

## **Practicalities of the VAT option to tax (Lecture B1285 – 34.28 minutes)**

An option to tax should be notified to HMRC on Form 1614A within 30 days of making the decision to opt to tax. Form 1614A can be signed and submitted electronically if preferred.

If the 1614A is not submitted within 30 days of the decision to opt you should submit a belated notification. Provided HMRC are satisfied that your client made the decision to opt and has charged VAT since that date then a belated notification will be accepted by HMRC.

A client should only consider opting to tax when input tax recovery is at stake. Exempt income will prevent input tax recovery – an option changes the income stream to standard rated and as such any related input tax is then deductible.

If a client incurs VAT on a property and they use it in their taxable business then the input tax is recoverable. There is no need to opt to tax as VAT is being recovered. If they were to sell the property within 10 years of the standard rated purchase then the client needs to consider the capital goods scheme prior to selling the property. If the purchase was for £250,000 or more (plus VAT) then the property is within the capital goods scheme and an exempt sale will result in a proportional input tax clawback. An option to tax prevents this clawback and in some cases creates a repayment where full input tax was not recovered on purchase.

If the client is buying the property for commercial letting an option to tax would be required to recover input tax on purchase. The rents would be exempt without an option to tax and exempt income would prevent input tax recovery.

If there is a standard rated property within a transfer of a going concern (TOGC) the buyer would need to opt to tax IF they wanted the property to be within the TOGC. They must opt to tax and notify HMRC by completion date to ensure the property is outside the scope of VAT. This may be advantageous if cash flow is an issue or if the buyer wants to reduce their SDLT exposure. TOGCs can include trading concerns and tenanted properties.

Generally an option to tax will be effective for a minimum of 20 years. Once 20 years has passed the taxpayer might choose to revoke their option to tax. A Form 1614J would need to be submitted to notify HMRC of their revocation. Unless the Form is submitted the option to tax will remain in place.

### *Disapplying the option to tax*

Normally an option to tax will result in VAT being charged on income derived from the property e.g. rent or sale proceeds. There are however a few occasions when the option is disappplied and the income reverts to exempt.

VAT Notice 742A Para 3 provides a useful summary of these occasions.

The main ones would be:

- Selling an opted property to a buyer with residential (or relevant residential) intent who provides the seller with a Form 1614D by exchange;
- Selling an opted property to a buyer with relevant charitable intent;
- Selling opted land to a housing association who provide the seller with a Form 1614G confirming their intent to build houses on the land;
- Selling opted land to a DIY housebuilder.

If you sell opted land to a developer the option to tax cannot be disapplied and VAT should be charged.

#### *Anti-avoidance rules*

Within the option to tax legislation there is an anti-avoidance rule which can catch clients unaware.

Consider a partially exempt trading company that wishes to buy a newly constructed property for £400,000 plus VAT. If the company bought the property the input tax of £80,000 would not be fully recoverable as they are partially exempt.

The shareholders of the company are considering forming a partnership and buying the property in the partnership. They plan to opt to tax the property and grant a lease to the trading company. They believe the partnership can recover the VAT on the property purchase as the costs incurred relate to taxable rental income. The lease would be at market value so they accept that the trading company would suffer the VAT on the lease rentals just as if they were letting from an unconnected landlord.

Due to the anti-avoidance rules within Schedule 10 Paragraph 12 the partnership's option to tax would be disapplied. The rental income would then be exempt and as a consequence the partnership would not be able to recover VAT on the purchase. If they have done so then this would be an error and penalties may apply.

The anti-avoidance test is explained very clearly in VAT Notice 742A paragraph 13 and is as follows:

1. Is the property within the capital goods scheme?

The property is bought for £400,000 plus VAT and as this is greater than £250,000 plus VAT (CGS limits) it will be within the capital goods scheme.

If it is within the capital goods scheme we must then consider Test 2. If it is not within the capital goods scheme then the anti-avoidance rule would not apply.

2. At the time for grant (of the lease) does the grantor or financier expect non-qualifying use by the grantor, financier or a connected person (s.1122 CTA 2010) within the next 10 years?

Non qualifying use will be more than 20% exempt activity or usage by a person who is not registered for VAT.

If test 2 is met then the option to tax is disapplied.

In the example above they will be connected parties i.e. a company owned by the partners. As such the grantor (the partnership) expects exempt use by a connected party (partially exempt company). The option to tax is disapplied.

*Contributed by Dean Wootten*