

Commercial property alert: are you ready for 1 August 2009?

“...there is some good news coming your way on 1 August 2009, which could save you VAT and SDLT...”

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If you are a commercial landlord or a potential buyer of commercial property, then there is a glimmer of hope even in the current depressed market. Put simply, there is some good news coming your way on 1 August 2009, which could save you VAT and SDLT.

Background

Almost 20 years ago, on 1 August 1989, the UK Government was forced by the EU to make a major change to the VAT system. The end result was that on that date land and buildings became subject to VAT. While older buildings remained “exempt”, owners could opt to waive that exemption.

Benefits of “option to tax”

The owners of old buildings back in 1989 saw advantages by opting to tax, as it then enabled them to recover VAT on running costs or improvement costs. They also had to charge VAT on rental income and on the sale price when they eventually disposed of the building. There were drawbacks though as set out below.

Exempt tenants

A substantial number of businesses are either fully or partially exempt from VAT. In other words they are restricted, or entirely unable from claiming back VAT. These businesses are put off from becoming a tenant or becoming a buyer of commercial property which is subject to an “option to tax”, by the cashflow disincentive. In the current market that is bad news.

This is about to change on 1 August 2009.

Important date and new advantage

The key date is the original VAT regime change of 1 August 1989. The reason is that the option to tax stays in force until revoked; it can only be revoked after 20 years has passed. This means that the status of any buildings which were subject to being “opted in” for VAT in 1989 can be revoked from 1 August 2009.

What if the previous owner made the option to tax?

Even if the previous owner made the option to tax, you as the new owner, can still revoke the election, provided 20 years has passed since the time of the first election.

Tax saving

If you are buying a commercial property ask the seller if it is subject to VAT. If the election was made more than 20 years ago, ask them to revoke it as soon as they hit the 20 year time frame. You may need to defer your transaction for a short time to achieve this before exchange of contracts. This will save you having to use funds or raising more finance than you need just the pay the VAT element. If your business is exempt, you would save the entire VAT cost on the purchase price, which if it were charged you would not be able to reclaim.

Stamp duty reduction too

In the above scenario the buyer would also save SDLT which ordinarily is charged on the whole purchase price including VAT if charged.

continued

Commercial property alert: are you ready for 1 August 2009? (continued)

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Example of potential tax savings

Bill is moving his business into smaller premises. Following negotiations, he has contracted to buy an office building for £230,000, excluding VAT. The original owner opted to tax the premises on September 1, 1989. The total purchase price will be £272,435, made up of £34,500 VAT and £7,935 for SDLT at 3%. If Bill can negotiate with the seller and get him to revoke the option to tax on 1 September 2009, and also delays exchange of contracts until that date, he will completely avoid paying VAT, and will pay SDLT of £2,300 at only 1%, as the purchase price without the VAT element now, has dropped to £230,000 and as such falls in the 1% SDLT band. The net “real” saving is on the SDLT of course being £5,635 (the difference between the 3% and 1% bands).