VAT on commercial and residential accommodation: Lodging, leasing or renting?

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The Value-Added Tax Act, No 89 of 1991 (VAT Act) contemplates the supply of two types of residential accommodation, ie the supply of “commercial accommodation” and “dwellings”. The distinction between commercial accommodation and a dwelling is essential, because the supply of commercial accommodation is subject to VAT at the standard rate, whereas the letting and hiring of a dwelling is exempt from VAT. In addition, where commercial accommodation is supplied together with domestic goods or services (furniture, water, electricity cleaning, maintenance, etc.) for periods longer than 28 days for an all-inclusive charge, VAT is only payable on 60% of such charge. It is unfortunately not always clear as to whether the accommodation provided comprises “commercial accommodation” or “dwellings”.

The definition of “commercial accommodation” in the VAT Act contemplates the supply of lodging, or board and lodging,

together with
domestic goods or services in any residential establishment which is regularly
and systematically supplied, but excludes a “dwelling” supplied in terms of an
agreement for the letting and hiring thereof.

A “dwelling” on the other hand is defined as any building
or structure used predominantly as a place of residence or abode of a natural
person, including fixtures and fittings, but it excludes the supply of
“commercial accommodation”.

It is not always clear as to whether the supply of
accommodation in a residential establishment comprises “commercial
accommodation”, and the South African Revenue Service (SARS) also refuses to
issue rulings to confirm whether or not a supply of accommodation comprises
“commercial accommodation”. The difficulty in determining what comprises
“commercial accommodation” has been highlighted in the case of Respublica (Pty)
Ltd (Respublica). Respublica owned a residential property which comprised of a
number of furnished units specifically developed for student accommodation.
Respublica entered into a five-year lease with a university for the sole
purpose of accommodating the university’s students. Respublica also supplied
domestic goods and services, ie water, electricity, maintenance, cleaning and

laundry services. The university paid an all-inclusive rental per bed per month. The students were required to vacate the units during university holiday periods.

Respublica approached the High Court for a declaratory order after it could not reach consensus with SARS as to whether the accommodation provided under these terms comprised “commercial accommodation”, subject to VAT at 60% of the all-inclusive rental. It was accepted that the accommodation provided did not comprise “dwellings”, and it was common cause that Respublica provided domestic goods and services.

SARS contended that “commercial accommodation” contemplates the supply of lodging. Since only natural persons can be lodgers, the university, being the lessee, was not capable of lodging and was merely a tenant. SARS further argued that there was no contractual relationship between Respublica and the students.

Respublica contended that the property was let to the university for the sole purpose of supplying accommodation to the students. Respublica was responsible for managing the property and the students and to enforce the house rules which the students were required to adhere to, and it supplied the domestic goods and services directly to the

students, who were the
recipients of its supplies.

The High Court delivered judgment on 29 February 2016 and found in favour of Respublica. The High Court was of the view that the words used in the definition of “commercial accommodation” must be read in conjunction with the purpose of which the property was let to the university.
It also agreed with Respublica that a nexus between the lessor and the end user is not a requirement for the supply of commercial accommodation.

SARS appealed directly to the Supreme Court of Appeal (SCA) against the High Court judgment. In its judgment delivered on 12 September 2018, the SCA reversed the order of the High Court, and held that the accommodation provided by Respublica does not comprise “commercial accommodation”. The SCA held that the decisive question is whether Respublica can be said to have provided lodging. By its nature, the university is incapable of living in accommodation, and can therefore not be a lodger. The SCA held further that there was no contractual relationship between Respublica and the students for the provision of the accommodation. The SCA was of the view that the VAT consequences of a supply must be assessed by reference, first and foremost, to the contractual arrangements under which the

supply is made.

Based on the facts, the SCA held that two distinct relationships were contemplated. The first being between Respublica and the university, and the second between the university and the student. The supply by Respublica was therefore neither “commercial accommodation” nor a “dwelling”, but was considered to be the supply of a building under a lease, subject to VAT at the standard rate.

If the VAT status of the supply must be assessed by the contractual arrangements under which the supply is made as held by the SCA, then the supply of accommodation to the students under an agreement with the students directly, as opposed to an agreement with the university, will qualify as “commercial accommodation”.

A landlord supplying student accommodation could find itself in a situation that it has a lease with a university for half of the number of beds in the building, and the other half is supplied to students under agreements entered into with the students directly. In terms of the SCA judgment, the rentals charged to the university are subject to VAT at the full standard rate, whereas the rentals charged to the students qualify as “commercial accommodation” at the reduced rate.

Suppliers of student accommodation should therefore carefully consider the terms of the agreements and their contracting parties in view of the SCA judgment.