

# VAT ON PROPERTY AND CONSTRUCTION



The VAT that a business incurs on its purchases and overheads is called “input tax”. For businesses that make only taxable supplies (either standard-rated, reduced-rated, or zero-rated) this input tax – with the exception of VAT incurred on certain specifically excluded items – is fully recoverable. A VAT registered business which makes exempt supplies, however, will not, usually, be able to reclaim the input tax it incurs in making those exempt supplies.

For businesses in the property sector, a technical exercise may need to be undertaken to identify whether the business is making taxable supplies and/or the extent to which it can recover input tax.

This flyer provides an outline of the VAT treatment of the following:

- The costs of construction of new dwellings and new commercial buildings;
- the costs of conversion of buildings;
- the sale of dwellings and commercial buildings; and
- the letting of dwellings and commercial buildings.

Certain building work may be subject to the “reverse charge”, meaning that the recipient rather than the supplier will be required to account for VAT. The detail of these provisions is outside the scope of this flyer.

## Construction of buildings

The VAT treatment of costs incurred on the construction of buildings will, generally, depend on whether the construction involves a dwelling or a commercial building.

### *Construction of a new dwelling*

The basic rule is that costs charged for the construction of a dwelling are zero rated.

Construction for these purposes does not include the conversion, reconstruction or alteration

of an existing building, or the enlargement or extension of an existing building, and other rules will need to be considered in these cases.

The zero rating specifically relates to the costs of construction works, and other costs incurred in respect of a new building cannot be expected to follow this treatment. Fees charged by architects, surveyors and property consultants, for example, will typically be standard-rated. In addition, there are a number of costs for which specific rules apply; for example, the cost of building materials will generally be included as part of the costs of construction works but certain goods or materials which are not classed for VAT purposes as “items ordinarily installed by builders” may be liable to VAT at the standard rate.

### *Construction of commercial buildings*

Costs charged for the construction of a new commercial building are generally standard-rated, although this position is subject to certain specific exceptions and the following will be zero-rated:

- The costs of construction of a building intended for “relevant charitable purpose”;
- The costs of construction of a building intended for “relevant residential purposes”, such as a hospice or a building providing accommodation to children or students.

### *Conversion works*

The standard position is that any costs incurred for conversion work will be standard-rated.

This standard position is subject to a very limited number of scenarios where the costs will be zero-rated, and a larger number of scenarios where the reduced rate of 5% will apply. This reduced rate will, most commonly, apply to the following:

- The conversion of a non-dwelling into a dwelling;
- The conversion of a number of dwellings (e.g. four flats) into a different number of dwellings (e.g. six flats); and
- The renovation or alteration of empty residential

premises which have not been lived in during the two years immediately before works begin. Certain costs do not qualify for the zero or reduced rate and will generally remain subject to the standard rate. These include the costs of:

- Raising or removing scaffolding;
- hiring goods;
- landscaping;
- professional services (architects, consultants, surveyors, etc.); and
- installing non-building materials.

### The sale of buildings

The VAT implications of the sale of a building will again depend on the nature of the building in question.

- 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 a freehold or a long leasehold interest, which in England is one of more than 21 years. Subsequent sales will be exempt for VAT purposes. The first grant of a major interest in a dwelling converted from a commercial building, by a person with “person converting” status for VAT purposes, will similarly be zero-rated.
- 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 other commercial freehold buildings are exempt for VAT purposes unless the vendor has “opted to tax” the building (for which see below).

### The Option to Tax

The option to tax essentially allows a business to convert what would otherwise be exempt property transactions into standard-rated ones, thereby allowing input tax associated with the transaction to be recovered.

An option to tax can only be made in respect of commercial buildings, and cannot apply to dwellings. It is personal to a specific VAT registered business and cannot be transferred. Once made, an option to tax must be filed with HMRC within 30 days.

### The letting of property

The VAT position where property is let can be summarised, very briefly, as follows:

- The letting of dwellings: The letting of dwellings is exempt for VAT purposes.
- The letting of commercial buildings: The letting of commercial buildings is exempt for VAT purposes unless the lessor has opted to tax the building in question, in which case it will be standard rated.

The VAT treatment of property transactions is complex and specialist advice should always be sought when considering activities in this area. Please do contact our expert advisors at Moore Kingston Smith to discuss your particular circumstances.

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