



## *VAT on property claims*

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### Introduction

The purpose of this short paper is to give an insight into VAT as it affects property claims. For the sake of brevity I have purposely not included those aspects outside the typical claim scenario.

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VAT will be a necessary consideration on many property claims. Whilst the rate has varied slightly over the years the current rate of 20% will apply to most work of a building nature with a few exceptions. The rules are set out in HMRC VAT Notice 708: Buildings and Construction<sup>1</sup>.

Not only will the loss potentially attract VAT at the prevailing rate but it will be a consideration in selecting the sum insured or the rebuilding cost of the property. Thus the claim or value at risk can be significantly increased where VAT incurred or a proportion thereof is not recoverable.

<sup>1</sup> HMRC VAT Notice 708: Buildings and Construction updated 23<sup>rd</sup> August 2016

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## The supplier of goods and services

It is incumbent upon the supplier of goods and services, usually the building contractor in this context, to raise VAT where it applies and failure to do so will render the supplying party liable to fines from HMRC. It is therefore possible that contractors may adopt a default position that VAT applies in all cases and charge it even in those situations where exemptions might be applicable. It is therefore necessary for the loss adjuster to be vigilant to those situations where an exemption applies. More on this later.

Currently, the supplier of services will be required to register for VAT purposes if their turnover is more than £83,000 in a 12 months period<sup>2</sup>. Typically this registration threshold increases slightly annually. There will be instances where work is carried out by small builders who will seek to remain within the VAT threshold to maximise their competitive advantage (when supplying services to those who cannot reclaim input VAT) and minimise paperwork. In these instances, whilst VAT will not appear on the invoice it does also mean that they will not be able to recover input VAT incurred on their materials used.

## Status of the policyholder

In the majority of commercial situations policyholders will be registered for VAT purposes and so the claim should not attract VAT. This is on the basis that the policyholder, whilst initially incurring VAT on their input costs, will then be able to recover that input VAT as part of their normal VAT return process. It follows that such policyholders will not normally need to include the VAT element within the sum insured calculation.

Whilst the VAT cannot be avoided where it is applicable it is also incumbent upon the policyholder to mitigate their loss and select the most efficient way of dealing with the potential liability. This means recovering VAT where this is possible. In some circumstances the policyholder may be restricted by a partial exemption, colleges and health authorities being frequent examples. The basic premise for input VAT to be recovered, is that VAT is charged on outputs, which are generated using the input on which VAT is sought to be recovered.

<sup>2</sup> HMRC VAT Registration Thresholds updated 1<sup>st</sup> April 2016





Where an entity has a mix of both taxable<sup>3</sup> and exempted supplies, they are typically only able to reclaim input VAT where it relates directly to the taxable supply. In addition, they may be able to claim a proportion of input VAT on overhead costs (input) which are attributable to both taxable and exempt supplies. No input VAT can be recovered in relation to inputs relating solely to exempt supplies.

The precise status, and proportion recoverable, may only be determined by reference to the finance officer or accountant and often written confirmation should be sought. Partial exemption VAT recovery rates are usually subject to annual review and agreement between the Insured and HMRC.

Needless to say it is imperative that the VAT status of the policyholder is ascertained at the earliest opportunity as this will have a bearing on the adjustment of the loss, and the potential adequacy of the sums insured. The information should be compared with that disclosed to insurers at the time of proposal. If the risk turns out to be one where input VAT is not recoverable, when the proposal indicated otherwise this will doubtless be a matter of concern to insurers as the liability for any claim would be automatically increased by 20% or the prevailing rate.

On purchasing a commercial property, the buyer must make an election to HMRC to “opt to tax” or not. Opting to tax, allows recovery of input tax in the construction or purchase and maintenance of the property, but compels the owner to charge VAT on the sale, or lease charges of that property.

There may therefore be instances where the policyholder is registered for VAT purposes but the particular risk property is not ‘opted to tax’. A landlord may choose not to “opt to tax” due to the particular expected class of tenant and their inability, in turn, to reclaim VAT charged on rent or service charges. Such types of business might include a bookmaker, insurance company, charity etc. If the tenant is VAT-registered it makes little difference, however, for a non VAT-registered tenant this will be a significant issue. If the building has not been ‘opted in’ the property owner will certainly be unable to recover the input VAT incurred on repairs or rebuilding and VAT will surely form part of the claim.

Following a large loss the owner of a building without an option to tax, may be motivated to opt to tax so as to reclaim the VAT element incurred on repairs or rebuild. They would then be required to

<sup>3</sup> Taxable in this case means subject to VAT.





charge output tax upon future rent and service charges, or any sale price. Such a decision is potentially onerous and one which the Insured will have to live with for sometime, since it cannot be revoked for a period of at least 20 years<sup>4</sup>.

### New build dwellings and other anomalies

The repair or construction of any building will normally be standard rated for VAT purposes. However there is an important anomaly as regards the construction of new-build dwellings or buildings for charitable purpose [e.g. village halls etc.] which can be zero rated for the purposes of the rules, subject to certain requirements. In the context of insurance claims this also includes the rebuild of damaged properties following serious damage.

The imposition of 20% VAT on a substantial repair of a dwelling or other qualifying building may very easily render the repair uneconomic when compared with the zero rated rebuild option once the lack of VAT is taken into account.

The rules do require closer examination<sup>5</sup> but in essence, for zero rating to apply the following criteria will need to present:-

- the building will need to be solely for a relevant residential or relevant charitable purpose
- in the case of dwellings: the building designed as a dwelling or number of dwellings
- in the case of a rebuild: the rebuild will need to involve the reconstruction from scratch following demolition of a pre-existing building down to at least ground floor level: however foundations, cellar, basement and ground floor slab can be retained. Also, existing party walls can be retained including a single façade or two façades if a corner site.

The demolition of the existing structure can be deemed 'closely connected' to the construction of the new building presumably where this work is carried out by the main contractor and therefore zero rated. However as a stand-alone demolition contract this will attract VAT.

In the applicable circumstances it is the first construction of the qualifying building that is zero rated. For a qualifying building all services provided by the main contractor in its construction, may be zero rated. Thus any works carried out after this time will not be zero rated, because it will no

<sup>4</sup> HMRC VAT Notice 742A: Opting to tax land and buildings: 16<sup>th</sup> April 2014

<sup>5</sup> HMRC VAT Notice 708: Buildings and Construction updated 23<sup>rd</sup> August 2016





longer be a new build project. For example any rectification works carried out after completion other than snagging by the original contractor as part of that contract will be liable for VAT.

Soft landscaping including the planting of trees, shrubbery and flowers would not normally be regarded as 'closely connected' to the construction unless required under the terms of the planning consent and therefore could be subject to VAT. Such costs may not form part of any claim in any event, depending on the policy wording.

Professional fees including architectural, surveying and supervisory roles will not normally be zero rated, but a grey area exists where these services are provided as part of a composite supply e.g. a design and build package by the main contractor and are therefore part of the supply of the service, which could then become zero rated.

Significantly, extensions to dwellings will not qualify for zero rating and detached buildings provided for the purposes of garages or swimming pools for example will not qualify as dwellings. The wording solely for residential or charitable purposes is material here.

Prior to 20<sup>th</sup> September 2015 listed buildings were eligible for VAT relief however that has now come to an end and repairs on listed buildings are now subject to full VAT. Places of worship, whilst no longer exempt from VAT, can claim relief under the Listed Places of Worship scheme provided by the Department of Culture Media and Sport<sup>6</sup>.

### Some practical aspects

In most cases VAT should not be included in settlements unless the policyholder can demonstrate that they have actually incurred it, and won't be able to recover it. This is most usually demonstrated by reinstatement and presentation of a bone fide invoice, and evidence of the VAT recovery position.

In rare instances fraudulent VAT invoices will be submitted or the VAT number of another party might be used to gain advantage. If this is suspected the VAT number can be easily checked through various free checking websites such as [http://ec.europa.eu/taxation\\_customs/vies/](http://ec.europa.eu/taxation_customs/vies/) which will quickly confirm whether the number is indeed valid or the correct identity relating to the VAT

<sup>6</sup> <http://www.lpwscheme.org.uk/>





number. The number should be 9 digits long the first 7 digits are random and the last two based upon a mathematical formula derived from the first 7 digits.

In summary, VAT on property is exceptionally complex, and each case is likely to have its own nuances. Accordingly, each case should be considered on its own merits, and specialist advice sought as necessary.

### Further reading

HMRC VAT Notice 708: Buildings and Construction available on line at

[www.gov.uk/government/publications/vat-notice-708-buildings-and-construction/vat-notice-708-buildings-and-construction](http://www.gov.uk/government/publications/vat-notice-708-buildings-and-construction/vat-notice-708-buildings-and-construction)

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