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## VAT – adding to home builders' woes

The last ten years have been good for the house-building sector. High demand has been sustained by steady economic growth, cheap finance, and favourable demographic trends, while the Government has done its best to create a more benign planning regime. But the collapse of mortgage lending and the continuing downward spiral of house prices in recent months points to much tougher times ahead for the sector. In this article we examine some of the VAT implications to arise from current trading conditions

A subdued market, particularly in one and two bedroom flats, has left many developers with unsold properties. Falling prices and rising rental yields have tempted some to rent out unsold properties. While this can make good financial sense, it's important to recognise the VAT implications.

Income from short-term residential lettings is VAT exempt – not zero-rated like new house sales - and this means that input VAT relating to rented properties may be clawed back by HMRC. In practice, HMRC may ignore short periods of rentals – perhaps up to 6 months – as incidental to the main business activity of selling new houses. But with house prices likely to remain depressed for another 2 to 3 years, it is likely that developers will face a proportionate clawback of input tax relating to rented properties. This clawback could be very significant if the developer paid VAT on the purchase of the site itself. It should, however, still be possible to claim back a proportion of this VAT when the property is eventually sold where it is clear that this was always the intention of the developer.

House builders are increasingly falling back on incentives to help shift unsold properties. Part exchange is useful where a buyer has a property to sell. But when the developer sells on part-exchange properties the sale will be VAT exempt, and VAT incurred on the associated legal and estate agency fees will therefore not be recoverable. There may also be an impact on the recovery of VAT incurred on general business overheads because HMRC are unlikely to accept that such sales are incidental to the main house-building business.

Other incentives include offering to pay legal or estate agency fees. In such instances it is important to recognise that the developer will not be able to recover the VAT on legal or estate agency fees because it will not actually instruct the service providers concerned.

More cost-effective from a VAT point of view would be to pay for the installation of flooring, such as wood, laminate or ceramic tiles. This kind of incentive can be very effective in attracting first-time buyers who often will not have funds available for these extras. The developer may recover VAT on such works, which are regarded as part of the build, unlike items such as white goods, carpets, etc., which fall under the input tax blocking provisions.

Investing money in furniture for “staging” show homes may also help to sell properties, but developers should remember that where such furniture is sold on to buyers, VAT must be charged.

Major downward revaluations of unsold stock, work in progress or land may force developers to sell off land held for speculative purposes to avoid breaching banking covenants. House-builders should consider carefully the pros and cons of opting to tax this land and the potential impact of such sales on their input tax recovery position.

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