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Investing in UK Property - VAT Considerations

Summary

One of the consequences of the fall in the value of sterling since the BREXIT referendum is that the UK is arguably a more attractive location for overseas investors. These past months have seen a rise in overseas investors purchasing UK property, particularly residential property.

Overseas investment in existing residential property may see properties subsequently rented out, or retained for use as a primary or secondary home. Some investors will develop brand new dwellings for onward sale or letting or will convert commercial buildings into new dwellings which will be sold or let.

The VAT legislation in relation to acquisition and supplies of property is complex. We have sought to address the most common general questions that arise in connection with residential property.

Purchase of Residential Property

The purchase of a residential property will not be subject to VAT as the transaction will either be exempt from VAT or will be subject to VAT at the zero rate. The first time sale of a new dwelling is subject to VAT at the zero rate and subsequent sales are exempt from VAT.

Although no VAT is charged on the purchase of a dwelling, all associated professional fees such as legal fees or surveyors will be subject to UK VAT when incurred in connection with a UK property.

There is a very important distinction between VAT zero rated and exempt supplies. VAT paid on costs incurred in making an exempt supply cannot be recovered, whereas VAT incurred on costs in making a zero rated supply can be recovered (subject to the normal VAT & business rules).

Sale or Letting

The first time sale of a new residential property is zero rated. This allows for recovery of VAT incurred on cost in connection with making the zero rated sale. Thereafter all subsequent sales are exempt from VAT.

Rental income received from a residential property is exempt from VAT. Any VAT incurred on associated costs such as property agents fees will be irrecoverable.

There are different rules for short term (less than 30 days) lets and income received from short term or “holiday” lets is subject to VAT at the standard rate of 20%.

A business making a zero rated sale of a value in excess of the VAT registration limit currently £83,00 is required to register for VAT. A business which makes only exempt supplies is not allowed to register for VAT.

Purchase of commercial property for conversion to Residential

The purchase of a commercial building can be either exempt from VAT or subject to VAT at the standard rate. This depends upon whether or not the vendor has opted to make the property subject to VAT (known as Option to Tax). However, when a purchaser makes it known to a vendor that the intention is to convert the commercial building into dwellings then the sale of the property can revert to being exempt from VAT.

Any works carried out on the property whilst it remains a commercial building (eg repair & maintenance or the like) will be subject to VAT at the standard rate.

The conversion works carried out to convert the works to dwellings should qualify for the reduced rate of VAT of 5%.

The onward sale of the new dwellings would be zero rated. This would allow for recovery of VAT incurred on associated costs. Should a decision be taken to let the completed dwellings then this would be an exempt supply and associated VAT incurred on costs would ordinarily be irrecoverable. We would recommend that advice is sought with regard to option that can be taken to minimize this loss of VAT recovery.

Properties Comprising both Residential & Commercial areas

This is a highly complex area and there are special VAT rules that apply to mixed use developments. VAT advice should be sought at the outset before a mixed use property is purchased as advice will be required on both the purchase and onward supplies.

Post BREXIT -will these VAT rules change ?

The fact that an independent UK will no longer have to comply with EU VAT law means that the UK will have more flexibility to set its own VAT rates. This will include the right to revise the scope of the VAT zero rating and exemptions applicable to supplies of residential property and to review the Option To Tax legislation applying to commercial property.

As negotiations for the UK's exit from the EU are in the early stages , it is not anticipated that the UK government will issue any guidance regarding VAT for quite some time.

Businesses should continue to follow the current UK VAT rules based on the UK and EU legislation until such time as HMRC advise otherwise.