

# Case Alert

## *Residential conversions – Upper Tribunal confirms VAT position*

### *Summary*

The construction of a new residential property and its first sale is, generally, zero-rated for VAT purposes provided that the building in question meets the statutory definition of a dwelling or number of dwellings in the case of flats.

The conversion of buildings can also, in some cases, qualify for zero-rating. The zero-rate will apply where a building (or part of a building) is converted from a non-residential use into a dwelling or number of dwellings.

The Upper Tribunal has ruled in a recent case that zero-rating is not available where the conversion incorporates both a non-residential and a residential part.

### Upper Tribunal

The Upper Tribunal has issued a judgment in a case involving the conversion of a building where the conversion incorporates both non-residential parts and residential parts of the old building into the new building. In *HMRC v Langaurd New Homes Ltd*, the developer converted a former public house into four maisonettes. Prior to the conversion, the ground floor was used as a public bar, with the 1<sup>st</sup> and 2<sup>nd</sup> floors being used as the pub manager's residential accommodation. The developer added a 4<sup>th</sup> floor and then split the property vertically into four separate dwellings. The bottom two dwellings incorporated part of the ground floor and part of the 1<sup>st</sup> floor (ie these new dwellings incorporated the previous non-residential part) whilst the top two dwellings incorporated part of the existing 3<sup>rd</sup> floor and the newly added 4<sup>th</sup> floor. The developer argued that the subsequent sale of the lower properties should qualify for zero-rating but HMRC considered that the supply should be exempt from VAT.

In its judgment, the Upper Tribunal agreed with HMRC. To benefit from zero-rating, the new dwelling created from the conversion cannot incorporate both residential and non-residential parts. According to the Tribunal, the law only allows for zero-rating where a non-residential building (or part of such a building) is converted in its entirety into a building designed as a dwelling or a number of dwellings. In situations where, as in this case, the non-residential and residential parts are converted into a dwelling, the conversion and onward sale do not qualify for zero-rating but are exempt from VAT.

***Comment – Developers beware. This judgment makes it clear that zero-rating is not possible where a non-residential and residential part are converted into a single dwelling. In such circumstances, the works may be liable to VAT at the reduced rate but the first sale of the converted property by the developer will be an exempt supply meaning that VAT incurred on the conversion costs are not likely to be reclaimable. This could have an unwanted impact on the developer's profits.***

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