

VAT TREATMENT ON PARTIAL CONSTRUCTION OF BUILDING

BARE LAND AND COVERED LAND

Bare Land: VAT Exemption & Definition

- **Definition:** Land without any completed buildings, partially completed buildings (i.e., construction beyond foundation level), or fixed civil engineering works.
- **VAT Treatment:** Supply (sale or lease) of bare land is **exempt from VAT**. This means no output VAT is charged, and no input VAT can be recovered on related costs.

Covered Land: The Taxable Trigger

- **Definition:** Land with any of the following:
 - **Partially Completed Buildings:** Construction must be **beyond foundation level**.
 - **Civil Engineering Works:** Fixed, immovable structures (roads, utility pipes) on the land. Underground pipes that do not break the surface or provide access to the specific plot do not count.
- **VAT Treatment:** The supply is a **standard 5% VAT supply** **Key Scenarios**
- **Leases:**
 - **Periodic Leases:** If a bare plot is leased and the tenant begins construction, the land becomes "covered." The landlord must start charging 5% VAT on all subsequent lease payments.
 - **One-Off/Musataha:** A single, upfront payment for a bare land lease (or a registered Musataha agreement) locks in the VAT treatment at the beginning. The entire supply remains VAT-exempt, even if the tenant later develops the land. This is a crucial distinction for long-term planning.

As per FTA Real Estate VAT Guide (VATGRE1, Section 5.8): "It is acknowledged that registered Musataha agreements differ from short and medium-term leases. Consequently, in instances where the parties enter into a Musataha agreement which is registered with the appropriate Land Department or Municipality as required under UAE property law, the lease agreement will be treated the same as a contract of sale or one-off lease and no adjustment to the VAT treatment would be required after that date. If the Musataha is not registered, the lease will generally be treated the same as any other lease agreement."

VAT TREATMENT OF COMPLETED BUILDING (NORMAL CASE)

The First Supply of a Residential Building

The **first supply** of a new residential building, which can be a sale or a lease, is **zero-rated for VAT**. This applies if the supply occurs within **3 years** of the building's completion.

- **Completion Date:** A building is considered complete on the earlier of two dates: the date it's certified as complete by an authority, or the date it's first occupied. This can be a key point for tax planning to determine the start of the 3-year zero-rating window.
- **Input Tax Recovery:** Because the supply is zero-rated, the developer can **recover all VAT** they paid on construction costs. This right to recover input tax is not affected by any subsequent, VAT-exempt supplies of the building.

Subsequent Supplies & Service Charges

- **Subsequent Supplies:** Any supply of a residential building after the first supply is **exempt from VAT**, even if it happens within the 3-year period. This means a second sale or a subsequent lease is VAT-exempt.
- **Service Charges:** Service charges for the upkeep of communal areas (e.g., maintenance, security) are **not part of the residential building supply**. They are considered a separate supply of services and are subject to the **standard 5% VAT rate**.

Special Cases

- **Off-Plan Purchases:** The purchase of a residential building off-plan is treated as a zero-rated supply, as it will be a future first supply.
- **Conversion of Buildings:** The first supply of a building that has been converted into a new residential building is zero-rated, provided the original building was not residential within the last 5 years and the supply occurs within 3 years of the conversion's completion. This rule allows for input tax recovery on the conversion costs.

What is a Mixed-Use Development?

A mixed-use development is a single property (building or land plot) that combines areas with different VAT treatments, such as residential (zero-rated/exempt) and commercial (standard-rated) spaces. When a part of the development is supplied, its VAT treatment depends on its specific use. If the entire property is sold, the consideration must be **apportioned** between the different uses to determine the correct VAT liability.

VAT Recovery on Development Costs

For mixed-use properties, a developer can **recover all VAT incurred on construction costs** because the initial supply of the commercial units is taxable, and the first supply of the residential units is zero-rated. Both zero-rated and standard-rated supplies allow for

the full recovery of input tax. This is a major tax planning advantage, ensuring the developer can claim back all the VAT paid on building materials and services

Mixed-Use Land

A plot of land can also be considered mixed-use, such as a farm with both commercial land and a residential farmhouse. If the land is supplied, the same **apportionment rules** apply to determine the VAT liability for each portion of the property.

VAT TREATMENT ON PARTIAL CONSTRUCTION OF BUILDING:

The VAT on Selling a Partially Completed Commercial Building

The sale of a partially completed commercial building is generally a **standard-rated (5% VAT)** supply. This is because the land has ceased to be "bare land" and the building is not a residential property, which would qualify for zero-rating on the first supply.

What if the Building Doesn't Exist at the Time of Contract?

If a commercial building is sold off-plan (i.e., before construction begins), the VAT treatment is determined by the contract.

- **Continuous Supply:** For contracts with periodic payments (e.g., installments based on construction milestones), the VAT is charged at each payment date or invoice date, whichever is earliest. This means the developer charges 5% VAT on each installment received from the buyer.
- **Single Supply of Goods:** The agreement to transfer a building at a future date can be considered a supply of goods from the outset. In this case, the VAT treatment would apply to the entire transaction, with the date of supply determined by the terms of the contract.

Perspectives

- **For Developers:** When selling a partially completed commercial building, the developer must charge and collect 5% VAT from the buyer. This allows the developer to recover all input VAT on their construction costs, as the sale is a taxable supply.
- **For Buyers:** A buyer of a partially completed commercial building will pay 5% VAT on the purchase. If the buyer is a VAT-registered business, they can generally recover this VAT, provided the building will be used for a taxable activity.

The Sale of a Partially Completed Residential Building

Standard-Rated Treatment (Most Common)

This approach treats the sale of a partially completed residential building as the sale of covered land.

- **For the Developer:** The developer must charge **5% VAT** on the selling price to the buyer, which is a standard-rated supply. The developer can fully recover the input VAT incurred on the construction costs of the building.
- **For the Buyer:** The buyer pays **5% VAT** on the purchase price. A key advantage for the buyer, particularly if they're a VAT-registered business, is that they can **recover the input VAT** they paid on the purchase. The buyer can also recover input VAT on subsequent costs incurred to complete the building, as these activities are part of a taxable supply chain for them.

Zero-Rated Treatment (Alternative)

This less common approach considers the sale of the partially completed building as the "first supply" of a residential building, which is zero-rated for VAT.

- **For the Developer:** The developer does not charge VAT on the selling price and can fully recover the input VAT incurred on the construction costs.
- **For the Buyer:** The buyer does not pay any VAT on the purchase price. However, this is where the main issue arises for the buyer. Since the initial supply from the developer was zero-rated, the buyer's subsequent sale of the completed building would be considered an **exempt supply** from a VAT perspective. The buyer also cannot recover the input VAT on any costs related to the subsequent sale or the remaining construction of the building. This is because the **Qqood contract** serves as legal proof that the "first supply" already occurred with the initial purchase. The buyer's argument that the remaining construction is a separate, new supply eligible for input VAT recovery is generally not accepted, as the transaction is treated as a whole, and the first supply has already happened.

As per FTA Real Estate VAT Guide (VATGRE1, Section 3.7): The purchase of a residential building 'off plan' i.e. direct from the developer prior to construction of the property, or purchase of a partly completed residential building, shall be zero rated, as a future supply of a residential building or as it will be used for residential purposes. This is assuming that the relevant conditions are met so as to be treated as a residential building.