

CHAPTER 24

LAND AND BUILDINGS: EXEMPTION AND STANDARD-RATING

24.1 The Basic Rule

Schedule 9 of VATA 1994 outlines supplies which are exempt from VAT. The category that covers land and buildings is Group 1 - Land.

[VATA 1994,
Sch 9, Group 1](#)

"The grant of any interest in or right over land or of any licence to occupy land, **other than**..... is exempt".

The "other than....." refers to a list of standard-rated supplies. Basically the grant of any interest in or right over land **other than** those listed in Group 1 is exempt.

The list of standard-rated items within Group 1 is one of the few occasions that the legislation specifies standard-rated supplies.

Consequently, if a land transaction is not within Schedule 8, Group 5 (zero-rated) or the list of standard-rated items within Schedule 9, Group 1, it will be exempt.

The items listed and hence standard-rated are;

- the **grant of any interest, right or licence** consisting of a right to **take game or fish**;
- the provision of **accommodation in a hotel**, inn, boarding house or similar establishment of sleeping accommodation;
- the grant of any interest in, right over or licence to **occupy holiday accommodation**;
- the provision of **seasonal pitches for caravans** and the provision of **pitches for tents or camping facilities**;
- the grant of **facilities for parking vehicles**; and
- the grant of any right to **occupy a box, seat** or other accommodation at a **sports ground, theatre, concert hall** or other place of entertainment.

The main item listed in Group 1 is item number 1(a) and it says the following:

"The grant of a fee simple in

- i) a building which has not been completed and which is neither designed as a dwelling or a number of dwellings, nor intended for use solely for a relevant residential purpose or a relevant charitable purpose; or

- ii) a new building which is neither designed as a dwelling or a number of dwellings, nor intended for use solely for a relevant residential purpose or a relevant charitable purpose after the grant."

A fee simple is a **freehold**.

In other words either;

- i. a freehold commercial building which has not yet been completed; or
- ii. a new freehold commercial building.

Consequently the **sale of the freehold in an uncompleted commercial building or a new commercial building will be standard-rated**.

A building is "new" if it was completed less than 3 years before the grant.

[VATA 1994, Sch 9, Group 1 Note 4](#)

It is important to appreciate that the **lease** of a commercial property is not within the list of standard-rated items in Group 1. Consequently any premium and/or rental income in respect of a commercial property, will be exempt, subject to an option to tax (Chapter 25).

Example 1

Are the following supplies standard-rated, zero-rated or exempt?

| | S.R | Z.R | Exempt |
|--|--------------------------|--------------------------|--------------------------|
| 1. The sale of the freehold of a 2 year old office block | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. The grant of a 99 year lease in a brand new factory. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 3. The sale of the freehold of a 5 year old factory. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 4. A farmer rents out a plot of land to another farmer. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

24.2 Supplies between landlords and tenants

(1) Lease payments

- *Inducements (reverse premiums).*

HMRC accept that lease obligations, to which tenants are normally bound, do not constitute supplies for which inducement payments on entering leases are consideration.

The majority of such payments are therefore likely to be outside the scope of VAT as they are no more than inducements to tenants to take leases and to observe obligations in them. There will be a taxable supply only where a payment is linked to benefits a tenant provides outside normal lease terms. However, merely putting such a benefit as an obligation in a lease will not mean it ceases to be a taxable transaction.

- *Variations of leases.*

Sometimes a lease is varied either to alter its terms (e.g. so that it can be used for different purposes), or to extend the length of the tenancy. Under English land law, the effect of such a variation is that the old lease is deemed to be surrendered (see below) and a new lease granted in its place. Where there is no consideration, no supply is seen as taking place.

VAT Notice
742, para 10.5

- *Surrender of lease.*

The grant of an 'interest in or right over' land or a 'licence to occupy' land includes a surrender of that interest, etc.

[VATA 1994,
Sch 9, Group 1
and Note \(1\)](#)

The general provisions relating to grants therefore also apply to surrenders, i.e. they are exempt subject to certain exceptions. Similarly, the assignment of any interest, etc. back to the lessor is generally exempt.

VAT Notice
742 para 10.3

- *Reverse surrenders and assignments.*

Normally, when a lease is surrendered, consideration is paid by the landlord to the tenant. A "reverse surrender" occurs where a tenant surrenders an onerous lease to the landlord before the term of the lease has expired and pays the landlord to accept the surrender.

The grant of an interest in or right over land, includes the supply made by the person to whom an interest is surrendered when there is a reverse surrender. The general provisions relating to grants therefore also apply to reverse surrenders, i.e. they are exempt subject to certain exceptions.

[VATA 1994,
Sch 9, Group 1
& Notes \(1\) &
\(1A\)](#)

VAT Notice
742 para 10.4

- *Dilapidation payments.*

A lease may provide for the landlord to recover from a tenant, at or near the end of the lease, an amount to cover the cost of restoring the property to its original condition. Such dilapidation payments represent a claim for **damages** by the landlord against the tenant. The payment is not consideration for a supply for VAT purposes and is outside the scope of VAT.

VAT Notice
742, para 10.10

(2) **Rental payments**

Rent is the periodic payment made by a tenant to a landlord and is normally the subject of a written agreement.

Rent payments can be non-monetary, and can include costs incurred by the landlord under the agreement which are recharged to the tenant. This may include items such as service charges and rates where the landlord is the rateable person.

Rental income is generally exempt from VAT, although the landlord may "opt to tax" rents from non-domestic property (Chapter 25).

(3) **Service charges, etc.**

The VAT treatment of service charges and other payments relating to premises depends upon the nature of the property and the terms of the arrangements. This will be particularly relevant when considering serviced offices.

General services for tenants of leasehold non-domestic property provided by the landlord.

Leases often stipulate that the landlord will provide, and the tenants pay for, the services required for the upkeep of the building as a whole. The lease may provide for an inclusive rental or it may require the tenants to contribute by means of an additional charge to the basic rent, generally referred to as a service or maintenance charge.

This service charge assumes the same VAT liability as the premium or rent payable under the lease.

The service charge is therefore generally exempt unless the landlord has "opted to tax" the property or the underlying lease is standard-rated, e.g. holiday or time share accommodation.

VAT Notice
742 paras 11.1,
11.2, 11.4

Specific services for tenants of leasehold non-domestic property provided by the landlord.

A payment made by a tenant to the landlord may be

- a) further payment for the main supply of accommodation and therefore exempt or, if the option to tax has been exercised, standard-rated,
- b) for supplies other than accommodation (normally standard-rated), or
- c) disbursements, and therefore outside the scope of VAT.

Example 2

Below are four transactions involving land and buildings. State whether each is a standard-rated, zero-rated or exempt supply for VAT.

| | S.R | Z.R | Exempt |
|--|--------------------------|--------------------------|--------------------------|
| 1. A factory owner grants a 5 year lease over one quarter of his one year old factory to another business. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. Wimpy Homes sells the freehold of a 20 year old house it purchased as a part-exchange deal with a customer. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 3. JC Ltd sells the freehold of a 1 year old office block. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 4. JC Ltd sells the freehold of a 4 year old office block. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Answer 1

| | S.R | Z.R | Exempt |
|--|-------------------------------------|--------------------------|-------------------------------------|
| 1. The sale of the freehold of a 2 year old office block | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. The grant of a 99 year lease in a brand new factory. | <input type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> |
| 3. The sale of the freehold of a 5 year old factory. | <input type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> |
| 4. A farmer rents out a plot of land to another farmer. | <input type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> |

The sale of the freehold of a 2 year old office block - two years of age means it is **new** and so this is a **standard-rated supply**.

The grant of a 99-year lease in a brand new factory. A factory is commercial. It is "new" but it is not a supply of the freehold - instead the grant of a lease. This is not a standard-rated supply and because it is **commercial property** it is therefore an **exempt supply**.

The sale of the freehold of a 5-year old factory - a factory is commercial, it is freehold, but it is **not "new"**. Therefore it is an **exempt supply**.

A farmer rents out a plot of land to another farmer. It is **not domestic** so it is not zero-rated. It is **not new, commercial, freehold**, so it is not standard-rated. Therefore this **must be an exempt supply**.

Answer 2

| | S.R | Z.R | Exempt |
|--|-----|-----|--------|
| 1. A factory owner grants a 5 year lease over one quarter of his one year old factory to another business. | X | X | ✓ |
| 2. Wimpy Homes sells the freehold of a 20 year old house it purchased as a part-exchange deal with a customer. | X | X | ✓ |
| 3. JC Ltd sells the freehold of a 1 year old office block. | ✓ | X | X |
| 4. JC Ltd sells the freehold of a 4 year old office block. | X | X | ✓ |

A factory owner grants a five year lease over one-quarter of his one year old factory to another business. A factory is a commercial property and the word "lease" indicates it is an exempt supply.

Wimpy Homes sells the freehold of a 20 year old house which it purchased as a part-exchange deal with a customer. Some domestic property is zero-rated, i.e. basically houses that are brand new and are being sold by the constructor. This house is not brand new, it is 20 years old. Wimpy Homes did not build it - so it is not a zero-rated supply. It cannot be standard-rated because that only applies to commercial property, so therefore it is an exempt supply.

JC Ltd sells the freehold of a 1 year old office block - it is freehold, commercial and new, so it is standard-rated.

JC Ltd sells the freehold of a 4 year old office block - it is freehold, commercial but it is old, so this is an exempt supply.