CHAPTER 23

LAND AND BUILDINGS – ZERO AND REDUCED-RATING

This chapter looks at land and buildings which fall under the category of zero-rated and reduced-rated supplies.

23.1 Construction of Buildings

Onward supply

VATA 1994, Sch 8, Group 5, Item 1a

Zero rated onward supply

AND

Type of supply

First Grant of a Major Interest
(s.96)

Dwellings
(Note 2)

Relevant Residential
(Note 4)

Relevant Charitable
(Note 6)

Type of Building

Freehold

or

Lease > 21 years

A “major interest” is a freehold or a lease exceeding 21 years. VATA 1994, s.96

A “relevant residential” purpose includes a: VATA 1994, Sch 8, Group 5, Note 4

• home or institution providing residential accommodation for children, or personal care for the elderly or disabled; hospice; or

• residential accommodation for students; or

• monastery, a nunnery or similar establishment. VATA 1994, Sch 8, Group 5, Note 6

A “relevant charitable” purpose is for use by the charity but not in the course or furtherance of their business, or for use of a village hall.
Also covered by the zero-rating legislation is the first grant of a major interest by a person converting a non-residential building into a building designed as a dwelling or intended for use for a relevant residential purpose. This might be where someone is converting a warehouse building into flats. When the flats are sold they will be zero-rated. VATA 1994 Sch 8, Group 5, Item 1b

Also extends to buildings converted to relevant residential.

Group 5 of Schedule 8 covers two more principal supplies; both relating to the costs of construction.

The first of these supplies is the supply in the course of a qualifying construction of services related to the construction. For example, a plasterer has a contract to plaster many of the new houses on a building site. The plasterer would be supplying services related to the construction of a new house and those services could be zero-rated. VATA 1994, Sch 8, Group 5, Item 2

However, zero-rating does not apply to the services of an architect, surveyor, consultant or any person acting in a supervisory capacity. These costs will be standard-rated.

Secondly, if that sub-contractor, as well as providing services, also supplies some building materials - for example, he brings his own plaster or he supplies his own bricks - the supply of those building materials can be zero-rated as well. VATA 1994, Sch 8, Group 5, Item 4

Building materials supplied on their own will always be standard-rated. It is only when they are supplied with a qualifying service that they become zero-rated.

Summary

Developer Co is constructing a new house which it intends to sell.
The following additional provisions apply where all or part of a building is intended for use solely for a relevant residential or relevant charitable purpose:

- No supply of services relating to a building (or part of it) can be taken as relating to a building unless it is made to a person who intends to use the building (or part) for such a purpose. The effect of this is that, although the main contractor can zero rate the construction of such a building, a subcontractor must standard rate all supplies to the main contractor on such building projects. These “to the user” provisions do not apply when building dwellings. VATA 1994, Sch 8, Group 5, Note (12a)

- Where all or part of a building is intended for use for a relevant residential or charitable purpose, a supplier of services cannot zero rate the supply until the customer has given him a certificate to that effect. VATA 1994, Sch 8, Group 5, Note (12b)

Where part of a building qualifies for zero-rating and part does not (e.g. shop premises with a flat over them), a supply relating only to the part within these provisions is to be treated as relating to a zero-rated building. Similarly, a supply relating only to the part outside those provisions is not zero-rated. VATA 1994, Sch 8, Group 5, Note (10)

In the case of any other supply, an apportionment must be made to determine the extent to which zero-rating applies.

Building work that relates to the fabric of the building affecting both qualifying and non-qualifying parts of the building must be apportioned, such as work to:

- roofs;
- foundations;
- lifts; and
- building services that supply the whole building (e.g. wiring and plumbing).

Summary

Building Co has been contracted to build a new nursing home on land owned by the Nursing Home Group

The bricklayer and carpenter are excluded from zero-rating as they are not providing their services direct to the nursing home group (Note 12a). The certificate is only effective for Building Co.
Building Co is providing zero-rated construction services and as such will be able to recover input tax on the build.

23.2 Deduction of Input Tax

Where a taxable person constructing a building for the purpose of granting a major interest in the building, incorporates goods other than building materials in any part of the building, input tax on the supply is excluded from credit. SI 1992/3222, Art 6

Input tax on related services of installing the goods can be reclaimed, provided the services are separately identified and VAT is correctly charged by the person supplying them.

Input tax can be recovered on goods which are not incorporated into the building or its site (e.g. free-standing items). A separate supply takes place when these goods are sold with the building on which output tax must be accounted for at the normal rate.

Where input tax has been blocked on goods incorporated in a building, any separate onward supply of those goods is an exempt supply. This includes items incorporated in showhouses where these sales are not treated as part of the supply of the building.

Example 1

Consider the following four supplies and decide whether they are zero-rated or not. Cross as appropriate.

1. Sale of 99 year lease in Flat 3 of a 6 flat conversion of an old warehouse in Salford by the builder Splendid Homes Ltd. ☐

2. Sale of freehold in Flat 2 in above development by Mr Smith who purchased it 3 months ago but never moved in due to job relocation. ☐

3. Supply of plumbing services to Splendid Homes Ltd by Johnny Plumb who fitted central heating into Flat 3. ☐

4. Supply of architect services to Splendid Homes Ltd in respect of the above development. ☐

23.3 Protected Buildings

Some protected buildings also fall into the zero-rated category as outlined in Group 6 of Schedule 8. A protected building is a building designed to remain as or become a dwelling or a number of dwellings or is intended for use solely for a relevant residential purpose or a relevant charitable purpose. That is the first condition.

The second condition is that the building is either a listed building or a scheduled monument.

A relevant residential purpose includes a children’s home, hospice, accommodation for students, nunnery, monastery etc., all those examples we
looked at before. A relevant charitable purpose again is for use by a charity but not in respect of its business activities. It is exactly the same definition as we had for construction of buildings.

**Onward Supply (Item 1)**

The first item that is zero-rated is the first grant by a person substantially reconstructing a protected building, of a major interest in, or in any part of, the building or its site. **VATA 1994, Sch 8, Group 6, Item 1**

Again a first grant and again a major interest - very similar to the construction of buildings group. For a person who is substantially reconstructing a protected building when they make the first grant of a major interest in that building, that first grant is a zero-rated supply.

Note 4 to Schedule 8, Group 6 states that a protected building is not to be regarded as substantially reconstructed unless one or both of the following conditions are fulfilled when the reconstruction is completed:

1. At least 3/5ths of the cost of the reconstruction work would, if supplied by a taxable person, qualify for zero-rating as the supply of services (and materials) in the course of an approved alteration, and/or
2. The reconstructed building incorporates no more of the original building than the external walls together with other external features of architectural or historic interest.

**From 1 October 2012** the 3/5ths rule will no longer apply when considering whether a property has been substantially reconstructed.

There are however transitional provisions whereby the 3/5ths rule is retained until 30 September 2015. These transitional provisions depend on the status of the project on 20 March 2012. Generally if the contract was in place or planning consent applied for or where at least 10% of the work was completed at that date then the transitional rules should apply.

**Approved Alterations (Items 2 and 3)**

The second item that is zero-rated is the supply in the course of an approved alteration of a protected building of any services other than the services of an architect, surveyor or any person acting as a consultant or in a supervisory capacity. This allows zero-rating of the services of sub-contractors. An approved alteration in the case of protected buildings is work for which there is planning permission and does not include work on repair or maintenance or any incidental alteration to the fabric of the building (Note 6). **VATA 1994, Sch 8, Group 6, Items 2&3**

Zero rating will also extend to the supply of building materials to a person to whom the supplier is also supplying services within item 2 which include the incorporation of the materials into the building in question.

Items 2 and 3 are removed from zero rating **from 1 October 2012**.

There are however transitional provisions which allow zero rating on approved alterations to continue until 30 September 2015 where a written contract was entered into prior to 21 March 2012 or where planning consent was applied for before the 21 March 2012.
There are also anti-forestalling rules to ensure that where the transitional rules are not in point any work performed on or after 1 October 2012 will be charged at the appropriate reduced or standard rate. Schedule 27 to FA 2012 provides the anti-forestalling provisions.

23.4 **Reduced Rated Supplies**

**Residential Conversions**

VAT is charged at the reduced rate of 5% on qualifying services supplied in the course of certain residential conversions. The VAT liability of conversion work is summarised in the following table. *VATA 1994, Sch 7A, Group 6, Item 1*

<table>
<thead>
<tr>
<th>Before conversion</th>
<th>After conversion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single household dwelling(s)</td>
<td>Single household dwelling(s)</td>
</tr>
<tr>
<td>Standard-rated (unless the number of dwellings changes)</td>
<td>Reduced-rated</td>
</tr>
<tr>
<td>Reduced-rated</td>
<td>Reduced-rated</td>
</tr>
<tr>
<td>Reduced-rated</td>
<td>Reduced-rated</td>
</tr>
<tr>
<td>Reduced-rated</td>
<td>Reduced-rated</td>
</tr>
<tr>
<td>Any building not listed above</td>
<td>Reduced-rated</td>
</tr>
</tbody>
</table>

**Building materials** are also subject to the 5% rate when supplied with a qualifying service. *VATA 1994, Sch 7A, Group 6, Item 2*

**Summary**

Developer Co buys an old warehouse and converts the property to flats.

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SALE OF FLATS
↑ ZR
↑ Sch 8
↑ Group 5
↑ Item 1B
CARPENTER 5% (Services & Materials)
→
WAREHOUSE CONVERTED TO FLATS SR ARCHITECT
↑ SR
Sch 7A
Group 6
MATERIALS
```

Developer Co can recover VAT incurred on the conversion due to the direct and immediate link to a taxable sale.
If the flats were let on six month tenancies rather than being sold, the rental income would be exempt and input tax would not be recoverable.

**Residential Renovations and Alterations**

The supply of qualifying services in renovation or alteration of a single household dwelling that has not been lived in for two years or more are subject to VAT at the reduced rate of 5%. *VATA 1994, Sch 7A, Group 7, Item 1*

The reduced rate is extended to qualifying services in the renovation or alteration of a building to be used solely for a relevant residential purpose (e.g. a care home) or a multiple occupancy dwelling (e.g. bed-sits), provided the premises have not been lived in for at least two years. *VATA 1994, Sch 7A, Group 7*

Building materials are also charged at the 5% rate when supplied with a qualifying service. *VATA 1994, Sch 7A, Group 7, Item 2*

**Summary**

Investor buys a house that has been empty for four years. The property is renovated and then let.

Exempt Sch 9
Grp 1
LET
↑

![Diagram](EMPTY HOUSE)

5% ↑ Sch 7A
Group 7
CARPENTER (Services & Materials)

Any VAT incurred on the renovation is irrecoverable due to the exempt let.

**23.5 D-I-Y Housebuilders**

A special VAT Refund Scheme puts D-I-Y builders and converters in a similar position to a developer selling them a zero-rated property, by refunding them the VAT on their main construction or conversion costs. *VATA 1994, s.35*

Under the scheme, HMRC must refund any VAT chargeable on the supply of any goods used in connection with construction or conversion work where the following conditions are satisfied:

a. The work must comprise:

   i. the construction of a building designed as a dwelling or number of dwellings;
ii. the construction of a building for use solely for a relevant residential purpose or for a relevant charitable purpose; or

iii. a “residential conversion” i.e. the conversion of a non-residential building into either a building designed as a dwelling or a building intended solely for a relevant residential purpose.

b. The work is carried out lawfully and otherwise than in the course of furtherance of any business.

c. The goods are building materials which are incorporated in the building in question or its site. Refunds can be claimed on the building materials which would be zero-rated when supplied with the zero-rated work but not on those which would be standard-rated.

d. The claim is made within such time and in such form and manner, contains such information, and is accompanied by such documents as HMRC require. SI 1995/2518, Reg. 201

Where a person carried out a residential conversion and arranges for the work to be done by someone else (‘a contractor’), then provided:

i. the condition in (b) above is satisfied, and

ii. the contractor is not acting as an architect, surveyor or consultant or in a supervisory capacity,

HMRC must, on a claim, refund any VAT chargeable on any services consisting of work done by the contractor.

The scheme can therefore be used to reclaim VAT on eligible goods used to construct a new qualifying dwelling, communal residential building or charity building, and on eligible goods and services used to convert a non-residential building into a qualifying dwelling or communal residential building.

The buildings must not be intended to be used for business purposes.

The completed claim form and supporting evidence must be sent to HMRC no later than three months after the completion of the construction or conversion.

HMRC accept that the scheme allows recovery on materials for holiday homes provided they are constructed for a non-business purpose.

Example 2

What is the VAT rate on the following building services:

• new dwelling work
• relevant residential and relevant charitable certificated work on a new build
• approved alterations to listed property
• repairs to listed property
• work on a qualifying conversion for a housing association
• work on a qualifying conversion
• work on a qualifying renovation
• new commercial work
• relevant residential and relevant charitable non-certificated work
• residential extensions.
ANSWERS

✓ Answer 1

1. Sale of 99 year lease in Flat 3 of a 6 flat conversion of an old warehouse in Salford by the builder Splendid Homes Limited. ✗

2. Sale of freehold in Flat 2 in above development by Mr Smith who purchased it 3 months ago but never moved in due to job relocation.

3. Supply of plumbing services to Splendid Homes Limited by Johnny Plumb who fitted central heating into Flat 3.

4. Supply of architect services to Splendid Homes Limited in respect of the above development.

The first supply was the sale of a 99 year lease; a 99 year lease is a major interest in flat 3 of a six flat conversion of an old warehouse in Salford by the builder Splendid Homes. The supply of a major interest in a brand new home by the builder is zero-rated.

Item number 2 is the sale of a freehold in flat 2 in the development by Mr Smith who purchased it three months ago and the flat has never been lived in. It is a supply of a major interest and it is in a brand new home but the supply is being made by Mr Smith and he is not the builder of that home and hence it is not a zero-rated supply. This is clearly not the first sale and to be zero-rated it must be the first grant of a major interest.

Number 3 is the supply of plumbing services to Splendid Homes Limited by Johnny Plumb, the sub-contractor. This is not covered by the zero-rated legislation, as it was incurred on a conversion rather than a new construction. Conversion costs are only zero-rated when supplied to a Relevant Housing Association [Item 3, Group 5, Schedule 8]. The services will be reduced-rated under Sch 7A Group 6.

In number 4 we have a supply of architect services to the builder. Architect services were one of those categories of sub-contractor whose services could not be zero-rated so this is not a zero-rated supply.
Answer 2

Liability of building services:

- new dwelling work is ZR (Sch 8, Group 5, Item 2)

- relevant residential and relevant charitable certificated work is ZR (Sch 8, Group 5, Item 2 and Note 12b)

- approved alterations to listed property are ZR if planning request submitted pre 21 March 2012 (Sch 8, Group 6, Item 2); S/R from 1 October 2012 otherwise.

- repairs to listed property are SR

- work on a qualifying conversion for a housing association is ZR (Sch 8, Group 5, Item 3)

- work on a qualifying conversion is 5% (Sch 7A Group 6)

- work on a qualifying renovation is 5% (Sch 7A, Group 7)

- new commercial work is SR

- relevant residential and relevant charitable non-certificated work is SR

- extensions are SR