

VAT issues when converting property (Lecture B1275 – 23.39 minutes)

Practitioners are starting to experience an increase in clients contemplating residential developments – often from existing properties. Whilst there have not been any recent changes to the law it is worth reviewing what the critical VAT issues are.

Converting commercial properties to dwellings

Purchase of commercial property

The purchase of a commercial property will be exempt. If an option to tax is in force the buyer will need to provide a certificate (Form 1614D) to the seller (on or before exchange) to secure exemption. The certificate should confirm the extent of dwelling use going forward e.g. two floors out of three. The option is only disapplied to the extent of the dwelling use e.g. two thirds.

Disapplying the option to tax will reduce the SDLT charge and improve cash flow. It also reduces the risk of irrecoverable VAT should the buyer not make any onward taxable supplies with the converted property.

Conversion work

Where the developer provides CIS end-user confirmation to the subcontractors, VAT should be charged at the reduced rate of 5% on qualifying services supplied in the course of the residential conversion. Generally the lower rate will apply to commercial property being converted to flats.

If no end-user confirmation was given the 5% CIS domestic reverse charge would be in point.

Building materials and certain electrical goods, supplied by the person providing the above services and incorporated into the building in question or its immediate site, are also subject to the reduced rate.

Building materials supplied in isolation will be standard rated.

Onward supply

The zero-rating legislation covers the first grant of a major interest by a person converting a non-residential building or a non-residential part of a building into a building designed as a dwelling or number of dwellings or intended for use solely for a relevant residential purpose. This might be where someone is converting a warehouse building into flats or a barn into a house.

If the major interest grant is not present then the onward supply will be exempt e.g. 12 month rental tenancies.

Providing an onward zero rated supply is made the VAT incurred on the conversion work is recoverable. It should be noted that the blocking order within SI 1992/3222 is still in point and this will restrict input tax recovery on building materials not ordinarily incorporated e.g. fridges and cookers.

Converting houses to flats

Purchase of the house

The purchase of a house will be not be subject to VAT.

Conversion work

When end user confirmation in point, VAT should be charged at the reduced rate of 5% on qualifying services supplied in the course of certain residential conversions. In the absence of end user confirmation the 5% CIS domestic reverse charge is in point. Generally the 5% rate (or DRC) will apply to houses being converted to flats as the number of dwellings is changing.

Building materials and certain electrical goods, supplied by the person providing the above services and incorporated into the building in question or its immediate site, are also subject to the 5% reduced rate.

Building materials supplied in isolation will be standard rated.

Onward supply

The onward sale (or rental income) will be exempt.

If the house has however been empty for 10 years or more the sale can fall within the zero rated provisions as a qualifying conversion.

Input tax will not be recoverable if the onward supply is exempt.

Planning

Developers who regularly convert houses into flats should have a separate services company so as to avoid any 20% VAT on building materials. The services company will pay VAT at 20% on their building materials but will then charge their “parent” company 5% VAT on the conversion contract. The 20% VAT is recovered which minimizes the project VAT cost to just 5%.

Mixed use conversions

When converting a mixed use property we need to proceed with caution as the rules are complex.

If we consider a pub with owners accommodation on the first floor – a self-contained flat possibly.

Purchase of the property

The purchase will be exempt providing the seller has not opted to tax the property. If the seller has opted to tax the sale proceeds will be apportioned between the exempt flat and the standard rated pub element. The option to tax never affects residential property.

The buyer could issue Form 1614D confirming residential conversion intent for the ground floor. This will disapply the option to tax and the purchase of the property will be wholly exempt.

Conversion work

The conversion work should be considered on a floor by floor basis.

Converting the ground floor pub area into one or more flats should secure 5% on the conversion work on the ground floor.

The work on the first floor would also have a 5% rate if you were creating an additional flat on the first floor i.e. one flat converted to two. If the original flat was simply refurbished then the rate would be 20%. You would have to change the number of dwellings on the first floor to secure the 5% rate.

Any work that is common to the ground and first floor would need to be apportioned.

Where end-user confirmation is not given the work will be subject to a domestic reverse charge rather than VAT being charged by the subcontractors but the rates will remain the same.

Onward supply

To secure zero rating on the onward sale of the flats you would need to meet two conditions:

The flat being sold came from wholly commercial i.e. the ground floor pub element.

There must be more dwellings in the building post conversion than there were before.

This essentially means that the flat(s) on the ground floor should be zero rated on sale which will then allow input tax recovery on the conversion work for the ground floor.

The first floor flats cannot be zero rated on sale as they came from the residential element. This is so even if there are more dwellings post conversion.

Contributed by Dean Wootten