

ALAN PINK TAX

Property Conversions – A Tough Decision

Here's a tricky question for you: do you want to pay tax at 15% or 5%? Even harder, how does paying tax at 0% grab you?

Believe it or not, you could well be in a position to make exactly that choice, in the context of VAT on property conversions.

Amongst other situations, you could well be in this bizarre situation if any of the following three cases applies to you:-

- You are carrying out major refurbishment to a listed building which will be used as a home.
- You are converting a residential property from a house into flats, from flats into a house, or from flats to a different number of flats.
- You are converting a building which was not previously residential into a residential building.

Listed Buildings

In the context of major refurbishment etc works to listed dwellings, your choice is between 15% and 0% VAT.

If you want to pay 15%, you should make sure that the work that's done falls short of an "alteration" of the property, but instead is treated as merely in the nature of a "repair". The policy behind this distinction has been criticised more than once, but whatever the reasoning, it's a fact that you can zero rate the alteration of the building but not a repair. Where your works fall somewhere in a grey area between the two, introduce as many features as you can which point in the direction of more radical alteration, providing, of course, this doesn't preclude your getting the listed building consent.

Another way you can do your bit for Britain by paying 15% rather than 0% is by carrying out the alteration yourself. By "yourself", we mean you as the

owner of the property. If the owner and the person doing the alteration are the same, the building materials which are bought will be charged to VAT at the full 15% rate, and it's most unlikely, in most circumstances, that you will be able to get any of that back.

If, however, you prefer to be a "tax dodger", refusing to pay your "fair share", the way you do this is to go through a separate entity which acts as a building contractor. That doesn't mean you have to go along to some third party, necessarily, because this works just as well if the building contractor is a company that you've set up and own yourself. This contractor can buy all the materials, claim the VAT back on them, and then re-invoice on to you as the property owner with zero per cent tax, as part of an all inclusive service. In other words, the VAT on the materials is "washed out" by interposing this company between the property owner and the builders' merchants.

A similar principle applies to the fees of architects, surveyors and other professionals, which are standard (15%) rated for VAT if they are supplied direct to the owner, and, indeed, are still standard rated if supplied to the intermediate company. Normally speaking, though, the intermediate company can reclaim the 15% and still effectively invoice on the value of the services with zero per cent VAT, providing that these services are sufficiently integrated in the intermediate company's supplies for those supplies to count as "design and build". Again, if you play your cards right, you can wash out the VAT on professional fees just as you can the VAT on building materials.

If you are using an external building contractor, though, don't be fobbed off by an invoice with 15% added on to it. This is something of a "default" position for most builders, who feel, sensibly, that they can't be penalised by HMRC for charging too much VAT, only for charging too little. So to be on the "safe side" they tend to apply the full rate of VAT if in doubt.

The answer is to throw the book at the builder. The particular legislation to quote to him (and we find that builders usually cave in if faced with somebody who seems to know what they are talking about) is items 2 and 3 of Group 6, Schedule 8, Value Added Tax Act 1994.

Other Conversions of Residential Buildings

Here your choice is generally between 15% and 5%. A number of different types of conversion qualify for 5% VAT, but the most commonly found is the rather inelegantly named “changed number of dwellings conversion”.

As the name implies, this particular rule is designed as an incentive to property owners to respond to the needs of the property market by either increasing the numbers of dwellings in a property (e.g. by converting a house to flats) or by doing the opposite. But again, if you are particularly keen on paying tax, you can foul things up and pay 15% if you want!

Obviously, the first way you can do this is by doing works which result in the same number of dwellings afterwards as before.

If you want 5% tax to apply, on the other hand, make sure the plans involve altering the number of flats. If there is a clearly identifiable separate part or number of parts of the property, the requirement for the number of dwellings to be different after the work applies to each separate part.

Bear in mind, also, that the minimum number of dwellings in the converted property is one. So conversion of a number of flats into a single house qualifies, but conversion of a house into a commercial building, for example, doesn't.

Rule 1, then, is to make sure that your conversion qualifies under the detailed rules as a “changed number of dwellings conversion”.

Rule 2 is similar to the principle we have talked about above in connection with listed buildings. That is, if you as the property owner are also the one doing the work, there is nothing for the 5% rate to “bite on”. As before, the builder's merchant will charge you 15% on the materials you buy. He can do nothing else. Similarly, any professionals will have to charge 15% VAT on their fees.

The answer, as before, is to have a contracting entity in between the owner and the supplier of these materials and professional services.

If you use a third party contracting company, again be prepared to “throw the book at him” if he insists on charging 15% VAT for a job that qualifies for the 5% rate. Here the statutory reference you will be flinging around his ears is Group 6 of Schedule 7A, VAT Act 1994.

Conversion of Non-Residential to Residential

Here the choice is, properly speaking, between 5% and 0%, but you can still pay 15% if you really try.

The conversion of old commercial premises into flats or a house should almost always qualify as a “changed number of dwellings conversion”, so your base line should be the 5% rate that we’ve just talked about above. But again, if you do the work yourself you will end up paying 15% on your materials and professional fees.

Let’s say we’ve got over that particular hurdle, though in the way suggested, by interposing a contracting entity, or alternatively that we never had the problem because we are using a third party contractor in any event, who knows the VAT rules well enough to charge you 5% on his invoices.

You would still rather that that 5% were 0%, wouldn’t you?

The way you bring about this desirable result depends on whether you are doing the conversion for yourself or your family to live in the resulting dwellings, or whether you are doing the conversion by way of “business”.

If it’s for yourself or your family, you are likely to qualify as a “DIY builder”, and you can use the special scheme pack (available from HMRC VAT Offices) whereby the VAT on materials and services can be claimed back. Be aware that this applies not just to your own home but the home, say, of a dependant relative that you are converting for them. It just has to be non business.

If, however, you are converting the property so that you can let or sell the resultant dwellings, then this constitutes a “business” from the VAT point of view, and there’s one way you can end up unable to reclaim the 15% or 5% VAT element of your conversion cost.

This is if you let out the resultant dwelling or dwellings as residential accommodation (not holiday accommodation). Such lettings are VAT exempt, which means that input VAT attributable, including all of the VAT on your conversion costs, is blocked from reclaim.

So you need to bring about some kind of “supply” of the finished dwellings so that this supply can be zero rated. A zero rated supply of the property

can wash out the input VAT you have suffered in a similar way to the use of an intermediate company in our other two situations.

If commercially you really don't want to sell the property, but want to hold on to it for rent for the foreseeable future, try engineering a supply from the current owner to a connected person, such as a company or LLP that they control.

The downside to making such a sale is normally that it crystallises the direct tax on any inherent "development profit" resulting from the conversion, in most cases.

In most cases, but not all. If your supply, for example, is the introduction of the property into an LLP, judicious arrangement of the LLP profit sharing entitlements between the LLP members can very often avoid any charge to direct tax occurring, whilst at the same time bringing about the necessary "supply" for VAT purposes.

But, as they say, that's a whole other story!

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