

Short Term Gain, Vat Pain

Many House Builders are currently letting their properties on short term leases as they cannot find a buyer for the property. Whilst this gives income in the short term it can mean that a higher cost is incurred in the longer term as the ability to recover VAT on costs could be lost.

A builder or developer who constructs a dwelling or converts a building from non residential use to residential use can usually treat the sale of the freehold of that dwelling or the grant of a lease (for more than 21 years) as a zero-rated supply. This is desirable as the house builder can then recover the VAT that it has incurred, for example on its construction costs, on the costs relating to the sale of the property.

Current market conditions may make it difficult for a house builder to sell its stock and, consequently, they may be tempted to reduce their losses by letting their properties until the market recovers. If, however, a house builder grants a tenancy of a dwelling, say on a six-month assured short hold tenancy, rather than selling it, this will make a radical difference to the builder's ability to recover input VAT.

A lease or tenancy for a term of 21 years or less is an exempt supply. Input VAT is not normally reclaimable on expenditure attributable to exempt business activities and the ability to elect to waive the VAT exemption does not apply to residential property. Accordingly, if a house builder makes short term lettings of unsold dwellings, it will be unable to fully recover its input VAT.

A house builder may also find itself having to pay a claw back charge to HMRC if it has previously reclaimed input tax on its VAT returns in respect of periods preceding the temporary letting of the property.

For more information please contact:

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