

VAT ON PROPERTY AND CONSTRUCTION



Introduction

The VAT that a business incurs on its purchases and overheads is called 'Input tax'. For businesses that only make taxable supplies (either standard-rate, lower-rate or zero-rate) this input tax, with the exception of certain specifically excluded items, such as business entertaining, is fully recoverable.

A VAT registered business which makes exempt sales cannot charge VAT on those exempt sales, the consequence of which is that it cannot usually reclaim the input tax it incurs on purchases and overheads used in making those exempt supplies.

Property and construction can involve all the UK VAT rates as well as VAT exemption, which means that planning is necessary in order to ensure that the input tax recovery position is maximised.

This brief summary will cover the VAT rate to be applied in the following:

Construction of new dwellings	Sales of dwellings	Letting dwellings
Conversion works	Sales of converted dwellings	Letting converted dwellings
Construction of new commercial buildings	Sales of commercial buildings	Letting commercial

This is a complex area of VAT legislation and guidance should be sought from a VAT advisor.

Construction of new dwellings

The construction of a building designed as a dwelling or a number of dwellings is zero-rated. There are two requirements to the zero-rating:

- The building must be designed as a dwelling or a number of dwelling; and
- The construction services must be performed in the course of construction of that dwelling.

The notes to the legislation point out that construction does not include the conversion, reconstruction or alteration of an existing building, or

the enlargement or extension of an existing building. There are further rules regarding enlargements and where the construction may, or may not, be creating additional dwellings such that the zero-rate may apply.

An existing building only ceases to be such when it demolished to ground level or the part remaining consists of no more than a single façade (or for a corner site a double façade) the retention of which is a condition of statutory planning consent.

Only construction works are covered. Fees paid to architects, surveyors and property consultants are always standard-rated. There are also a number of specific costs that have special treatment, for example building materials would generally be included in the contract for zero-rated works but there are other goods/materials which are not classed for VAT purposes as "items ordinarily installed by builders", and which are then liable to VAT at the standard rate.

Conversion works

The works (and basic building materials as explained above) of converting a non-dwelling into a dwelling are subject to the lower rate of VAT of 5%.

The works of converting a single house or a single flat into two or more flats are subject to the lower rate of VAT of 5%.

The works of converting two or more flats into a single house or a single flat are subject to the lower rate of VAT of 5%.

The works of converting a number of dwellings e.g. four flats into a different number e.g. six flats are subject to the lower rate of VAT of 5%.

The works of renovating or altering empty residential premises are subject to the lower rate of VAT of 5%. The premises must not have been lived in during the two years immediately before works begin.

Construction of commercial buildings

The construction of a new commercial building is standard-rated.

The sale of dwellings

The first grant of a major interest in a newly constructed dwelling, by the person constructing it is zero-rated. A major interest is the freehold sale or the grant of a long lease, which in England is greater

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than 21 years. Subsequent sales or the sale of existing buildings are VAT exempt. They can be zero-rated if there has been no previous grant of a major interest and are made by the person constructing the dwelling. Multiple people may have “person constructing” status but this status cannot be transferred unless as part of a recognised “Transfer of a Business as a Going Concern”.

The sale of converted dwellings

The first grant of a major interest (by a person with ‘person converting’ status for VAT purposes), in a dwelling converted from a commercial building is zero-rated. Subsequent sales are VAT exempt.

The sale of commercial buildings

The sale of a new commercial building is standard-rated. A building is classified as new for a period of three years following completion. Sales of non-new commercial freehold buildings are VAT exempt unless the vendor has “opted to tax” the building. Long leasehold sales are exempt unless the lessor has “opted to tax” the building.

The Option to Tax

‘The option to tax’ allows a business to convert what would otherwise be exempt property transactions into standard-rated ones. This allows input tax to be recovered if the option has been correctly exercised and notified to HMRC. Care must be taken to ensure a contract for sale or lease clearly states that VAT will be charged in addition to the basic price. This is to protect the vendor from otherwise being required to account for VAT from the net price.

An option to tax does not apply to dwellings.

Key points are as follows:

- The option is personal to a specific VAT registered business or specific VAT registered property owner. It is not transferrable between businesses and /or VAT registrations, although slightly different rules apply to VAT Group registrations.
- The ‘option to tax’ has to be filed with HMRC within 30 days
- There is a six-month cooling off period following which it is irrecoverable for 20 years
- Due to past VAT saving structures there are complex

anti avoidance provisions

The letting of dwellings

The letting of dwellings is VAT exempt. As mentioned above an ‘option to tax’ has no force over dwellings. As a result of the rent being exempt any input tax on costs and overheads of a property rental business is irrecoverable. Even if the tenant has opted to tax a particular building, if the tenant used the building for charitable purposes it can disapply the landlord’s option, making the rent VAT exempt. The tenant must inform the lessor of the intended use, in writing.

The letting of converted dwellings

The letting of a dwelling that was previously commercial is VAT exempt.

The letting of commercial buildings

The letting of commercial buildings is VAT exempt unless the lessor has ‘opted to tax’ the building in question.

Relevant residential and relevant charitable buildings

Pretty much the same provisions apply to the construction and sale of relevant residential ‘RRP’ and relevant charitable purpose ‘RRP’ buildings. For example the construction and sale of such buildings are zero-rated. A RRP building includes a residential home for children or student accommodation. A RCP building is determined by its use and not by its ownership. A high street charitable shop would not qualify as it is in business, whereas a building providing free accommodation for the homeless would qualify.