

Insights

VAT ON DILAPIDATIONS – WHERE ARE WE?

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Who would have thought 6 months ago that we would be talking at length about the VAT status of dilapidations payments? How did we get here and is there light at the end of the tunnel?

Historically, HMRC have accepted that dilapidation payments are compensation payable by an outgoing tenant to relieve it of the obligation to return the property to the landlord in good repair. As compensation, these payments have been treated as outside the scope of VAT in practice. This is because VAT is a tax on supplies made for consideration, not on payments as such.

In 2020, HMRC indicated that case law from the CJEU showed that this treatment was incorrect and that VAT is in fact chargeable. They did this in a business brief (RCB 12/20), but also said that they would be applying their new approach retrospectively for the last four years. A number of landlords were wondering how to approach their potential VAT liability for matters that they had long considered settled. Having got the attention of the real estate sector HMRC then admitted last week that they were going to reconsider the position further and issue revised guidance “shortly” .

Significantly, HMRC have indicated that any change in policy will be prospective. As it is not retrospective landlords can stop worrying about past deals, that is potentially unless they in the meantime started charging VAT following RCB 12/20. HMRC’s revised brief will include guidance on what to do if they changed how they treat such payments because of the interim guidance.

Now we have been told that any change in approach will be in the future, taxpayers can continue to treat such payments as outside the scope of VAT. However, it is advisable for landlords to include a VAT exclusive clause in the relevant contract, to allow them to charge VAT to the tenant should HMRC treat the transaction as chargeable to VAT.

In short, we await HMRC’s clarification of their view; until they make this clarification, we should continue to treat dilapidation payments as outside the scope of VAT in practice.

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