VAT: Conversion of Redundant or Derelict Buildings

The cost of converting redundant or derelict buildings can be significantly affected by VAT. Property renovations can attract rates of 0%, 5% and 20% and there is a general exemption that applies for the lease and sale of property. Where the VAT exemption applies, this can lead to situations where the VAT on a project is blocked from recovery (i.e. professional fees and construction costs). This Comment On looks at some of the main VAT considerations regarding property renovations, although we advise that the VAT implications of any property project should be reviewed by your VAT adviser.

VAT on works to empty properties

The first issue to consider is whether VAT is chargeable on works to the property, and at what rate. The VAT rate charged on works will depend on a number of factors, including:

- The type of property being restored/renovated e.g. commercial or residential.
- The extent of the works being undertaken e.g. renovation, alteration, repairs or installations.
- The use of a property after works are complete, e.g. residential or commercial.

Identifying relevant VAT issues to a property project at the outset is critical to ensure that there are no potential hidden liabilities.

VAT on construction costs

<table>
<thead>
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<th>Summary of VAT issues that can arise on construction costs</th>
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<td>Current Use of Property</td>
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<tr>
<td>Commercial</td>
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<td>Empty Building (10 + years)</td>
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<td>Dwelling (Empty for 2 years or more)</td>
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<td>Multiple occupancy dwellings</td>
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1. Evidence such as council tax records may be required to confirm empty status
2. For 5% VAT to apply to works, the number of dwellings after the renovation works must change (e.g. 5 flats into 3)
- Works that are required to enable disabled access to buildings qualify for 0% VAT (e.g. ramps, lifts and toilets).
- The installation of energy saving materials into residential buildings is 5%. This commonly includes solar panels, loft wall and floor insulation, wind turbines, bio mass boilers etc.
- Professional fees of architects, surveyors etc will be subject to VAT at 20%.

Can any VAT charged be recovered?

If VAT is incurred on the costs associated with the renovation of a building (and in most cases there will be), it may be possible to recover the VAT in full or in part, depending on the future use of the building. The building will have to be used for taxable purposes in order for any VAT to be recoverable. If the building generates exempt income (such as residential lettings) the VAT will be irrecoverable.

An “option to tax” turns what would normally be an exempt lease (or sale) into a taxable supply and the business needs to submit a formal application to HMRC to impose the option over a particular property. Having an option to tax in place ensures that VAT on expenditure to the property can be recovered; however this will not apply to residential properties. The option only applies to buildings let as offices, workshops or for functions for example.

Holiday letting income is standard rated so any VAT incurred on the refurbishment of accommodation used for holiday lettings should be fully recoverable. We would recommend that professional advice is sought at the outset of projects in order to determine whether VAT can be recovered.

Do I need to be VAT registered?

VAT registration is compulsory where a person’s taxable turnover exceeds certain limits. Since April 2016 this limit is £83,000 and this usually rises with the Budget each year. VAT registration can be voluntary where it can be demonstrated to HMRC that there is an intention to make taxable supplies e.g. planning permission, business plans.

As summarised above, VAT can only be recovered against costs that relate to buildings which will generate taxable supplies. It cannot be recovered where the building will be used for exempt purposes. Sometimes income will be both taxable and exempt; in these instances the input tax is apportioned pro-rata between the two elements. For example, a building could have a commercial unit on the ground floor and flats above.

If the existing business is VAT registered, any VAT due on the income from property will have to be accounted for through its VAT return. Any associated VAT on expenditure can be recovered (subject to the rules outlined above).

Note: We would stress the importance of obtaining professional VAT advice before proceeding with a property project. This summary is intended as a general guide and should not be used in place of professional advice.

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