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Income Tax treatment of rental deposits

It is common in the property letting industry that lessors may require lessees to pay a rental deposit upon entering into a rental agreement.

Introduction

There has always been debate and uncertainty on whether or under which circumstances these deposits would be regarded as "gross income". The South African Revenue Services (SARS) recently issued a draft Interpretation Note, ("IN") – "Taxation of the receipt of deposits". This IN provides guidance on the words "received by" in the definition of "gross income" in section 1(1) of the Income Tax Act (**the Act**) and the treatment of the receipt of a deposit in the ordinary course of business.

What are the tax implications of rental deposits?

Section 1(1) of the Act, defines the term "gross income". Receipts or accruals are included in the gross income of taxpayers if, amongst other requirements, the amounts are received by taxpayer "on his own behalf for his own benefit".

In terms of the draft IN careful consideration should be given to the rental agreement. Generally and depending on the agreement the lessor would receive rental deposits in the position of a "trustee", whereby the lessor may have an obligation to refund the deposit to the lessee upon termination of the lease. Since the deposit is not the lessor's money and the lessor is contractually liable to refund the rental deposit at the time it is received, the amount is not received by the lessor "on his own behalf for his own benefit" and thus is not included in the lessor's gross income.

Based on the facts of the agreements an enquiry needs to be performed to determine if the deposit is received by the lessor on its own benefit and on its own behalf. It is further important to note that retaining tenant deposits in a separate bank account does not automatically negate the risk that the amounts received as deposits could constitute gross income.

Rental deposits should be distinguished from up-front rental payments or premiums. Up-front rental payments and premiums are generally not refundable and relate to the use of the lessor's property, which would generally constitute rental income that may be included as gross income.

In order to determine whether tenant deposits would constitute gross income, a detailed evaluation should be performed of the relevant agreement.

Other considerations

Apart from the matters highlighted above you would also need to consider various other aspects such as:

- The other income tax implications

- The VAT implications of tenant deposits
- Requirements of the Consumer Protection Act

How can we help?

We are able to assist you with determining the appropriate tax consequences and preferred approach based on your specific facts and circumstances.

Contact us



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