
The GST included in the project cost of the house appears to be as follows:

Output tax payable
Input tax paid not recovered 11 455

Input tax paid \[\frac{10}{110} \times A\$(55 000 + 71 000)\] 11 455
Less: Input tax claimed back
On stand
On construction costs

Net GST included in the project cost 11 455

Based on inclusive consideration
- \% input tax paid (A$11 455/A$250 000) 4.58\%
ANNEXURE E: IMPROVED RESIDENTIAL PROPERTY WITH A VALUE OF R375 000 - DEVELOPER REGISTERED FOR VAT OR GST PURPOSES

1 EXAMPLE 5

A property developer registered for VAT or GST purposes acquired a residential stand from a township developer registered for VAT or GST purposes for R80 000 (£80 000; C$80 000; A$80 000).

He constructed a house on the property, at a cost of R220 000 (£220 000; C$220 000; A$220 000). During the period of construction, VAT was paid by him on 50% of the construction costs of the house, namely on R110 000 (£110 000; C$110 000; A$110 000).

On completion of the house, he sold it for R375 000 (£375 000; C$375 000; A$375 000).

In paragraphs 1.1 to 1.5 the legislation of the various countries will be applied to example 5.

1.1 South Africa - Value-added tax

As the stand was purchased from a township developer registered for VAT purposes, the developer would, in terms of section 16(3) of the Act (see paragraph 3.4), have claimed an input tax credit on the cost of the stand of R80 000.
During the period of construction, the developer would, in terms of section 16(3) of the Act, have claimed an input tax credit for VAT paid on an amount of R110 000 for goods and services.

In terms of section 7(1) of the Act, output tax would be payable on the selling price of R375 000.

The net VAT payable on the above transaction is summarised as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable (14/114 x R375 000)</td>
<td>R 46 053</td>
</tr>
<tr>
<td>Input tax paid, not recovered</td>
<td>-</td>
</tr>
<tr>
<td>Input tax paid [(14/114 x R(80 000 + 110 000))]</td>
<td>23 333</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td>23 333</td>
</tr>
<tr>
<td>On stand (14/114 x R80 000)</td>
<td>9 825</td>
</tr>
<tr>
<td>On construction costs (14/114 x R110 000)</td>
<td>13 508</td>
</tr>
<tr>
<td>Net VAT payable</td>
<td>46 053</td>
</tr>
</tbody>
</table>

Based on inclusive consideration

- % VAT payable (R46 053/R375 000) 12,28%
- % input tax paid (R23 333/R375 000) 6,22%

1.2 South Africa - Transfer duty

As the property transaction is deemed a taxable supply for VAT purposes, in terms of section 9(15) of the Transfer Duty Act (see paragraph 7.4), the transaction is exempt from transfer duty.
1.3 United Kingdom - VAT

As the stand was purchased from a township developer registered for VAT purposes, the developer would, in terms of section 24(1) of VATA (see paragraph 4.4), have claimed an input tax credit on the cost of the stand of £80 000.

During the period of construction, the developer would, in terms of section 24(1) of VATA, have claimed an input tax credit for VAT paid on most of the goods and services. Section 24(1) of VATA excludes two items that would relate to this transaction, namely carpeting and a stove. Assume that the cost of the stove and carpeting amounted to £10 000. After the deduction of these two items, the developer could claim an input tax credit on £100 000.

In terms of Schedule 8 to VATA, no output tax would be payable on the selling price of £375 000, as the supply of the house is zero-rated.

The net VAT payable on the above development is summarised as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total output tax payable</td>
<td></td>
</tr>
<tr>
<td>Input tax paid, not recovered</td>
<td>1 489</td>
</tr>
<tr>
<td>Input tax paid (\left[\frac{7}{47} \times £(80 000 + 110 000)\right])</td>
<td>28 298</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td>26 809</td>
</tr>
<tr>
<td>On stand (\left[\frac{7}{47} \times £80 000\right])</td>
<td>11 915</td>
</tr>
<tr>
<td>On construction costs (\left[\frac{7}{47} \times £100 000\right])</td>
<td>14 894</td>
</tr>
<tr>
<td>Net VAT payable</td>
<td>1 489</td>
</tr>
</tbody>
</table>
350

Based on inclusive consideration
- % VAT payable (£1 489/£375 000) 0,40%
- % input tax paid (£28 298/£375 000) 7,55%
- % input tax recovered (£26 809/£375 000) 7,15%

1.4 Canada - GST or HST

As the stand was purchased from a township developer registered for GST, the developer would, in terms of section 169(1) of the ETA (see paragraph 5.4), have claimed an input tax credit on the cost of the stand of C$80 000.

During the period of construction, the developer would, in terms of section 169(1) of the ETA, have claimed an input tax credit for VAT paid on the goods and services of C$110 000.

In terms of sections 165 and 221(1) of the ETA (see paragraphs 5.7.1 and 5.10.1.1), output tax would be payable on the selling price of C$375 000 and the developer would be responsible for collecting the output tax from the recipient and paying it over. The rebate in terms of section 254 of the ETA (see paragraph 5.9.1) applicable to this transaction is whichever is the lesser of C$8 750 or 36% of the output tax, applied in the formula relating to properties whose value exceeds C$350 000, but is less than C$450 000.
The net federal VAT payable on the above transaction is summarised as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable ((7/107 \times \text{C$375 000}))</td>
<td>24 533</td>
</tr>
<tr>
<td>Less: Section 254 new housing rebate (\text{C$8 750} \times \text{C$}(450 000 - 375 000) / 100 000)</td>
<td>6 563</td>
</tr>
<tr>
<td>Net output tax payable</td>
<td>17 970</td>
</tr>
<tr>
<td>Input tax paid, not recovered</td>
<td></td>
</tr>
<tr>
<td>Input tax paid ((7/107 \times \text{C$}(80 000 + 110 000)))</td>
<td>12 430</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td>12 430</td>
</tr>
<tr>
<td>On stand ((7/107 \times \text{C$80 000}))</td>
<td>5 234</td>
</tr>
<tr>
<td>On construction costs ((7/107 \times \text{C$110 000}))</td>
<td>7 196</td>
</tr>
<tr>
<td>Net VAT payable</td>
<td>17 970</td>
</tr>
</tbody>
</table>

Based on inclusive consideration

- % GST payable \((\text{C$17 970}/ \text{C$375 000})\) 4.79%
- % input tax paid \((\text{C$12 430}/\text{C$375 000})\) 3.31%

OR
Where applicable, the net HST payable on the above transaction is summarised as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable ((15/115 \times C$375,000))</td>
<td>C$48,913</td>
</tr>
<tr>
<td>Less: Section 254 new housing rebate</td>
<td></td>
</tr>
<tr>
<td>(C$8,750 \times C${(450,000 - 375,000) / 100,000})</td>
<td>C$6,563</td>
</tr>
<tr>
<td>Net output tax payable</td>
<td>C$42,350</td>
</tr>
<tr>
<td>Input tax paid, not recovered</td>
<td>-</td>
</tr>
<tr>
<td>Input tax paid ([15/115 \times C$(80,000+110,000)])</td>
<td>C$24,783</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td></td>
</tr>
<tr>
<td>On stand ((15/115 \times C$80,000))</td>
<td>C$10,435</td>
</tr>
<tr>
<td>On construction ((15/115 \times C$110,000))</td>
<td>C$14,348</td>
</tr>
<tr>
<td>Net HST payable</td>
<td>C$42,350</td>
</tr>
</tbody>
</table>

Based on inclusive consideration
- % HST payable \((C$42,350 / C$375\,000)\) | 11.29% |
- % input tax paid \((C$24,783/C$375\,000)\) | 6.61% |

1.5 Australia - GST

In terms of section 75-5 of the GST Act, as discussed in paragraphs 6.3 and 6.7.1, property developers may choose to use the margin scheme to calculate the amount of GST on the taxable supply of real property.

According to section 75-20 of the GST Act, where the margin scheme is used, no creditable acquisitions arise on any acquisitions regarding the taxable supply. The property
developer may therefore not claim any input tax credits on the cost of the stand of A$80 000 or on the construction costs of A$220 000.

Section 75-10 of the GST Act provides for GST to be paid on the taxable supply at 1/11 of the margin. According to section 75-10(2) of the GST Act (see paragraph 6.3), the margin is defined as the difference between the considerations of the supply and acquisition. In this example, the supply is A$375 000 and the acquisitions are A$80 000 and A$220 000. The margin is therefore A$75 000. GST at 1/11 is payable on this margin, amounting to A$6 818 (A$75 000 x 1/11). Assume that the margin on the purchase of the stand was A$15 000.

The net GST payable on the above transaction is summarised as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>GST payable on margin (A$75 000 x 1/11)</td>
<td>6 818</td>
</tr>
<tr>
<td>GST paid, not recovered</td>
<td>11 364</td>
</tr>
<tr>
<td>GST paid [10/110 x A$(15 000 + 110 000)]</td>
<td>11 364</td>
</tr>
<tr>
<td>Less: GST tax claimed back</td>
<td>-</td>
</tr>
<tr>
<td>On stand</td>
<td>-</td>
</tr>
<tr>
<td>On construction costs</td>
<td>-</td>
</tr>
<tr>
<td>Net GST included in the project cost</td>
<td>18 182</td>
</tr>
</tbody>
</table>

Based on inclusive consideration

- % GST payable (A$18 182/ A$375 000) 4.85%
- % GST payable on margin (A$6 818/ A$375 000) 1.82%
- % input tax paid (A$11 364/ A$375 000) 3.03%
ANNEXURE F: IMPROVED RESIDENTIAL PROPERTY WITH A VALUE OF R375 000 - DEVELOPER NOT REGISTERED FOR VAT OR GST PURPOSES

1 EXAMPLE 6

A person not registered for VAT or GST purposes (incidental property developer) acquired a residential stand from a person registered for VAT or GST, for R80 000 (£80 000; C$80 000; A$80 000).

He constructed a house on the property, at a cost of R220 000 (£220 000; C$220 000; A$220 000). During the period of construction, VAT was paid by him on 50% of the construction costs of the house, namely on R110 000 (£110 000; C$110 000; A$110 000).

On completion of the house, he sold it for R375 000 (£375 000; C$375 000; A$375 000).

In paragraphs 1.1 to 1.5 the legislation of the various countries will be applied to example 6.

1.1 South Africa - Value-added tax

Owing to the fact that this is a once-off development, the person is an incidental developer, who is not required in terms of section 23(1) of the Act to register as a vendor.
As he is not registered for VAT purposes, the incidental developer may not claim back an input tax credit for the VAT on the cost of the stand or the construction costs on which VAT was paid.

For the same reason the sale of the house would not attract output tax.

The net VAT that was included the cost of the building project can be broken down as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (R)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable</td>
<td>-</td>
</tr>
<tr>
<td>Input tax paid, not recovered</td>
<td>23 333</td>
</tr>
<tr>
<td>Input tax paid [14/114 x R(80 000 + 110 000)]</td>
<td>23 333</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td>-</td>
</tr>
<tr>
<td>On stand</td>
<td>-</td>
</tr>
<tr>
<td>On construction costs</td>
<td>-</td>
</tr>
<tr>
<td>Net VAT included in project cost</td>
<td>23 333</td>
</tr>
</tbody>
</table>

Based on inclusive consideration

- % input tax paid (R23 333/R375 000) 6,22%

The incidental developer does not pay output tax, but the purchaser of the property is liable for transfer duty, as illustrated in 1.2 below.
1.2 South Africa - Transfer duty

1.2.1 Company, close corporation or trust

In terms of section 2(1) of the Transfer Duty Act, the transfer duty payable by the entity acquiring the property is 10% of the selling price.

Total transfer duty payable (10% x R375 000) R37 500

1.2.2 Natural person

According to section 2(1) of the Transfer Duty Act, transfer duty is payable at 1% on the first R70 000 at 5% on the difference between R70 000 and R250 000, and at 8% on amounts over R250 000, on property acquired by a natural person.

The transfer duty payable by the purchaser of the house is:
Transfer duty [(1% x R70 000) + (5% x R180 000) + (8% x R125 000)] R19 700

% transfer duty on value (R19 700/R375 000) 5.25%

1.3 United Kingdom - VAT

In terms of section 35(1) of VAT Act (see paragraph 4.8.3), the developer not registered for VAT purposes is placed in the same position as the developer registered for VAT purposes, therefore the application would be identical to the application in paragraph 1.3 of Annexure D, where total VAT payable amounted to £1 489 (0.40%).
1.4 Canada - GST or HST

An incidental developer cannot claim back input tax on the cost of the stand or the building costs, as in terms of section 169(1) of the ETA (see paragraph 5.4), only registrants may claim back input tax. In paragraph 5.8.2, it was determined that an incidental developer cannot be a registrant, as he does not meet the criteria of developing property on a regular or continuous basis.

On the other hand, the sale of the house would, in terms of section 3 of Part 1 of Schedule V to the ETA, be exempt.

The federal VAT included in the project cost of the house would be as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable</td>
<td>C$12 430</td>
</tr>
<tr>
<td>Input tax paid, not recovered</td>
<td>12 430</td>
</tr>
<tr>
<td>Input tax paid ( \left[ \frac{7}{107} \times C$(80 000 + 110 000) \right] )</td>
<td>12 430</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td></td>
</tr>
<tr>
<td>On stand</td>
<td>-</td>
</tr>
<tr>
<td>On construction costs</td>
<td>-</td>
</tr>
<tr>
<td>Net VAT included in the project cost</td>
<td>12 430</td>
</tr>
</tbody>
</table>

Based on inclusive consideration

- % input tax paid \( \frac{C\$12 430}{C\$375 000} \) \( \approx 3.31\% \)

OR
Where applicable, the HST included in the project cost of the house would be as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable</td>
<td></td>
</tr>
<tr>
<td>Input tax paid, not recovered</td>
<td>C$ 24,783</td>
</tr>
<tr>
<td>Input tax paid [15/115 x C$ (80,000 + 110,000)]</td>
<td>C$ 24,783</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td></td>
</tr>
<tr>
<td>On stand</td>
<td></td>
</tr>
<tr>
<td>On construction costs</td>
<td></td>
</tr>
<tr>
<td>Net HST included in the project cost</td>
<td>C$ 24,783</td>
</tr>
</tbody>
</table>

Based on inclusive consideration

- % input tax paid (C$24,783/C$375,000) 6.61%

1.5 Australia - GST

According to section 9-5 of the GST Act (see paragraphs 6.7.1 and 6.10), a taxable supply can only be made by a supplier registered or required to be registered for GST purposes. As the person selling the house is not registered for GST purposes, a taxable supply cannot be made. It therefore appears that no GST would be charged on the sale of the house.

In terms of sections 11-20 and 15-15 of the GST Act (see paragraph 6.3), input tax credits can only be claimed for creditable acquisitions. In terms of section 11-5 of the GST Act (see paragraphs 6.3 and 6.4), a creditable acquisition can only be made by a registered person. It therefore appears that no input tax credits may be claimed back.
The GST included in the project cost of the house appears to be as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>A$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable</td>
<td></td>
</tr>
<tr>
<td>Input tax paid not recovered</td>
<td>17 273</td>
</tr>
<tr>
<td>Input tax paid (\frac{10}{110} \times A$(80 000 + 110 000))</td>
<td>17 273</td>
</tr>
<tr>
<td>Less: Input tax claimed back</td>
<td></td>
</tr>
</tbody>
</table>

- On stand
- On construction costs

Net GST included in the project cost: 17 273

Based on inclusive consideration:

- % input tax paid \(\frac{A\$17 273}{A\$375 000}\) 4.61%
1 INTRODUCTION

Owing to the fact that all input tax credits in South Africa may be claimed back, only the output tax payable influences the effective VAT rate. The alternative rebates calculated in the examples in this annexure will therefore only deal with the output tax payable.

2 IMPROVED RESIDENTIAL PROPERTY WITH A VALUE OF R70 000

2.1 Example 7

A property developer registered for VAT purposes acquired a residential stand from a township developer registered for VAT purposes for R12 000.

He constructed the first phase of the house on the property, at a cost of R42 000. During the period of construction, VAT was paid by him on 50% of the construction costs of the house, namely on R21 000.

On completion of the house, he sold it for R70 000.
### 2.1.1 New housing rebate of 50%

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable</td>
<td>R 8 596</td>
</tr>
<tr>
<td><strong>Less</strong>: Proposed housing rebate</td>
<td>R 4 298</td>
</tr>
<tr>
<td>Net output tax payable</td>
<td></td>
</tr>
<tr>
<td>Based on inclusive consideration</td>
<td></td>
</tr>
<tr>
<td>- % VAT payable</td>
<td>6.14%</td>
</tr>
</tbody>
</table>

### 2.1.2 New housing rebate of 60%

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable</td>
<td>R 8 596</td>
</tr>
<tr>
<td><strong>Less</strong>: Proposed housing rebate</td>
<td>R 5 158</td>
</tr>
<tr>
<td>Net output tax payable</td>
<td></td>
</tr>
<tr>
<td>Based on inclusive consideration</td>
<td></td>
</tr>
<tr>
<td>- % VAT payable</td>
<td>4.91%</td>
</tr>
</tbody>
</table>

### 2.1.3 New housing rebate of 70%

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable</td>
<td>R 8 596</td>
</tr>
<tr>
<td><strong>Less</strong>: Proposed housing rebate</td>
<td>R 6 017</td>
</tr>
<tr>
<td>Net output tax payable</td>
<td></td>
</tr>
<tr>
<td>Based on inclusive consideration</td>
<td></td>
</tr>
<tr>
<td>- % VAT payable</td>
<td>3.68%</td>
</tr>
</tbody>
</table>
3 IMPROVED RESIDENTIAL PROPERTY WITH A VALUE OF R250 000

3.1 Example 8

A property developer registered for VAT purposes acquired a residential stand from a township developer registered for VAT purposes for R55 000.

He constructed a house on the property, at a cost of R142 000. During the period of construction, VAT was paid by him on 50% of the construction costs of the house, namely on R71 000.

On completion of the house, he sold it for R250 000.

3.1.1 New housing rebate of 50%

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable (14/114 x R250 000)</td>
<td>R 30 702</td>
</tr>
<tr>
<td>Less: Proposed housing rebate (50% x R30 702)</td>
<td>R 15 351</td>
</tr>
<tr>
<td>Net output tax payable</td>
<td>R 15 351</td>
</tr>
</tbody>
</table>

Based on inclusive consideration
- % VAT payable (R15 351/R250 000)                                         6,14%

3.1.2 New housing rebate of 60%, limited to R25 000

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable (14/114 x R250 000)</td>
<td>R 30 702</td>
</tr>
<tr>
<td>Less: Proposed housing rebate (60% x R30 702)</td>
<td>R 18 421</td>
</tr>
<tr>
<td>Net output tax payable</td>
<td>R 12 281</td>
</tr>
</tbody>
</table>
Based on inclusive consideration
- % VAT payable (R12 281/R250 000) 4,91%

3.1.3 **New housing rebate of 70%, limited to R25 000**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output tax payable (14/114 x R250 000)</td>
<td>R30 702</td>
</tr>
<tr>
<td>Less: Proposed housing rebate (70% x R30 702)</td>
<td>R21 491</td>
</tr>
<tr>
<td>Net output tax payable</td>
<td>R9 211</td>
</tr>
</tbody>
</table>

Based on inclusive consideration
- % VAT payable (R9 211/R250 000) 3,68%

4 **IMPROVED RESIDENTIAL PROPERTY WITH A VALUE OF R375 000**

4.1 **Example 9**

A property developer registered for VAT purposes acquired a residential stand from a township developer registered for VAT purposes for R80 000.

He constructed a house on the property, at a cost of R220 000. During the period of construction, VAT was paid by him on 50% of the construction costs of the house, namely on R110 000.

On completion of the house, he sold it for R375 000.
4.1.1 New housing rebate of 50%

Output tax payable \((14/114 \times R375\,000)\) \(\text{R}46\,053\)
Less: Proposed housing rebate \((50\% \times R46\,053)\) \(\text{R}23\,027\)
Net output tax payable \(\text{R}23\,026\)

Based on inclusive consideration
- % VAT payable \((R23\,026/R375\,000)\) 6.14%

4.1.2 New housing rebate of 60\%, limited to R25 000

Output tax payable \((14/114 \times R375\,000)\) \(\text{R}46\,053\)
Less: Proposed housing rebate
\((60\% \times R46\,053, \text{limited to} \ R25\,000)\) \(\text{R}25\,000\)
Net output tax payable \(\text{R}21\,053\)

Based on inclusive consideration
- % VAT payable \((R21\,053/R375\,000)\) 5.61%

4.1.3 New housing rebate of 70\%, limited to R25 000

Output tax payable \((14/114 \times R375\,000)\) \(\text{R}46\,053\)
Less: Proposed housing rebate
\((70\% \times R46\,053, \text{limited to} \ R25\,000)\) \(\text{R}25\,000\)
Net output tax payable \(\text{R}21\,053\)

Based on inclusive consideration
- % VAT payable \((R21\,053/R375\,000)\) 5.61%
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