In a nutshell

Struggling with the VAT rules on land and buildings? KAREN BULLEN summarises the rules for students and the rest of us.

The subject of the VAT liability on land and buildings is something that many students find difficult, but it is also a topic that can bring high marks in exams if the basics are understood. It regularly features in part II of the ATT Paper 6, where it can be worth up to 20 marks. Further, in CTA Awareness Module A there could be a five-mark question on the VAT implications of different types of real property supplies.

There is not scope here to address *all* aspects of land and buildings, so I will focus on the VAT treatment of supplies of dwellings and commercial properties, which are topical in the exam. Note that the word 'supplies' includes an outright sale or the grant of a lease in relation to the property.

Back to basics

First, we must go back to some basics. The outright sale of a building or the grant of a lease on one can be a zero-rated, standard-rated or an exempt supply. The VAT treatment depends on the type of building and the type of supply:

- On the type of building, we must determine whether it is a commercial property or a dwelling.
- On the type of supply, we must distinguish between a sale of the freehold or the grant of a lease.

At the risk of getting ahead of ourselves, the advantages and disadvantages of the respective VAT treatments can be seen in ***Type and Treatment***.

The ***Property Supply Summary*** diagram shows the type of supply that could apply for the sale or lease of dwellings and commercial properties.

KEY POINTS

- This article is relevant for ATT Paper 6 and CTA Awareness, Module A.
- Mastering a few key points can make it easier to understand VAT on land and buildings.
- Outright sale or lease of a building can be zero-rated, standard-rated or exempt.
- The VAT treatment depends on the type of building and the type of supply.

© iStock.com/Massimo Merlini

The VAT rates and exemption

From the ***Property Supply Summary*** diagram, we can see that the supply of a dwelling is zero-rated or exempt and the supply of a commercial property can be exempt or standard-rated.

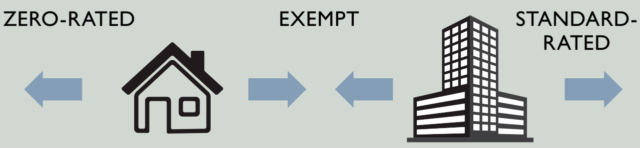
This tells us that the supply of a dwelling can never be standard-rated and the supply of a commercial property can never be zero-rated. I like to think of this as logical as far as government policy is concerned. If the supply of a dwelling was standard-rated, the price of homes would rocket and housing would become even more unaffordable.

If we extend this logic, we need new affordable housing in the UK. The way to do this is to zero-rate the supply of newly built homes – or homes converted from old commercial premises – so that no VAT is charged to the person buying the home and the builder can recover any VAT he suffers because he is still making a taxable supply – albeit taxable at the zero rate. Note here that an outright sale and a lease for more than 21 years both count as a zero-rated supply Conversely, and continuing our logic argument, 'old' homes do not create any new affordable housing, so these are exempt supplies.

TYPE AND TREATMENT

Type of supply	VAT treatment
Zero-rated taxable supply 0% Standard-rated taxable supply 20%	Charge appropriate rate of output VAT and recover input tax on purchases used to make taxable supplies.
Exempt supply	No output VAT charged and no input VAT recovery on purchases made to make exempt supplies.

PROPERTY SUPPLY SUMMARY



In relation to commercial properties, only new outright sales are standard-rated. Everything else is exempt. This means that, as soon as the word 'lease' is seen in relation to a commercial property, it *must* be an exempt supply. Remember this phrase in relation to commercial properties: 'leasES' – where 'ES' stands for exempt supply. As an aside, 'new' for these purposes means less than three years old and the 'more than 21 years' lease rule for dwellings does not apply here.

To summarise:

- *Zero-rated*. Sales of new dwellings (either newly built or converted from commercial premises).
- *Standard-rated*. New commercial outright sales.
- *Exempt*. Everything else – such as leases of commercial premises/sales of old dwellings.

So, if three scenarios are learned, this should supply the basic knowledge to start answering questions.

Try out this knowledge in ***Test 1***, by putting a cross in the box (or boxes) to indicate whether the supply will be standard-rated, zero-rated or exempt. The answers can be found on page 26.

The option to tax

Whenever we see an exempt supply in relation to commercial premises, there is one further rule to learn: the supplier can 'opt to tax' the premises. This means that, instead of the supply being exempt it becomes standard-rated. The option is made on a building-by-building basis and applies to all future supplies made with that building. Note that bare land can have an option to tax on it too.

The benefit of making the option is to enable VAT suffered on it to be recovered, as illustrated by ***Leslie***.

Readers can test their knowledge of VAT rates and the option to tax on property with ***Test 2***. Again, check the boxes that will or could apply. The answers are on page 26.

LESLIE

Leslie leases out several office blocks and these are all exempt supplies to tenants (remember commercial 'leasES'). One office block will soon need a total refurbishment and this will cost £1m plus £200,000 VAT. This input VAT will be irrecoverable because the lease is an exempt supply in relation to the building. Leslie therefore opts to tax the building. From now on standard rated taxable supplies are made in relation to that building. This means that 20% output VAT must be added to the rent charged to tenants and, when the building is sold in the future, VAT must be charged on the sale price. However, Leslie can now recover the input tax of £200,000 on the refurbishment because it will now relate to a taxable supply.

Summary

As mentioned at the start of this article, we are only covering the basics on land and buildings, but by keeping in mind the simple rules outlined it should be possible to tackle questions in this area with more confidence.

Good luck with studies and property-owning clients.

Karen Bullen FCA, ATT, CTA is a senior tutor with Tolley Exam Training and is head of their Manchester Centre.

TESTS

Test 1

		Standard -rated	Zero -rated	Exempt
1	The sale of the freehold of a two-year-old office block			
2	The grant of a 99-year lease in a brand new factory.			
3	The sale of the freehold of a five-year-old factory.			
4	A farmer rents out a plot of land to another farmer.			

Test 2

		Standard -rated	Zero -rated	Exempt	Option to tax
1	Freehold sale of two-year old factory				
2	Grant of a 21-year lease in a brand-new office block				
3	A farmer rents out a plot of land to another farmer				
4	A landlord leases out two floors of a building to an insurance company tenant				