Client Briefing

VAT and Property:

Common VAT mistakes with property renovations

In many property renovation projects VAT is sometimes overlooked when the initial budgets and costings are being devised. This, however, can lead to costly repercussions further down the line... in some cases with the project costing up to 20% higher than budgeted.

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shipleys LLP

Background

VAT in relation to property is very complex and it's no wonder that many get confused when it comes to their renovation project. It's also why it's important that any project involving property should have considered the treatment of VAT at an early stage. This will help to avoid costly mistakes being made.

Mistake 1 – VAT rate on empty property renovations and alterations

The first common mistake we often see relates to the refurbishment of residential properties, which have been empty for two or more years. Here the contractor will be able to fully recover VAT incurred on building materials, equipment hire etc, but only needs to charge VAT at 5% (rather than the standard rate) to the property owner. Expect to show proof that the properties have been vacant for the two or more years, but in doing so you will make a significant VAT saving on the project.

Mistake 2 – VAT rate on projects which increase or decrease the number of dwellings

Another VAT rate mistake we see is with projects where a conversion of a residential property increases or decreases the number of dwellings. Again the contractor can recover VAT at 20% on materials etc but only needs to charge VAT at 5% when billing the landlord or property owner. It's worth stressing that the increase/decrease of dwellings should fit within HMRC's definitions in order to qualify for the VAT reduction – so do take specialist advice.

Mistake 3 – VAT rate on projects which convert commercial property to residential

Where a project converts commercial property to residential dwellings, again the 5% VAT rate applies. If the newly created residential units are to be sold rather than let, the sale proceeds will be zero VAT rated. This rating applies to the first sale after the conversion, with subsequent sales being VAT exempt. The zero rating allows VAT to be recovered on costs.

Mistake 4 – Not having the right legal structures when converting commercial property to residential, with a view to letting

If you are looking to convert a commercial property into residential with a view to letting, the VAT implications will depend on the ownership structure you have in place. With the right structure you can sell the properties to a subsidiary company to attract the zero VAT rating. That entity then conducts the VAT exempt letting activity.

Mistake 5 – Not operating the Contractors Industry Scheme where applicable

Not specifically a VAT issue, but one which catches out many property investment companies. If your property investment company has an average annual cost of £1million construction work over a three period, you will need to operate the Contractors Industry Scheme (CIS).

If the principle activities of the property investment company change to be that of a development company, registration under the CIS will also be necessary.

Under the Scheme contractors are expected to deduct money from a subcontractor's payments and pass them on to HMRC.

The deductions count as advance payments towards the subcontractor's tax and National Insurance. It's therefore important to keep track of your average annual construction work costs. HMRC is cracking down on those who don't register for the Scheme.

Summary

Hopefully this short guide shows you why it is important to consider and organise yourself for the VAT treatment of your project, as soon as possible. You will obviously need to get the construction company/contractor on board with the VAT planning.

Remember it is the supplier's responsibility to charge VAT at the correct rate. If they fail to do so, your only recourse is to go back to them and ask for relevant invoices to be reissued at the correct VAT rate. You won't be able to seek reimbursement from HMRC.

If you are planning a property development project and need help planning its tax efficiency, contact the team at Shipleys

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