

Introduction

1. The British Property Federation (BPF) represents the real estate sector – an industry which contributed more than £115bn to the UK economy in 2019 and supported 2.4 million jobs¹. We promote the interests of those with a stake in the UK built environment, and our membership comprises a broad range of owners, managers and developers of real estate as well as those who support them. Their investments help drive the UK's economic success; provide essential infrastructure and create great places where people can live, work and relax.
2. Current legislation provides limited scope for HMRC to apply a market value to supplies at below value where parties are not connected. We understand that there is concern that retailers selling a bundle of goods directly to the general public are 'value shifting' – that is to say reducing the value ascribed to standard-rated elements of the bundle in favour of a higher value to elements that are reduced-rated, zero-rated or exempt. It is suggested that HMRC may require new powers to prevent value shifting where this is clearly done wholly or mainly to reduce the VAT charged to customers who cannot recover this.
3. While it is clear that the focus of any proposed legislation would be targeted at retailers selling a bundle of goods, we wanted to alert HMRC of potential issues arising in the real estate sector. The uncertainty currently faced by the sector in respect of the treatment of dilapidations following last year's RCB 12 on compensation payments has demonstrated the danger of introducing new measures without considering their repercussion on property and construction, one of the most complex areas of VAT.
4. We have highlighted below some potential areas where suppliers may be charging a mixture of standard-rated supplies and supplies at a different liability. We are not suggesting that these are particularly at risk of value shifting, but it is important that they are considered as part of the present consultation and that it is ultimately clear how – if at all – any new rules apply.

Mixed tenure

5. A contractor constructing where part of the building qualifies for zero-rating, and part does not, will have to allocate their charges between these elements. Examples include:
 - 5.1. A building comprising shops and offices on the lower floors with flats above
 - 5.2. A building comprising a residential care home and a day care centre
 - 5.3. A school building with classrooms in one part of the building and a boarding house in the other
 - 5.4. A university laboratory where some labs are used for publicly-funded research and others for privately-funded research.
 - 5.5. A home with small outbuildings intended for use as a home office or workshop.

¹ <https://bpf.org.uk/our-work/research-and-briefings/>

- 5.6. A live-work unit (likely to become more popular as many more people are working from home)
6. Similar situations arise in respect of the reduced rate of VAT for conversion works. Examples would include:
 - 6.1. A building that has been empty for two years which is being repurposed as a mixed commercial/residential property
 - 6.2. The refurbishment of a block of flats, where the number of dwellings is changing on some floors but not others
 - 6.3. The conversion of a pub with landlord's accommodation into flats
7. Where a property owner has opted to tax a building and is selling or leasing an entire building that is mix of commercial and residential units, there will be mixed liabilities.

Excluded items

8. Certain items are specifically excluded from VAT reliefs. Zero-rating extends to building materials supplied and fitted by the building contractor. Items that do not fall within this category would include: -
 - 8.1. Unincorporated items, such as free-standing furniture sold with a show flat
 - 8.2. Items that HMRC do not accept are ordinarily incorporated in a building of that type, such as a bathroom mirror in a flat
 - 8.3. Items that are specifically excluded from the definition of 'building materials', such as carpets and 'white goods'.
9. Similar rules apply to reduced-rated conversions and refurbishments.

Valuation issues

10. Contractors will typically break-down their charges for a contract as follows: -
 - 10.1. Applying a materials cost per unit to the quantity of work required for each area, e.g. X taps required per flat at a cost of £Y per tap
 - 10.2. Applying a labour cost per unit, e.g. X hours to plumb a bathroom at a cost of £Y per hour
 - 10.3. Applying percentages to these for such categories as preliminary works, contingencies, overheads and profit
11. Where not all charges are subject to the same rate of VAT, Notice 708 section 16.1 requires that the supplier should apply a fair and reasonable apportionment. We understand that HMRC would generally disapprove of floor area as being over-simplistic (a view with which we concur). Contractors will therefore typically use the above costing structure to allocate their charges. However, applying this may not be

straightforward. For instance, where a contractor is supplying white goods, they are still entitled to zero-rate the installation of these items. Whether the various add-on percentages should be applied to these white goods or not is debatable and might well vary between suppliers. Some suppliers may be genuinely only seeking to recover costs. Some might keep any discounts they receive for buying white goods in bulk, and therefore consider that they should not also apply an overheads charge too. How forensic an analysis is done may well depend in practice on how closely their customer reviews their allocation.

12. For a developer selling a show flat, they might with some justification allocate an amount below cost to the free-standing furniture, curtains, etc on which they should charge VAT. A second-hand set of curtains fitted for a particular window may have negligible re-sale value to the developer; but on the other hand is clearly much more valuable to the buyer.
13. Under the recently-introduced domestic reverse charge for construction services, it is the responsibility of the customer to account for VAT up the supply chain. A customer's view of a fair and reasonable allocation of costs between different VAT liabilities may differ to those of a supplier.

Recommendation

14. If the proposed value shifting rules are only going to be targeted at retailers selling a bundle of goods, we recommend that it is made clear that this does not apply to real estate and construction transactions.
15. If new value shifting rules are intended to be employed on transactions relating to property and construction a wider consultation should be initiated to ensure that clearly anomalous matters like the examples above are fully captured and considered before a law or policy change is brought about.
16. We should be happy to discuss our concerns further.

Ion Fletcher
Director of Policy (Finance)
British Property Federation

020 7802 0105
ionfletcher@bpf.org.uk