



VALUE ADDED TAX FOR REAL ESTATE TRANSFERRED (AS PART OF A GOING CONCERN)

Circular Number:000000 issued on [•] 000 2020

TAX CIRCULAR

Subject Matter of This Circular

The transfer of a package of assets which form an entire business or Economic Activity - and are transferred as a going concern - is not subject to Value Added Tax, provided that certain criteria are met.

This Circular considers the application of these special rules to business transfers which include Real Estate, and the circumstances in which these can be transferred as a going concern for VAT purposes.

Please note the Circular does not provide detail on the applicable VAT treatment if the Real Estate is not eligible to be transferred as a going concern. If the criteria are not met, readers should refer to the published guidance material available for supplies of real estate, based on the specific facts for that supply.

1. Conditions for a business to be transferred as a going concern

The general requirements to allow a business (Economic Activity) to be transferred from a Transferor to a Transferee as a going concern, and without VAT are summarized below :

- a. A transfer of a single asset (such as a piece of real estate) is not a business in itself. The transfer should constitute a bundle of the assets (both the tangible property, and the intangible assets such as contracts or rights) required to carry on the business;

- b. There must be some cohesion between the transferred assets such that collectively they are capable of being operated as a separate business;
- c. The Transferee must use the assets for a business (Economic Activity) and should start to use the goods and services acquired as soon as commercially feasible;
- d. The Transferee's business must be the same type of business as that carried by the Transferor on before the transfer;
- e. The Transferee should be a Taxable Person in respect of conducting the business which is transferred; and
- f. The Transferor and Transferee must agree in writing that the transfer is of an Economic Activity for VAT purposes.

This Circular applies these general requirements to various situations where real estate is transferred as part of a business.

2. Commercial properties which are occupied by Transferor before sale

This category concerns any person who owns and occupies commercial real estate, (such as an office, shop, factory, farm, hotel, etc.) which is used as an asset of that person's own existing business.

If the real estate is transferred as part of a package of assets forming an entire business, or a standalone part of a business which can be separately operated by the Transferrinee, the package of assets is capable of being transferred as a going

Refer to Article IV, Transactions not falling within the scope of Tax – transfer of an Economic Activity, Implementing Regulations; and the full interpretative guidelines issued by GAZT on the Transfer of a Business

concern. Conditions a) and b) will therefore be met. The other general criteria c) – f) must also be met for the sale to be eligible to be transferred without VAT.

Example (1): An owner of two hotels sells one hotel, together with the staff and operational contracts to run the hotel, to a new operator. This one hotel, together with the associated contracts, is a part business that can be transferred as a going concern.

If the real estate was used as part of the Transferor's business, but is then transferred as a standalone asset, this is not eligible to be transferred as a going concern.

Example (2): A mechanic leases a larger workshop to carry on his business. He moves the equipment to the new workshop and sells the former workshop premises which he had owned and used for the business. The sale of the old workshop is not a package of assets and is not the transfer of a going concern.

3. Commercial rental activities

This category concerns commercial real estate which is used by the owner to lease, rent, license, or to otherwise make supplies of that property to third persons.

- A commercial property rental business constitutes a Taxable Economic Activity for VAT purposes. The transfer of a commercial property and the lease of that property to a third party is a package of assets capable of being transferred as a going concern.

3.1 Transfer of an existing lease

An existing lease contract will typically be transferred from the Transferor to the Transferee by way of a contract novation, such that the Transferee takes on the benefits and obligations of the contract. Alternatively, the Transferor can arrange for the existing lease to be terminated, and a new contract to be signed with the Transferee with similar terms and with immediate effect. GAZT accepts that in both cases, the Transferor transfers the property with the benefit of the lease contract.

3.2 Vacant or partly-vacant real estate

A vacant property, without any existing commercial tenant or lessee, is not able to be transferred as an ongoing Economic Activity. This applies regardless of whether the real estate is being actively marketed or prepared for future lease.

If a Transferor holds a large office building or complex with different units, or a property portfolio, it is not necessary for every unit is subject to an existing lease at the time of transfer. However, where the real estate is partially vacant, the vacant part of the real estate must be actively marketed for lease, or being prepared to be actively marketed for lease, at the time of the transfer.

Example (3): A commercial office building has five floors. At the time of transfer three floors are tenanted, one is being actively marketed for lease, and one floor is being refurbished in preparation of being actively marketed for lease. As there is a lease in place which will be transferred with the building, and the remaining vacant areas are either being marketed for lease, or being prepared for active marketing for lease, the transfer may be transferred as a going concern.

GAZT considers that unless exceptional circumstances apply, at least 50% of the market rental value must be transferred subject to existing leases to constitute an ongoing Economic Activity.

GAZT will consider the commercial reality of an arrangement in determining whether an Economic Activity is transferred in respect of real estate transactions. Where it determines a lease is entered into for the primary purpose of seeking to obtain a benefit under the transfer of a Going Concern provisions for VAT purposes, it will not consider the conditions at a) and b) to be met. Conditions to indicate a lease being entered into for the primary purpose of obtaining a VAT benefit include a short lease term (less than twelve months), leases to Related Persons or leases which are substantially below market value.

3.3 Sale and lease-back arrangements

A commercial property owner may decide to sell a property it occupies and enter into a new agreement to have Transferee lease the property back for the Transferor's continued use. In these cases, whilst the Transferor continues to use the property in the same way, the Economic Activity carried on by the Transferee (property rental) will be materially different to the Economic Activity of the Transferor before the transfer. Therefore, condition (d) is not satisfied and the transfer cannot qualify as a going concern.

4. Residential properties

Residential property, being a dwelling which is used or leased as a primary residence, is not eligible to be transferred without VAT as a going concern.

- If a residential property is transferred together with an existing residential lease, the business being transferred is exempt from VAT. This means that the transfer of the rental business does not result in the Transferee being a Taxable Person. If the Transferee is a Taxable Person in respect of other, separate business activities, this does not affect the treatment of the property rental business.

5. Mixed-use buildings or complexes

- A single building or real estate complex can include both residential and commercial units. The owner of such a mixed-use building or complex therefore carries out a business which involves both taxable commercial rental and exempt residential rental elements.
- As a default for mixed use buildings or complexes, the value of the commercial rental business should be separately identified. If the transfer of the commercial part of the building meets the criteria to be transferred as a going concern, this part of the business can be separately identified and transferred without VAT. In these cases, the transfer of the remaining residential or non-commercial component of the business should follow the standard VAT treatment for that type of real estate.
- GAZT accepts that if the residential units form part an ancillary part of the commercial building or complex, the entire building can be treated as a single composite supply of a going concern, provided that the building is transferred under a single land title and all other conditions are met. For this purpose, GAZT considers that where 10% or less of the market rental value transferred is subject to existing residential leases, the residential leases will be ancillary to the commercial building.

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