



VAT | saving VAT on property professional fees

team



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who needs to know?

This is of interest to any organisation which cannot reclaim all of its VAT, and which is having new building work carried out, alterations to listed buildings, or certain kinds of renovations and conversions which change the use of an existing building. This will include some charities, schools, commercial care home owners, and similar organisations.

what kind of services are involved?

The VAT reduction cost scheme concerns costs of construction works which are used either for a relevant charitable purpose, a relevant residential purpose, or as a dwelling. It refers particularly to fees chargeable by surveyors, architects, and similar professionals. It can involve brand new construction, certain works to listed buildings, or certain conversions which involve a change of function to these categories of use.

It is relatively well known that in such circumstances, the construction services provided by the building contractor can be zero rated, or in certain cases subject to a 5% rate. This eliminates or reduces the VAT burden for a purchaser who cannot reclaim the VAT. What is less often considered, is the fact that these reliefs do not apply directly to the services of professionals that may be involved.

The purpose of this bulletin is to give broad guidance as to how to reduce the VAT cost of the services of professionals. In order to achieve this, it is important to consider the position at the very beginning of the job.

"Design and Build": how it works

This is achieved by a "design and build" contract. This allows the services of professionals to be subsumed within a wider service of the construction/building works concerned. As long as the professionals are contracted with the building contractor, so that he pays their fees and reclaims VAT that they charge to him (at the full rate), then he can wrap that charge into the supply he makes of the qualifying building, but in doing so only charges at the lower rate. This means that the VAT that is originally charged by the professionals is removed through being reclaimed by the contractor, but the contractor does not have to charge that particular VAT rate to the charity or commercial care home owner.

The most straight forward way of doing this is to ask the contractor to carry out a design and build contract themselves, either using their own favoured professionals, or agreeing to take on professionals selected by the customer (or jointly selected between them).

This can sometimes be unattractive because the customer often prefers to retain ultimate contractual control over the professionals, thus not blurring the dividing line between the professionals and the contractor. In any case the contractor is often hired part way through the work carried out by the professionals. In that situation, it would not have been possible to have arranged for the professionals to charge their fees to the contractor who had yet to be hired. For this reason, the following approach has been widely adopted. This is for the organisation which is the final consumer to create, at the very beginning, a subsidiary company which will act as its main contractor, and which will therefore engage the services of the professionals and of the third party building contractor. The subsidiary then wraps these charges in a global fee which is subject to the reduced VAT charge.

are there any downsides with this?

This is a sufficiently widely used arrangement that any downsides that might exist have probably been assessed as generally being acceptable in order to gain the significant advantages mentioned above. But, as with any arrangement concerning VAT, there are potential difficulties along the way which have to be taken into account.

One of these is the fact that the above mentioned arrangement does appear, fairly clearly to be a VAT avoidance scheme, unless of course, there is a good commercial reason for having the contractual relationships dealt with by a separate company, controlled by the customer. However, any wholly contrived scheme could come under attack from HMRC on that basis alone as being "abusive". To date, there have been no cases that have been brought to our attention, where HMRC has taken that point on the straightforward application of the arrangements discussed above. That is not a guarantee that they will refrain from doing so in any future case.

There is also the fact that the VAT relief (0% or 5%) solely applies to the main contractor (i.e. the subsidiary), and not to any contractors downstream of that company. This means that the building contractor who would normally charge at zero rate or 5% rate to you, will in fact charge VAT on the whole charge to the subsidiary contractor company. This means that, if there is any difficulty with the scheme, such as a challenge from HMRC, the amount of VAT that might not be successfully reclaimed from HMRC is an amount based on the full contract price, rather than merely the amount chargeable on the professional fees. Given that it is quite common for professional fees to constitute c. 20% of the cost of any project, this would have the effect of increasing, fivefold, the amount of VAT that would be applicable to certain developments. If a successful challenge was made by HMRC on the recovery of input tax by the contractor, this would have a much more severe effect than if there had been no arrangement made in the first place.

Detailed consideration must also be given to cashflow. The contractor company will

often have to pay VAT in full to the various subcontractors in advance of being able to reclaim it from HMRC. This needs to be considered in the funding arrangements and in the deadlines for paying subcontractors.

conclusion

Currently this has the benefit of not being a controversial arrangement, and subject to detailed implementation principles (which are not included above), it should do good service for organisations going forward. As long as an organisation is prepared to take the risk of an unexpected sudden challenge from HMRC, there is much to be gained from this VAT reduction cost scheme.

To give an illustration:

If you have a new construction budget of £2m, of which 25% is professional fees, and the construction project itself was zero rated rather than rated at the standard rate, then the saving by effecting this scheme, would be in the region of £87,500.

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