

Rental Income – VAT perspective

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Introduction

United Arab Emirates (UAE) is one of the fastest growing economies in the recent past due to its flexibility to operate businesses and liberal social economic environment for expatriates.

However, 2016 being the challenging year for the UAE especially for the real estate sector. GDP growth declined from 4.5% in 2015 to 2.3% in the year 2016. Dubai is getting attraction in the real estate investments because of 2020 EXPO which would really be requiring great amount of investment and such infrastructure in place to conduct this event. Data from MEED projects suggests that new construction tenders across the UAE could increase by more than 95% in 2017 which will be around USD 100 billion of worth.

Rental for residential or commercial properties in UAE is one of the major sectors have always been and likely to boom further having significant upside potential in the coming future. Significant portion of businesses and expatriates depend upon rented accommodation/ places for residential or commercial purposes.

VAT – Rental Incomes

VAT would be applicable on all goods/ Services which are mentioned in the VAT Law and Executive Regulations. Goods has been defined with an INCLUSIVE definition (i.e. anything can be covered including the mentioned items unless specifically excluded) which states that “*Physical property that can be supplied including real estate, water, and all forms of energy as specified in the Executive Regulation of this Decree-Law*” Which means it covers everything which can be supplied physically unless it has been specifically exempted by the law.

Now, **services** has been defined as “*Anything that can be supplied other than Goods*” which essentially covers all value additions which are not physical goods unless specifically excluded by the law.

Hence Rental will be covered under the definition of services which are being provided by an owner to a tenant in lieu of rental incomes and that would be covered and subjected to VAT in UAE.

Zero rated Vs. Exempted supplies

Law provides certain supplies which are to be charged **with VAT of 0%** called as “**zero rated supplies**” which essentially means that Output liability will be ZERO for making such supply of such goods/ services however any VAT which would have been paid on purchases/ expenses for making such **supplies can be considered for refund or to pay any other VAT liability.**

There are certain **exempted supplies** mentioned in the law which essentially means that there is **no liability to pay VAT** (being exempted from VAT) on these items and hence all VAT which would have been paid on any purchases/ expenses **will also NOT be allowed to adjust or consider for refund.**

Classification of Rental Income – VAT rate

Article 45 covers these two points-

45 (9). The first supply of residential buildings within (3) years of its completion, either through sale or lease in whole or in part, according to the controls specified in the Executive Regulation of this Decree-Law

45 (11). The first supply of buildings converted from non-residential to residential through sale or lease according to the conditions specified in the Executive Regulation of this Decree-Law.

Analysis:

1-**Any residential property** given for rental/ leasing purposes will be under “Zero rates supplies” only when it is **not more than 3 years old** after its completion,

2-Such Zero-rated category is **allowed at ONE time** only being its first supply within the 3 years of its completion,

3-**Any commercial property** converted into residential for rental purposes/ leasing will come under “Zero rate supplies” only **at ONE time** being its First supply,

4-As we have discussed above, **Zero rated supplies** can get the benefit of all VAT paid on its purchases/ expenses related to such Zero rated supplies,

5-Conversion of any commercial property to residential property can get benefit to be considered under ZERO rated category but only at ONCE (when such conversion is done at first time) whereas in case of a residential category it is allowed to make its first supply within 3 years from its completion in order to remain the benefit of ZERO rated category.

Now, as per **Article 46** which specifies Supplies which are Exempt from Tax covers “..... 2. *Supply of residential buildings through sale or lease, other than that which is zero-rated according to Clauses (9) and (11) of Article (45) of this Decree-Law.*

Analysis:

1-**All residential properties** which are being supplied through lease/ rental purposes will be exempted which means VAT liability will not arise,

2- Once a supply is in the category of exempted supplies then all **VAT paid on any purchases/ expenses will not** be allowed to utilize or to get as refund,

Concluding REMARKS RELATED TO VAT rate on rentals income

1-**All residential properties** which are being supplied/ given on lease/rental will be treated as zero rated **for ONE time only** within its first 3 years after its completion and hence one can take an advantage to get any VAT paid on purchases/ expenses incurred,

2- **Once the benefit** has been utilized as mentioned above, the **all residential property** will be covered as **exempt supply** category and hence **no benefit of any VAT paid** on its related expenses/ purchases,

3- **One time conversion** from any commercial property to residential will **also be covered under zero-rated supplies** and all VAT paid on related expenses/ purchases can then be utilized/ refunded,

4- **All commercial properties** given on lease/ rentals will be subjected to **VAT of 5%**,

Registration:

Subject to the threshold of the turnover for registration, it is to be noted that there is **no need** to get VAT registration **if** a person **deals in exempted supplies** only (being a case where only residential properties are given on leases/ rentals), However as per **article 15** which states that *the Authority may except a Taxable Person from mandatory Tax Registration upon his request if his supplies are only subject to the zero rate.*

Hence person involving **fully into exempted supplies** category **will not be required** to take VAT registration however if a **person is only involved in Zero rated supplies** then a request for waiver of registration can be made, however registration is required subject to minimum threshold limit. It is also pertinent to note that the Input Tax Credit will not be available in such cases.

Date of supply/ Point of VAT imposition

As per **article 26** which deals in **special cases** to impose VAT where the supply of Goods or Services for any contract that **includes periodic payments** or consecutive invoices is the earliest of any of the following dates, provided that it does not exceed one year from the date of the provision of such Goods and Services:

- a. The date of issuance of any Tax Invoice.
- b. The date payment is due as shown on the Tax Invoice.
- c. The date of receipt of payment.

Hence whenever either of above three would happen then VAT liability will be arises.

Place of supply of services

As per **Article 29** the place of supply of Services shall be the **Place of Residence** of the Supplier means where the rental property situated.

Effect on existing rental agreements- Transitional Rules

If a contract **has been concluded prior** to the enforcement of this Decree-Law, regarding a supply to be wholly or partly made after the effective date of this Decree-Law, but such contract does not contain clauses related to Tax on the supply, it **shall be treated** as per the following:

- a. The **Consideration shall be considered** inclusive of Tax if chargeable according to this Decree-Law.
- b. **Tax** shall be calculated **on the supply regardless** of whether it has been taken into account when determining the Consideration for the supply

Analysis:

It means that if for example there is a rental agreement which has already been executed **before the effect of VAT laws in UAE** and there is nothing mentioned about the taxability of the VAT then it will be treated as if the **supply was subjected to VAT** and tax amount will be calculated on the amount irrespective of any effect of tax has been assumed/ considered in the transaction.

Value of Supply

As per **article 34**-The value of supply of Goods or Services for Consideration shall be as follows:

1. If the entire **Consideration is monetary**, the value of the supply shall be the Consideration less the Tax.
2. If all or part of the Consideration is not monetary, the value of the supply is calculated as the overall monetary part plus the market value of the non-monetary part of the Consideration, and shall not include the Tax.

Analysis:

It means for example if there are some services which are being received from the tenant in lieu of reduced rentals overall, then such services will be calculated using market value and then full value of

