Should derived public entities include real estate tax in taxable amount of land lease services for VAT purposes? (1) 3/50/23

Where lease services are supplied for a consideration, any person (including a public entity or a derived public entity) will be treated as a taxable person for VAT purposes unless the consideration received is a token sum. So the lease service will be a supply governed by the VAT Act. This article explores whether real estate tax (RET) collected from the tenant in addition to the rent qualifies as part of the rent and whether VAT should be charged on it.

Determining the taxable amount of a supply

This amount is not easy to determine – the VAT Act has an entire chapter dealing with this (Chapter V, *The taxable amount of a supply*), and even so, you will not always find a clear answer to all questions.

Under the fundamental principle for determining the taxable amount in the VAT Act, the taxable amount in a supply of goods or services is the consideration for goods or services supplied.[1] The taxable amount of services comprises all costs and all statutory taxes, duties and other charges payable on those services, excluding VAT.[2] The taxable amount of a lease comprises all the payments prescribed by the lease agreement.[3] The VAT Act states that the taxable amount excludes any discounts (granted at the time of a supply or later) and compensations. The scope of the term "compensation" is not clear enough, and so the taxable person should be very careful in treating the payment received as a compensation.

When it comes to commercial undertakings (public entities in particular), the amount of a supply of goods or services should include the amount of any financing that has been received from central and local government in order to completely or partially cover expenses incurred in manufacturing goods or providing services and is directly linked to their price.

Including other taxes in the taxable amount

Back to the question of whether the taxable amount should include other taxes such as RET, the answer is not clear at all.

As mentioned above, the VAT Act states that a service provider should include in the taxable amount any taxes payable in relation to his services. So in this particular situation we need to find out whether RET is payable in relation to the land lease service.

Before the Constitutional Court issued a recent ruling,[4] the accepted view was that if the landlord was liable to pay RET and this was a cost item of the lease service under the lease agreement, then RET should be included in the taxable amount. This explanation can still be found on the website of the State Revenue Service (SRS).

According to the SRS guidance, evaluating the inclusion of RET in the taxable amount of a supply involves examining a number of conditions, such as who pays RET, whether the property comprises residential or non-residential premises (artist studios), and what the conditions are for supplying the housing maintenance and management services included in the property management contract and for determining the amount of those services. When asked whether the property owner (landlord) who pays

RET and to whom the municipality has sent a notice of RET should include this RET in the taxable amount of the lease, the SRS answered that since the amount of the lease comprises all costs associated with the supply of this service, including the amount of RET charged by the municipality, the entire amount of the lease is subject to 21% VAT.

In practice the only alternative was when the actual payer of RET was a person to whom the property had been leased and the owner merely collected this RET before forwarding it to the municipality. This payment was then treated as a compensation, rather than a part of the taxable amount of services, and VAT was not charged on it.

(to be completed in our next edition of Flash News)

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[1] Section 34(1) of the VAT Act

[2] Section 35(3) of the VAT Act

[3] Section 34(7) of the VAT Act

[4] Ruling C26128713, SKC-201/2019 of 28 June 2019