

## **Dealing with a property slow down (Lecture B1355 – 22.33 minutes)**

### *New builds*

What if residential developers experience a slowdown in the next 12 months. They may be minded to temporarily let until the market recovers. Temporarily letting the property will be exempt from a VAT perspective and input tax on the build is at risk (subject to HMRC de-minimus rules).

To protect developers, we should always advise them to trade through a limited company. This will give them the greatest flexibility to deal with a downturn in the property market. If the developer needs to temporarily let the new homes, they could simply set up a letting subsidiary.

The property would then be sold to the newly formed letting subsidiary. This would be a zero-rated sale from a VAT perspective and input tax recovery in the development company is secured.

The sale would be free of SDLT due to the SDLT group exemption for supplies between a parent company and their 75% subsidiary. The subsidiary will be 100% owned but you only need 75% for the SDLT group exemption.

There will be a market value uplift in the development company for corporation tax purposes as the property needs to be appropriated before it is transferred NG/NL to the subsidiary company. With the corporation tax rate rising to 25% from 1 April 2023 it will be an advantage to have an uplift as the uplift is currently taxed at 19%.

The downside to using a letting subsidiary is that it creates an associate for the new corporate tax regime from 1 April 2023 with the upper and lower limits shared amongst associated companies. For larger companies this may not be an issue but for small businesses we would need to do a cost benefit analysis.

### *Converting property*

There will be similar considerations when a developer purchases a commercial property with a view to converting the building to flats before making zero rated sales of the flats.

The purchase of the commercial property should be exempt although this would require a Form 1614D if the seller has opted to tax the property.

Once purchased the developer may engage sub-contractors to work on the conversion. The subcontractors' invoices will be subject to the 5% domestic reverse charge or 5% VAT where the developer confirms end user status.

The sale or long lease (>21 years) of the flats will be zero rated which allows input tax recovery on the conversion costs. The developer should be mindful of the blocking order within SI1992/3222 (6) which prevents input tax recovery on building materials not ordinarily incorporated into the conversion (e.g. white goods).

Where the developer is unable to sell the converted flats, they should consider transferring the flats to a subsidiary company so that they may let the flats. The transfer would be zero-rated so input tax recovery is secure for the developer. Transferring the flats will trigger a market value disposal for direct tax purposes but realising profits early is a positive step with increased corporation tax rates around the corner. The SDLT group exemption means there is no SDLT on the transfer to the letting subsidiary.

Once again, we would have an associated company for the purposes of the new corporation tax regime from 1 April 2023.

It should be noted that if the developer was planning to convert a house into flats the conversion work would still be at 5% but the sale of the converted flats would be exempt. In this instance it would be important to minimise the developers' exposure to VAT so that they only ever incur 5%. This may well involve contracting with one main contractor (connected or otherwise) to perform the conversion work.

*Contributed by Dean Wootten*