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Dear Tony

VAT advice on the refurbishment of the public hall complex

The council engaged us to advise on the VAT implications of the refurbishment of the public hall complex, including options to maximise VAT recovery. We have undertaken this using information obtained from the council's website and other information that you have provided. This letter sets out the implications and options, along with our recommendations.

The project

- 1) You advised me that the council intends to refurbish the public hall complex that it owns. I understand that the council's offices are based in the building, but approximately 80% of its use is as halls for hire. The project budget allows for costs of up to £208,333, plus VAT of up to £41,667.

VAT implications of hall hire

- 2) Making supplies of services (including the use of buildings) in return for any form of payment is a business activity for VAT purposes (Section 5 of VAT Notice 749 - Local Authorities and Similar Bodies).
- 3) The leasing or hiring of rooms is generally exempt from VAT (under Group 1 of Schedule 9 of the VAT Act 1994). This is good for hirers, who don't have to pay VAT, but it has an impact on the council's ability to reclaim VAT on the building.
- 4) Where the council makes VAT exempt sales, it is only entitled to reclaim VAT on the associated costs if the amount of VAT is less than £7,500 in the financial year (explained fully in Section 8 of VAT Notice 749).

- 5) This threshold covers all activities, so where the council makes other VAT exempt sales (such as other leases) it would need to look at the total VAT incurred across all these activities, rather than looking at them individually. If the VAT incurred in relation to exempt sales is over £7,500 then none of it is reclaimable.
- 6) If it exceeds the threshold, the council will not be entitled to recover VAT incurred in relation to VAT-exempt sales. It would still be able to recover VAT incurred in relation to its non-business activities and its taxable business activities.
- 7) Although most room hire is VAT-exempt, the provision of wedding facilities is a standard rated supply. If rooms are used for weddings, the council will be able to apportion some of the refurbishment costs to its taxable business activities. A simple approach would be to apportion the cost based on the split of income between taxable and exempt activities.
- 8) With VAT of around £41,000 and up to 80% of it relating to the council's VAT-exempt business activities, the project would push the council well over the £7,500 threshold. It would be unable to recover that VAT on the project and would lose the ability to recover VAT on other exempt activities, such as the Guildhall.

Options for reclaiming VAT

- 9) If the £7,500 threshold is exceeded, the council can examine whether, over a 7-year period, the average annual VAT on exempt activities is under £7,500 (see VAT Notice 749 Section 8.5). This involves looking at the year the threshold is exceeded, the four previous years and two projected future years. Based on the available information (Table 1 below) the council appears to be close to the threshold already and is unlikely to have the scope to use this approach.

	2016/17	2017/18	2018/19
Potential VAT on exempt activities	£6,426	£6,320*	£5,687*

*Estimated

- 10) An approach sometimes used is to lease the building to a third party to run for £1 and treat any expenditure on it as non-business. This is unlikely to work in this case, since the council's offices and member facilities are integrated into the building. Similarly, allowing free use of the facilities would lose the council more money than simply accepting that it cannot reclaim VAT on the refurbishment.
- 11) The council could make an Option to Tax on the building. This is a formal decision that all future supplies of the building will become taxable supplies. VAT must then be charged on room hire or leases and on any future sale of the property. In return, the council can reclaim any VAT incurred in running or refurbishing the building. HMRC must be notified of that decision within 30 days. An Option to Tax cannot normally be revoked for at least 20 years. If most hirers are not VAT registered, the council will need to examine how competitive its hire charges are, as it may not be able to increase them by 20% without losing customers. This could result in the council losing up to 1/6th of its hire income in VAT.

12)The council can simply accept that it will be unable to reclaim approximately 80% of the VAT on the refurbishment works and that it might be unable to reclaim around £6,000 of VAT on exempt activities in the year the works take place. This is sometimes the best approach, where the loss of income because of VAT is greater than the initial VAT saving. Over 20 years, the council could lose £66,667 of its income in VAT, based on an income budget of £20,000. Discounted by 3% per annum to allow for inflation, this still equates to over £50,000 at today's values. This is greater than the initial VAT of £32,800 (80% of £41,000), even if £6,000 of unrecoverable VAT is added.

Recommendations

13)The council needs to assess whether it would be better off:

- a. making an Option to Tax and charging VAT, or
- b. simply accepting that it won't be able to reclaim some of its VAT in the year(s) the works take place.

14)To do this, it will need to assess the competitiveness of its charges and the potential to increase them by up to 20%, either upon commencement of the works or phased in over a number of years. It should also consider the potential for growth in income.

15)The council will also need to establish accurate costings for the works and assess how to fairly apportion its costs between non-business, VAT exempt business and taxable business activities. It will then be able to accurately identify how much VAT might be unrecoverable.

16)It will then be in a position to decide whether an Option to Tax is appropriate by comparing two situations:

- a. Making an Option to Tax, reclaiming VAT on the works (and on remaining VAT exempt activities) and charging VAT to its customers over 20 years or more, and
- b. Accepting that a proportion of its VAT will be unrecoverable whilst the work is undertaken and that it will be able to retain the full amount of any hire income (but please note the comments regarding weddings).

17)If it decides to Opt to Tax, the council should follow the guidance in VAT Notice 742A, Opting to Tax and we will be happy to advise further if required.

18)The council should note that wedding packages are taxable, regardless of whether there is an Option to Tax or not. If the council is anticipating income from weddings, it should take account of this when considering the options above.

Disclaimer

19)This advice covers the situation based on the information that the council has provided, but The Parkinson Partnership LLP cannot accept responsibility for any errors or omissions on the council's part in providing that information.

20) This advice is provided exclusively for Liskeard Town Council and The Parkinson Partnership LLP accepts no liability towards any other party that may access or use this information as a result of it being disclosed by the council.

I trust that this covers all the issues but let me know if you have any questions. As you know, our quote included aftercare to the end of the project, so please come back to us if you need further advice.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Steve Parkinson', written in a cursive style.

Steve Parkinson
The Parkinson Partnership LLP