



WTS Dhruva Alert on Real Estate

Updated Real Estate Guide and VAT Public Clarification (VATP018) on Change in the permitted use of a building

Introduction

The Federal Tax Authority ('FTA') has amended the 'Real Estate VAT Guide | VATGRE1' ('the Real-estate Guide') to elaborate on the VAT treatment on certain transactions undertaken by the businesses operating in the real-estate sector. The FTA has also issued VAT Public Clarification VATP018 on 'Change in the permitted use of a building' ('VAT Public Clarification') clarifying the date of supply provisions at the time of sale or lease of a building considering its current permitted use.

In this alert, we have summarized key implications arising out of the updated Real Estate Guide and VAT Public Clarification:

Summary of key amendments to Real Estate Guide

Sr. No.	Amendment relates to	Update/ changes made in the Guide	WTS Dhruva Analysis
1	Labor Accommodation	It is clarified that input tax shall not be recoverable where the accommodation is ' not necessary ' for the employee to perform their role; for example – accommodation provided in hotel apartments	<ul style="list-style-type: none"> The amendment emphasises that input tax on accommodation given to employees can be recovered if it is necessary for the performance the role (assuming it is a part of contractual obligation and a normal business practice). Businesses may need to carefully evaluate what may constitute as necessary to perform the role. For example - serviced accommodation provided to employees at a remote site could still be regarded as necessary to perform role basis which input tax may be recovered. Conversely, input tax may not be



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			<p>recovered if the hotel accommodation is given to an employee as per contractual obligation, but it may not be essential / required for performing the role.</p> <ul style="list-style-type: none"> While the amendment pertains to accommodation provided to employees, the rationale for input tax recovery would be equally applicable for goods / services provided to employees as a part of any contractual obligation.
2	Bare land	<p>It is clarified that placing of temporary movable structures on land will not be treated as covered by building or civil engineering works; basis this the land shall continue to be treated as 'bare land'</p>	<ul style="list-style-type: none"> Sale or lease of bare land is exempt under VAT. Previously, there was an ambiguity whether placing temporary structures on land would make land a partially completed building or civil engineering works and accordingly subject to VAT. With the amendment, it is clarified that land shall continue to be treated as bare land even if temporary movable structures are placed on the land. It is important for businesses to analyse whether at the time of sale or lease of bare land is there any structure created or any kind of foundation work undertaken or is it just placing temporary moveable structures on land. It is worthwhile to evaluate what constitutes a 'temporary movable structure', i.e. structure which can be fixed and removed for fixing at another location.
3	Leasing bare land for development	<p>Transaction to be bifurcated as per date of supply provisions [Article (25) or Article (26) of VAT Decree Law]</p> <p>Article (26) – If the supply is treated as made <u>periodically</u> then</p> <ul style="list-style-type: none"> if the land is a bare land as on the date of supply (ex. Issuing an invoice /receipt of payment), it would be treated as supply of bare land. Change of land after the date of supply would not require any adjustment. 	<ul style="list-style-type: none"> There is a change in tax position in respect of the given transaction as compared to previous version of the Real Estate Guide (February 2019). Previously, upfront lease payment was required to be apportioned between the time period it was treated as bare land and the time period it ceased to be bare land. For example, upfront payment was received in Jan 2020 for a 12-month lease. Landlord treated the upfront payment as exempt supply in Jan 2020. Subsequently, in April 2020, tenant initiated development on land. Accordingly, landlord was required to apportion rent and pay VAT on the balance nine months (Apr 2020 to Dec 2020) considering it as taxable supply. In the above example, post amendment, there may not be a requirement to apportion rent pertaining to the period post development, as the date of supply is

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		<ul style="list-style-type: none"> Subsequent supply would be treated as taxable supply if the lessee prepares the land for construction. <p>Article (25) – In case of one-off payment for lease, no adjustment is required in respect of tax treatment (exempt) taken earlier if land ceases to be a bare land subsequently. Ex. 10-year lease with full payment made at the time entering in to a lease for bare land, and construction commencing later.</p>	<p>already triggered at the time of upfront advance payment as per Article (25) of the VAT Decree Law.</p> <ul style="list-style-type: none"> However, in case of periodic lease rentals as the date of supply would trigger basis Article (26) of the VAT Decree Law; the lease rentals invoiced post undertaking development by the tenant would be subject to VAT. As previously businesses may have treated the lease portion post development as taxable (despite receiving upfront lease payment), there is an opportunity to revisit the past transactions and reverse VAT basis the amendment. The amendment has emphasised on the date of supply provisions (whether supply can be classified under Article (25) or (26) of VAT Decree Law) in determining the VAT treatment for leasing of land. It is important for the businesses to apply the principles appropriately in current / future lease contracts. The key take-away from the amendments is that the status of the land on the date of supply would determine the taxability of the lease rentals.
4	Musataha Agreements	<p>Musataha agreements are different from short term and medium-term leases. These are generally long-term lease of bare land with a right to the lessee to construct and enjoy the constructed property.</p> <ul style="list-style-type: none"> <u>If agreement registered with Land Department or Municipality</u>, it will be treated as a contract of sale or one-off lease and no adjustment to the VAT treatment would be required subsequently. <u>If the Musataha is not registered</u>, the lease will generally be treated in line with any other lease agreement. 	<ul style="list-style-type: none"> Taxability on Musataha agreements was not clear until now. Prior to the amendment, businesses (in case of Musataha agreements) on a conservative basis may have taken a tax position that till the time land is treated as bare land it will be VAT exempt and from the time it ceases to be a bare land, VAT would apply on the remaining instalments / consideration apportionable to the period after the construction commenced, considering the arrangement as similar to a normal lease. The amendment clarifies that Musataha agreements entered for leasing of bare land would be at par with sale of bare land exempt from VAT regardless of the change in use of land subsequently by the tenant or staggered payment terms. It is important for the businesses to reassess the tax position adopted earlier and make necessary changes such as issuing tax credit notes, etc if VAT is charged post development.

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		<ul style="list-style-type: none"> If <u>unable to register (due to uncontrollable circumstances)</u>, businesses may file a clarification with the FTA to decide on the VAT treatment 	<ul style="list-style-type: none"> An important aspect to note that if the businesses are unable to register Musataha agreement with the relevant authority then clarification could be sought from the FTA to confirm the tax treatment.
5	Input tax apportionment	<ul style="list-style-type: none"> Amendment has emphasized the businesses should evaluate whether the standard method reflects actual use of goods / services towards taxable supplies. If standard method does not reflect actual use of expenses towards taxable supplies, then the businesses should evaluate if the Floor space method which is available for businesses in sale / lease of commercial and residential properties could be applied (post approval from the FTA). 	<ul style="list-style-type: none"> The amendment is to read together with the input tax apportionment provisions and Input tax Apportionment: Special Methods Guide VATGIT1. Advisable for the businesses in Real-estate sector to evaluate the input tax recovery as per Floor space method / any other alternate method considering the nature of business and compare with the standard method at the end of each tax year. If the difference is more than AED 250,000 then adjustment is to be undertaken and special input tax apportionment method is to be applied post FTA approval.
6	Owners' Association ('OA')	<ul style="list-style-type: none"> Management Entity ('ME') included along-with OA. ME's may include the developer, the management company, or the hotel project management company. OA/ ME is regarded as 'person' for VAT purposes and it is required to register if threshold is exceeded. Taxability of ME is similar to OA. 	<p>There is no major change in respect of the given update. However, by including ME along-with OA, the FTA has cleared the uncertainty of whether a ME conducting same activity as that of OA is required to follow the guidance applicable to OA or not.</p>

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7	VAT refund on New residences	VAT refunds applicable to UAE Nationals building new residences is to be claimed through FTA E-services portal	It is clarified that refund claims are to be filed on the FTA E-services portal.
8	The word 'supplied'	The word 'supplied' is replaced with 'transferred or made available for use to the buyer or lessee' at certain places in the guide	Such change is done to bring more clarity on how a particular transaction is required to be read and interpreted.

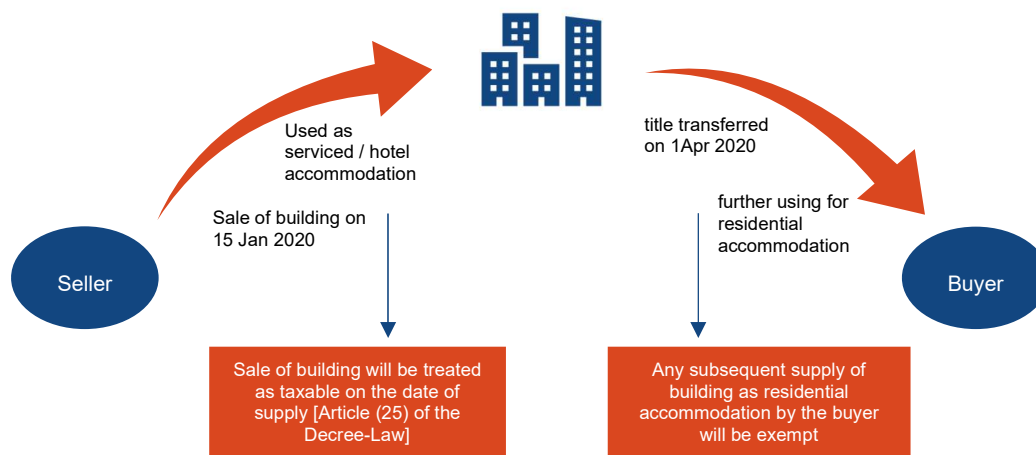
Summary of key aspects of VAT Public Clarification VATP018 on 'Change in the permitted use of a building'

The given Public Clarification has clarified two important points –

- VAT treatment on sale of a building and its subsequent use by the purchaser
- Applicability of relevant date of supply provisions in respect of sale or lease of building

VAT treatment on sale of a building and its subsequent use by the purchaser

The FTA has clarified that the sale of a building constitutes the supply of a single indivisible good at the date of supply. The VAT treatment shall be determined independently on each transaction at each date of supply. If the purchaser subsequently changes the permitted use of the building, then it will not impact the VAT treatment of the preceding sale. It can be explained by way of following illustration –



Aforesaid rationale would also be applicable in case residential building is sold and subsequently its use is changed to serviced/ hotel accommodation.



Date of supply provisions

1. Sale of a building

As stated above, sale of real estate is an indivisible supply of a good and the general date of supply rule stated under Article (25) of VAT Decree Law shall apply. The date of supply is the earlier of the date –

- Ownership of the building is transferred to the purchaser (as evidenced by the registration at the relevant government entity);
- On which the purchaser took possession of the building;
- Payment was received in respect of the supply of the building; or
- A Tax Invoice was issued in respect of the supply of the building.

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It is imperative to note that the sale of a building would always be classified under Article (25) of VAT Decree Law regardless whether the contract may include periodic payments or consecutive invoices. Moreover, the FTA has also stated that ownership transfer (title transfer) or possession of building by the purchaser to be considered in determining the date of supply. The given transaction can be explained by way of an illustration–

Company A has sold commercial building under a contract to Mr B in Jan 2019 for AED 10 Million. As per the contract, Mr B will pay AED 10 Million in 10 instalments of AED 1 Million each commencing from Jan 2019. Title to the building will be transferred to Mr B after paying 6 instalments i.e. in July 2019. Post which Mr. B can take possession of the building and pay remaining instalments.

Applying the aspects stated in the Clarification,

- Company A is liable to pay VAT on each monthly instalment received of AED 1 mn till June 2019 [as per Article (25) of VAT Decree Law r.w. Article (19) of Executive Regulations]
- In July 2019, as supply has been triggered on account of title being transferred, Company A is required to pay VAT on the balance instalment of AED 4 mn in July 2019 [as per Article (25) of VAT Decree Law]

2. Lease of a building with periodic payments or consecutive invoices

As per the Clarification, special date of supply rules stated under Article (26) of VAT Decree Law shall apply in case of lease of a building with periodic payments or consecutive invoices. The date of supply would be the earliest of following events –

- Any Tax Invoice is issued in respect of the lease of the building;
- Any payment is due as shown on the Tax Invoice;
- Payment is received in respect of the lease of the building; or
- 12 months lapsed from the date the right to use the building was provided to the lessee.

As leasing would involve periodic payments and the businesses may have decided on the tax treatment basis the date of supply provisions specified under Article (26) of VAT Decree Law; there is no change to this extent.

Conclusion

The revised Real Estate Guide has brought a lot of clarity on the taxability of transactions in Real Estate sector. Based on the conjoint reading of the updated Real Estate Guide and VAT Public Clarification VATP018, it can be observed that the FTA has placed emphasis on the date of supply provisions and how the triggering point should be identified to decide the VAT treatment.

Based on the updates, it is advisable for the businesses to ascertain the impact on past tax positions and aspects to be considered while entering into arrangements in future. There are certain critical dates which businesses need to capture such as date of transfer of building, date of possession, date of change in use of bare land, etc and same would require timely review / validation to avoid any errors.

Moreover, if the commercial building is sold in entirety along with existing tenants then the businesses may need to evaluate whether the transfer can be regarded as 'Transfer of business as a going concern' considering whether the stipulated conditions are met as specified in the VAT Decree Law or whether VAT should be levied on such transfer.



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