UK VAT Indirect Tax Conference
Real Estate breakout

VAT and real estate

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Agenda

- Understanding the lifecycle of a property for an owner-occupier
- Capital goods scheme.
- Disapplication of the option to tax.
- Place of supply of land related supplies.

VAT and real estate
Supplies of land and the option to tax

- Convert exempt supply to taxable supply but option can be disapplied:
  - Generally for supplies of residential or charitable properties.
  - Anti-avoidance – “developers” of exempt land.

- Get credit for VAT incurred but have to charge VAT.

- Opt to tax land and/or buildings.
  - Physical property not the legal interest, e.g. opt to tax a building and it impacts all of your interests in that building.

Option to tax

- There are two ways to make an option to tax:
  - Property by property basis
  - Real estate election
- Property by property – two stage process
  - Decision to elect, e.g. Board Minute, issue invoice plus VAT
  - Notification of election to HMRC with 30 days of decision
- Permission to opt to tax
  - Automatic if no exempt supplies
  - If exempt supplies, HMRC's permission may be required
- Real Estate Election
  - Opt over all property interests held at that time plus all future properties
  - Can revoke future property options with 30 days of acquiring interest

VAT and real estate
Supplies of land and the option to tax

- Personal – anybody can opt any land/building.
- Effectively binds other members of a VAT group registration.
- Irrecoverable for 20 years.
- Can be revoked within 6 months under certain circumstances (cooling off period).
- Unilateral act – decide to opt and then notify HMRC (in writing).
  - HMRC acknowledge receipt.
  - May need HMRC's permission if you have already made exempt supplies.

Corporate Occupiers

Lifecycle of a property

1. Acquisition – Freehold or Lease
2. Lease inducements including reverse premiums, rent frees, contributions to fit out
3. Surrenders, Assignments and exits from leases
4. Dilapidations
5. Sale of Freehold

Acquiring Freehold

- Is the property new?
- Has the current owner opted to tax?
- Is the property partly let? Will the tenant remain?
- Is the property in the CGS?
- If relevant will the option to tax be disapplied?
- How will the building be used by the Purchaser?

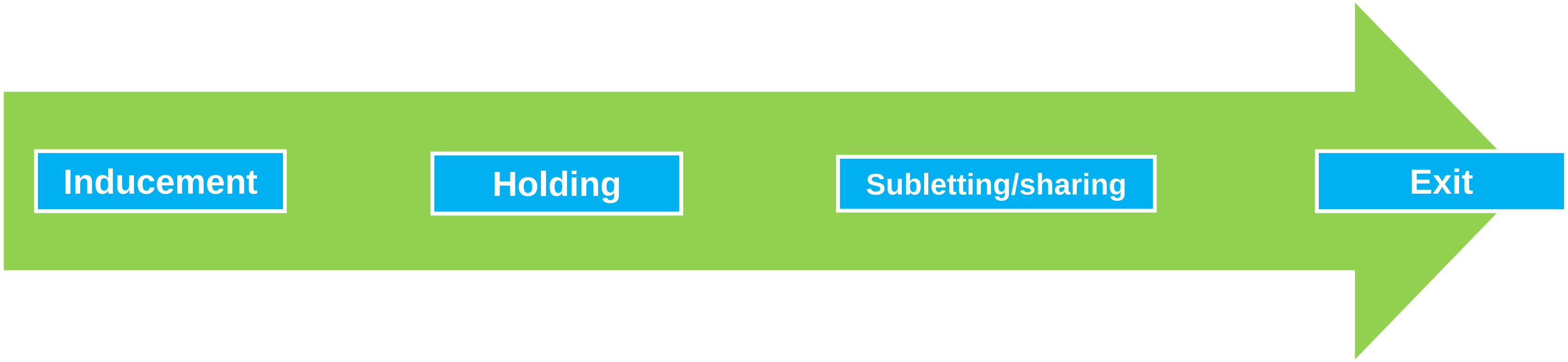
Acquiring Valuable Leasehold

- Has the current owner opted to tax?
- Is the property in the CGS?
- If relevant will the option to tax be disapplied? Issue for Lessor but could impact rent charges.
- How will the building be used by the Purchaser?
- Will there be an inducement to enter into the lease?

Property occupiers

Landlord and tenant relationship

- Several key stages in a landlord and tenant relationship.



- VAT issues and opportunities are prevalent in each of these stages – getting it wrong can be costly.

1. Lease inducements

- Three common situations
  - Non-specific reverse premiums (also contribution to non-qualifying fit-out)
  - Rent free periods/Rent rebates
  - Contributions to qualifying fit-out

Reverse premium (general)

VAT – Depends!

1. Lease inducements

Rent free period

Landlord

Rent free worth £100

Tenant

No VAT issues

Contributions to fit out (qualifying for capital allowances)

Landlord

Cash of £100 towards fit-out

Tenant

VAT – depends!

1.Lease Inducements - VAT

- No VAT consequences if tenant provides nothing in return for inducement.

- The tenant may have to account for VAT on the inducement if it does something in return, e.g.:

  - *carries out building works / fit out refurbishment works.*
  - *acts as an “anchor tenant”.*

- Important to know in advance if amounts are agreed VAT inclusive. If VAT becomes chargeable could reduce benefit of inducement by 20%

Property occupiers
Holding

- Rent and service charges
  - Should the landlord charge VAT on rent and service charges?
- Nominee companies
  - A nominee entity may hold the legal title to the lease on behalf of the tenant e.g. general partnerships.
- VAT consequences
  - The tenant may not be able to recover VAT charged on rent by the landlord.
  - Tribunal case – Hawes & Curtis.

2. Sharing & Subletting

- Does the tenant charge VAT to the sub-tenant?
  - *If the tenant has not opted to tax, no VAT is charged (exempt supply).*
  - *If the tenant has opted to tax, VAT should be charged to the sub tenant (taxable supply).*

- Risk – if the tenant has not made an option to tax, VAT charged by the head landlord to the tenant will be irrecoverable or if CGS item then potential change to the original use percentage.

- In the tenant's best interest to opt to tax the property to ensure full VAT recovery on all the expenses it incurs in the course of its business.

Property occupiers
Sharing and subletting

- Sharing
  - Tenants typically share their offices with group companies.
  - Tenant might charge a fee for the sharing arrangements.
- VAT consequences
  - Does the tenant need to charge, and account to HMRC for, VAT?
    - *If the sharer occupies a defined area?*
    - *If the sharer does not occupy a defined area and merely shares facilities?*
    - *VAT groups?*

Property occupiers
Exit

- Types of exit:
  - Surrender lease to landlord.
  - Assign lease to a new tenant.
  - Sale of property if owner

Property occupiers
Exit

Surrender of lease - VAT consequences

- Landlord pays tenant:
  - Should the tenant charge VAT?
  - Should tenant opt to tax?
- Assignment of lease
  - Tenant pays someone to take over an onerous lease (inducement).
- VAT consequences
  - Should the prospective tenant charge VAT on the inducement?
  - If so then is can the tenant recover the VAT?

Property occupiers
Exit

- Contrast VAT treatment
  - Tenant pays landlord to take lease – supply of land, exempt subject to landlord's option to tax.
  - Tenant pays third party to take lease – supply of services, taxable.

3. Lease surrenders

Tenant paying landlord to surrender

Landlord

Surrender payment of £100

Tenant

VAT – same VAT treatment as rent payments

Tenant paying landlord to vary lease terms

Landlord

Variation payment of £100

Tenant

VAT – same VAT treatment as rent payments

3. Lease assignment

Existing tenant assigning lease to new tenant

VATable transaction irrespective of Option to Tax

4. Dilapidations

Tenant paying landlord in lieu of dilapidations

VAT

- Dilapidations are a compensation payment for damages and are outside the scope of VAT.
- Issues for tenant if Landlord has not opted as cost of dilapidations could be 20% higher

5. Sale of Freehold

- New, old or opted to tax?
- CGS implications?
- Will sale be a TOGC if part sub-let?
- Are they acquiring a new property?

Capital Goods Scheme

Capital Goods Scheme
What is it?

- Recognises that items of capital expenditure can be used by businesses over a number of years and that the taxable/exempt use may vary.

- Provides a mechanism to adjust the initial input tax recovery to reflect this change in use.

- What is capital expenditure?
  - HMRC normally accept the accounting treatment of the business
  - If treated as a cost in arriving at the profit/loss – not capital expenditure.

The Capital Goods Scheme

- Qualifying assets
  - Land and buildings, civil engineering works & refurbishments > £250k
  - Computer equipment, aircraft, ships, boats or vessels > £50k
- Adjustment period
- Land and buildings, civil engineering works & refurbishments - 10 years
- Computer equipment – 5 years

- Method of calculation:

$$\frac{\text{Total input tax on capital item}}{\text{Adjustment period}} \times \text{ the adjustment \%}$$

Where adjustment % is the difference between initial ‘use’ and the interval in question

Disapplication of the option to tax

Option to Tax
Anti-avoidance

- Specific “anti-avoidance” measures

- Option to tax disapplied where:

  a) Where there is a **“grant”** by a person (“the grantor”) who was a developer of the land; and

  b) The **“exempt land test”** is met

Option to Tax – Disapplication

How does this work in practice?

Four things need to happen:

1. A "**grant**" of an interest in land/buildings arises;
2. The grant must be made by a "**developer**" of the land/buildings – the land/building must be a CGS item or expectation that it will be;
3. The land is occupied by a "**relevant person**" i.e. the grantor, development financier or someone connected to either of these; and
4. That occupation is not '**wholly**' or '**substantially wholly**' for 'eligible purposes'

REMEMBER - THE ABOVE TERMS DO NOT HAVE THEIR USUAL MEANING BUT ARE DEFINED WITHIN THE LEGISLATION

Option to Tax – Disapplication
Definitions

- A **grant** made by any person ("the grantor") is made by a developer if the land/building is (or will be) a capital item in the hands of the grantor
- Exempt land test is met if at the time the grant was made the "**relevant person**" intended or expected the land would be "**exempt land**"
- Relevant person means "**the grantor**" or a "**development financier**", or a person connected with the grantor or a development financier

Option to Tax – Disapplication
Definitions

- **Development financier** is someone who has:
  - provided finance for the developer's capital item; or
  - has entered into an arrangement for the provision of finance for the developer's capital item
- **Finance** includes both the direct or indirect provision of funds:
  - Providing/procuring funds
  - Making of a loan
  - Provision of guarantee of security in relation to a loan
  - Consideration for a share issue or issue of other securities for the raising of funds
  - Provision of consideration for the purchase of shares/securities issued by someone else for the raising of those funds
  - Any other transfer of assets or value the consideration for which is made available

Option to Tax – Disapplication
Definitions

- Land is **exempt land** if:
  - A relevant person is in occupation of the land; and
  - that occupation is not **wholly**, or **substantially wholly**, for **eligible purposes**

- **Occupation** – defined by additional conditions
  - Essentially "de-minimis" limits referable to whether the occupation is in respect of land and/or a relevant building and the relationship between the grantor, development financier and the occupier

Option to Tax – Disapplication

Definitions

- Occupation for **eligible purposes** means by a taxable person for the purpose of making supplies:
  - in the course or furtherance of business; and
  - which have associated VAT credit

- **Wholly** is defined as 100% and **substantially wholly** is defined at least 80% - HMRC Public Notice 742A

Option to Tax – Disapplication
Summary - How does this work in practice?

- Four things need to happen:

1. A “**grant**” of an interest in land/buildings arises;
2. The grant must be made by a “**developer**” of the land/buildings – the land/building must be a CGS item or expectation that it will be;
3. The land is occupied by a “**relevant person**” i.e. the grantor, development financier or someone connected to either of these; and
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REMEMBER - THE ABOVE TERMS DO NOT HAVE THEIR USUAL MEANING BUT ARE DEFINED WITHIN THE LEGISLATION

Anti-avoidance
Further issues

- Under basic anti-avoidance one of the main conditions is that there must be grant of an “interest”

- What happens if there is no new grant? Can the option be disapplied in any circumstances?

Yes!

Land related services – place of supply

Basic rules

- B2B supplies - Place of supply where recipient located
- B2C supplies - Place of supply where the supplier belongs

Above only applies to **services**

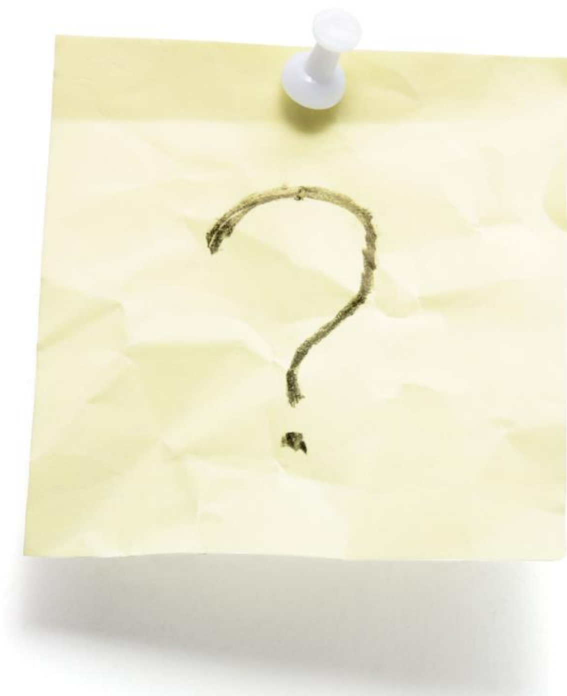
Exception
Land related services

- Land – supplied where land is situated irrespective of where you or your customer belongs.
- Examples of land-related services:
  - The provision of hotel accommodation or similar;
  - Services of experts and estate agents;
  - The granting of rights to use immoveable property.
- Examples of services which are not land-related
  - Secondment of staff to a building site, which is a supply of staff.
  - Advice or information relating to land prices or property markets
  - Services of an accountant in calculating a tax return from figures provided by a client, even where those figures relate to rental income.

Exception
Land related services

- Reverse charge applicable on UK land-related services, where the recipient:
  - Is registered for UK VAT;
  - “belongs” in the UK; and
  - services are supplied by an overseas entity.

Questions?



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