

# CONVERTING A PROPERTY INTO A HMO?

## HOW TO SAVE UP TO 75% OF YOUR VAT COSTS

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A common property investment strategy is to buy a property and convert it into a HMO. This can be an expensive strategy however, not helped by the 20% VAT charged by suppliers and builders. However, in many cases it is possible to pay up to 75% less VAT for certain 'qualifying' conversions.

**Why can't I just VAT-register and reclaim all of the VAT I incur, just like many businesses do?**

Residential rental income is completely exempt from VAT, and so it isn't even possible to VAT-register a residential rental business. This is unlike a commercial property rental business, or even a 'Furnished Holiday Let' (also known as 'Serviced Accommodation') business. Therefore, it isn't possible for single-let or HMO landlords to claim back any of the VAT that they incur on a property refurbishment project.

**So what's different about HMO conversions?**

There are special provisions which can mean that 'qualifying' property conversions, most commonly a conversion of a single-let property to a HMO property, qualify for a 5% reduced rate of VAT.

The 5% VAT rate applies to materials and services related to the conversion, and any repairs or construction works within the immediate vicinity of the building site, eg a garage.

**What exactly is a 'qualifying conversion'?**

A 'qualifying' HMO conversion is one where:

- before the conversion the premises being converted do not contain any multiple occupancy dwellings
- after the conversion those premises contain only a multiple occupancy dwelling OR two or more dwellings
- the use to which those premises are put after the conversion is not to any extent use for a relevant residential purpose (meaning, not a hospice, school, barracks, or similar).

For the tax geeks, the above is covered by the tax legislation within Group 6, Schedule 7A of the Value Added Tax Act 1994.

**OK, sounds good – do I need HMRC permission to claim the 5% reduced VAT rate?**

The VAT-registered contractor dealing with the refurbishment project simply needs to 'self-assess' that the project itself is a 'qualifying conversion', in order to then charge the landlord the 5% VAT rate.

However, it should be noted that if the main contractor makes a mistake in assessing the project as a 'qualifying' project, it would be the main contractor who would suffer the consequences, ie the main contractor would have to pay the extra VAT and HMRC penalties and interest.



Unsurprisingly, therefore, some main contractors may be unnecessarily cautious when assessing the VAT status of a renovation project, which obviously would mean the landlord unnecessarily paying VAT at the standard rate of 20%.

Therefore, landlords should ensure that they provide the main contractor with plenty of evidence that the renovation is of a qualifying nature, such as:

- Before and after floorplans
- Planning permission documents, eg for any extension or new loft
- Any 'Certificate of Lawfulness' that may be available
- Drawings, or pictures of similar conversions

**How does the main contractor deal with the VAT position?**

The main contractor simply invoices the landlord for the project (materials and labour) and charges 5% VAT rather than 20% VAT.

The main contractor then recovers the VAT via the quarterly VAT return process.

For example: the purchase of a £5,000+VAT kitchen by the main contractor results in a total cost of £6,000 for the main contractor, on purchase. The main contractor then charges the landlord £5,000+VAT (at 5%) = £5,250. The main contractor then includes these transactions on the next quarterly VAT return and recovers £750 (£1,000 VAT paid out to the kitchen supplier, less £250 VAT paid by the landlord), meaning that the landlord has only paid 5% VAT on the kitchen, and the main contractor is not out of pocket.

In the real world, some main contractors may ask for additional funds to be provided for cashflow purposes to bridge the gap between paying for the kitchen and receiving the VAT refund from HMRC, eg in the worst case, the kitchen could be purchased on 1st January (day #1 of the VAT quarter), and the VAT repayment may take until mid / late April to be repaid by HMRC – clearly for large projects the main contractor would not want to be responsible for this cashflow shortfall.

**What about expenditure that the main contractor DOESN'T incur?**

Materials and labour that are **NOT** provided by the VAT-registered main contractor are subject to VAT at the standard rate of 20%. It therefore makes sense to ensure that the main contractor purchases all materials for the project, rather than the landlord purchasing materials for the project.

Note that expenditure on furniture for the property is subject to VAT at the standard rate of 20%.

### SUMMARY

For a qualifying conversion of a property into a HMO, saving 75% of the VAT incurred on the renovation can be big money to many landlords. We regularly see clients spend £50,000-£100,000 on such works, and saving up to £15,000 of VAT can mean the difference between a viable project, or not, or can mean a substantially better finish can be achieved within budget. In these tough tax times for landlords, every little helps ...