

NO VAT CLAIMS FOR RESIDENTIAL RENT EXPENSES: By Jonathan Hore

Property investment is probably one of the oldest means of investing and undoubtedly produced many of the world's wealthiest people. However, we cannot afford to talk about property investment without mentioning rental income. One technical issue that comes to mind is the VAT claims on expenses by rental earners. Particularly VAT registered rental earners who receive both commercial and residential rental income. Some of them are repeatedly caught offside when it comes to input VAT claims. To be specific, the most concern arises when they claim VAT on expenditures related to residential property. However, such claims are prohibited by the law and potentially punishable. Today, I want to discuss the VAT treatment of expenses incurred in respect of residential accommodation. In this article, words including the masculine shall be deemed to import the feminine.

Input tax basics

Generally, input tax refers to VAT that is suffered by a VAT registered person on the acquisition or purchase of goods or services. The basic mechanics of the VAT system allows an input tax claim on goods or services acquired to make taxable supplies. Let me break it down for you. Taxable supplies basically mean those goods or services that are ordinarily charged a VAT rate of 14% or 0% such as commercial rent. Technically this means you cannot claim input tax on any purchases or expenses used in producing any other supplies other than taxable supplies i.e., no input tax for exempt supplies. The term exempt supplies refers to goods or services not subject to VAT at 14% or 0% such as residential rent. This seems straight forward, doesn't it?

However, there are some cases where registered persons may offer both taxable and exempt supplies which are technically referred to as mixed supplies. Specifically, persons who earn rentals from letting out commercial properties and residential properties are mixed suppliers. I know you may know this already but allow me to explicitly clarify just for the avoidance of doubt, commercial rent is a taxable supply and residential rent is an exempt supply. So, how then do we determine our input tax claim for mixed suppliers?

Enter mixed supplies

As I have alluded to above, input tax can only be claimed on goods or services acquired to make taxable supplies. In this case a person can only claim input tax on expenses acquired and used in the process of generating commercial rent. Technically, any VAT incurred on expenses directly attributable to residential rental income is automatically a prohibited claim! You might probably be querying what happens where you may not be able to explicitly distinguish input tax that relates to the commercial properties and residential properties. Well, in such circumstances the VAT Act requires a person to apportion the input tax based on the turnover method. Let me dig deeper.

Apportioning VAT

Basically, the turnover method measures the ratio of taxable supplies to total supplies, the resultant percentage being referred to as the VAT factor. The main objective of apportioning the input tax rest entirely on allowing a person to deduct a portion attributable to generating taxable rent. Let me simplify this with an aid of an example. If Tiro earns total rental income of P3m with P2m being commercial rent and the balance arising from residential properties rent, this means Tiro will only be able to claim 66% (P2m/P3m) of VAT on all expenses he cannot easily link to either commercial or residential properties. However, where commercial rental income constitutes more than 90% of the total rental income, KUDOS!!, the law permits a claim of 100% the input tax without any apportionment.

Additionally, alternative methods can be applied to apportion the input tax where a taxpayer has reasonable proof that the turnover method is misleading or not properly providing an accurate apportion, subject to BURS approval.

Am out

Well folks, I hope that was insightful. As Yours Truly says goodbye, remember to pay to Caesar what belongs to him. If you want to join our Tax WhatsApp group or to know about our 9 Tax e-books, send me a text on the cell number below.