Value Added Tax (VAT) Issues For Property Developers
In this article we discuss the VAT issues which could affect a property developer in the Kingdom of Saudi Arabia. The VAT impact for property owners and property holding companies shall be covered in a separate article.

In established VAT regimes, transactions involving the sale and lease of commercial properties are subject to VAT while the sale or lease of residential property may generally be considered as either as a VAT-Zero rated or VAT-Exempt supply. For mixed-use properties (i.e. residential and commercial within the same development), VAT is generally chargeable on that part of the property that is approved for commercial use while the residential portion may either be zero-rated or exempt from VAT. This creates issues for a property developer as the Input VAT that a developer incurs on costs attributable to the residential portion of the development may not be recoverable if it is treated as an Exempt supply.

**VAT on transactional steps**

It is common for buyers to pay a deposit or booking fee when purchasing a commercial or residential property. Subsequent payments could be by way of instalments and/or a lump sum payment on completion/delivery. The VAT treatment for deposits may differ for residential and commercial properties and additional issues may arise on the supply of ‘fixtures and fittings’.

For a commercial property, VAT may be chargeable on the following:
- Deposits;
- Progressive payments;
- Final lump sum payment; and
- Cost of fixtures and fittings.

A residential property buyer may request the developer to install additional fixtures and fittings or the developer may incentivize purchasers by offering partly/fully furnished properties. While the sale of residential property may generally treated as a VAT Zero-rated or VAT-Exempt Supply in various countries, the fixtures and fittings could be subject to VAT. It remains to be seen how the Saudi VAT law, once introduced, would define ‘fixtures and fittings’ and their VAT treatment.

The supply of air-conditioning units, kitchen/bedroom/bathroom fittings (and fixtures) could be subject to VAT for both commercial and residential properties. This could make the VAT accounting somewhat complex as Input VAT which a developer would incur on fixtures and fittings for residential properties could be recoverable (assuming these are treated as Taxable Supplies). Therefore, an appropriate calculation would be needed to ensure not only that the correct amount of Input VAT is claimed but also that Output VAT is appropriately accounted for, particularly where a lump-sum price is agreed. As is customary in VAT laws, an underpayment of VAT might attract penalties.
**VAT on completion**
The laws in other countries generally require VAT to be accounted for on any remaining sum on completion on the earliest of the following:
(a) receipt of final payment;
(b) issuance of the final invoice;
(c) transferring property title to the buyer; or
(d) giving possession to the buyer.

Depending on the VAT law, the above ‘events’ might have to be monitored to ensure compliance.

**Other Services**
Property developers may also provide management and maintenance services such as security, janitorial services and concierge/helpdesk for commercial and/or residential developments.
Generally, under VAT laws, such services are treated as Taxable Supplies for commercial as well as residential properties. If the same approach is adopted in the Kingdom of Saudi Arabia, then the provider of such services would be required to charge VAT. Additional VAT implications could arise if the management company is also collecting payments towards a sinking fund (for repairs and maintenance of common utility areas). The treatment of such payments under VAT laws in other countries varies.

**Mixed developments**
A commercial development may be integrated with a residential tower/apartments. There may not be VAT on the sale of residential property as the sale of residential property could be treated as an Exempt Supply under VAT laws. Given this, the Input VAT recovery by the developer may restricted only to the portion directly attributable to the commercial development. Once again this could give rise to some fairly complicated VAT restriction and apportionment calculations as a business could have to segregate the VAT charged between the commercial and residential development. There could however be common costs such as architects and engineering fees or costs in relation to common utility areas (lobby, elevators, etc.).
Conclusion
The proposed VAT could have significant implications for property developers. Once
the VAT law is issued, a significant window of time might not be available to ensure
that the business is efficiently VAT compliant as the law could become effective
within a few months from the date of issuance. Entities engaged in the business of
property development need to undertake a VAT readiness exercise at this stage to:
(i) identify potential VAT touch points in their business operations;
(ii) perform a mapping exercise and assess the level of flexibility needed in their
    accounting and IT systems to account for the likely introduction of VAT in the
    Kingdom of Saudi Arabia as and when the law is introduced and becomes
effective;
(iii) assess the changes needed in the internal operations or to contractual
    arrangements with third parties to plug any potential VAT leakages; and
(iv) make and execute the implementation plan for the required changes keeping
    enough flexibility for any additional changes that might be required when the
    law is finally issued.

As VAT generally involves the entire supply chain of a business, a property
development entity may need to involve stakeholders from various business
functions in the above process, depending on the size and complexity of business
operations. The business functions could include finance, procurement, sales,
engineering/construction, IT, legal, etc. A project manager may be needed to
ensure that the different pieces of the jigsaw puzzle are smoothly brought together
without much disruption to the business.

About the author
Gurdeep Randhay is a Director at KPMG Al Fozan & Partners and leads the VAT
practice. He can be reached at grandhay@kpmg.com for any clarifications in relation
to the contents of this article.