Reinstatement
Cost Assessments

ARMA
PARTNER

VAT on Residential Reinstatement Cost Assessments

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The question of how VAT is applied to Reinstatement Cost Assessments is an area of some confusion and debate among Chartered Surveyors, Insurers and Loss Adjusters.

Managing agents sometimes ask that VAT be included in the sum insured. A typical quoted scenario is:

If VAT is only applied to certain elements, like professional fees and removal of debris costs, then if there is a loss above 80% of the sum insured and insurers do not declare a total loss, there is significant risk that the building could be underinsured, as VAT of 20% must now be applied to repairs.

For example, we faced the unfortunate scenario of a loss that was deemed 80% by insurers, and the commercial decision was made by them not to demolish but to work with the existing structure, which meant we were under-insured.

In this particular instance, the management company was responsible for insuring, and our client simply nominated the insurer with whom cover was placed. The onus is on the insured to insure, making them liable for any underinsurance. Likewise our client cannot instruct the insurers to insure for any particular amount, as the instruction has to come from the management company.

The risk comes when a loss of over 80% occurs in which VAT would be applicable and would therefore take the total sum to in excess of 100% of the Reinstatement Cost Assessment. It would be expected, however, that with a substantial loss of over 80% plus being destroyed, it would be more cost effective to demolish the remainder and rebuild. But this may not be permitted with a listed building when attempts are made to retain some of the original structure. Nevertheless, the VAT rules do make allowance for retention for statutory reasons as part of construction of a new dwelling.

RICS guidance note, Reinstatement cost assessment of buildings, 3rd edition, February 2018

8.4 VAT states:
"The RICS member or RICS-regulated firm should record whether the assessment includes or excludes VAT. It is advisable for assessments to take into account the building and trading position of the insured and consider each case individually with the client and the broker before the finalisation of the assessment to determine which elements, if any, VAT needs to be applied to. Even though many policies include a free allowance for VAT over and above the sum insured, it is advisable to carry out this exercise because this may not always be the case. RICS members and RICS-regulated firms should also be aware that property owners can elect the VAT status of individual properties within their ownership, and that the VAT status of their properties may not be consistent."

HM Revenue and Customs VAT Notice 708: buildings and construction (Updated 31st December 2020)

HM Revenue and Customs VAT Notice 708: buildings and construction (Updated 31st December 2020) states that a zero-rated building is constructed when 'it is built from scratch, and before work starts, any pre existing building is demolished completely to ground level (cellars, basements and the slab at the ground level may be retained)' and it is 'either designed as a dwelling or a number of dwellings. Dwellings can also be zero rated if 'the new building makes use of no more than a single façade (or a double façade on a corner site) of a pre-existing building, the pre-existing building is demolished completely (other than the retained façade) before work on the new building is started, and the façade is retained as a condition or requirement of statutory planning consent or similar permission.

Listed Buildings
Listed buildings used to be exempt from VAT on works. However this was revised on 1st October 2012. Approved alterations to listed dwellings now attract a rate of 20% VAT.

Dwellings
Construction of new qualifying dwellings, communal residential buildings and conversion for a housing association of a non-residential building into a qualifying dwelling attract a 0% rate of VAT.

A qualifying building is being constructed when:

- *it is built from scratch, and, before construction starts, any pre-existing building is demolished completely to ground level (cellars, basement and the "slab" at ground level may be retained)*
- *the new building makes use of no more than a single façade (or a double façade on a corner site) of a pre-existing building, the pre-existing building is demolished completely (other than the retained façade) before work on the new buildings is started and the façade is retained as a condition or requirement of statutory planning consent or similar permission.*

Day One value vs sum insured

The Day One 'declared value' is the cost of rebuilding and associated costs at the level applying at the commencement of the insurance period, without any provision for inflation. This is different from the 'sum insured', which will often make allowance for things like inflation over the term of the policy and VAT shortfalls in the event of partial loss. Each policy wording would need to be reviewed individually.

With every RCA from EK RCAs a 'rebuilding period' is given as part of the calculation to assist yourselves and insurers in deciding the total 'sum insured'.

BCIS Guidance

The Building Cost Information Service (BCIS) provides data for use in assessing the reinstatement cost of buildings. They produce tables and guides for use by surveyors and insurers in assessing the sum insured for owners of dwellings. The vast majority of Reinstatement Costs applied to residential mortgaged property are assessed using their tables and online systems. This accounts for the majority of residential properties in the UK.

Within their tables and software, VAT is not applied to the Reinstatement Cost Assessments, since it is not applicable on a total rebuilding of dwellings. But it does allow for VAT on fees, demolition, outdoor leisure facilities etc, which are not exempt.

However we strongly recommend that VAT is applied on all residential dwellings due to the 80% loss fallacy as explained on page 2 of this article, and as per our opinion piece and white paper "Is the treatment of VAT on RCAs proving to be taxing" — whilst not "fact" like the rest of this factsheet — our view remains that not including for VAT in residential dwellings runs a risk of under-insurance in near but not total loss situations.

Conclusion

Surveyors preparing a Reinstatement Cost Assessment should include a statement within the report explaining how they have applied VAT and recommending that the client's insurer/ broker reviews the policy wording to ensure the correct sum insured is provided.

Anyone commissioning an RCA and instructing the surveyor not to include VAT on works should be fully aware of the possible implications of under-insurance. VAT remains a contentious area, but increasingly industry thought is moving towards universal inclusion as the default.

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How can Earl Kendrick Building Surveyors help?

Our Team at Earl Kendrick Building Surveyors are experts in Reinstatement Cost Assessment and Managing Reinstatement Works in the event of a claim. We are able to prepare a careful assessment of what it would cost to rebuild a property if it were destroyed and can support the Client in overseeing a claim in the event of damage or destruction. Our full range of expertise as Building Surveyors allows us to assess damage and prepare specifications for the reinstatement of the property and to act as Contract Administrators for such projects.

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