

Hawkhurst Town Council (“HTC”)

Value Added Tax Advisory Services

New Village Hall

Background

The Council are Sole Corporate Trustees of 2 Trusts.

- 1 Hawkhurst Community Trust (“HCT”) which run Copt Hall (WI Hall). The income is low at £3,000 and does not cover costs so the Council grant fund any costs that remain unpaid.
- 2 Fields in Trust (“FIT”) hold the King George V Playing Fields and a small hall. They have little or no income, so the Council grants them approximately £14,000 to cover costs.

Hawkhurst Community Trust 2018 (“HCT2018”) was set up in 2018 with new Trustees from the Parish with the intention that it operate the new hall. This Trust is already active in the local area. HPC have no direct link to this Trust.

New Village Hall

The Council own the land and buildings and various plans have been discussed in order to get the new village hall built.

The cost of building the new village hall is expected to be in the region of £2million to £3million so there will be at least £400,000 VAT that on the face of it will not be recoverable by the Council based on the anticipated exempt use.

Sources of Funding

1. The sale of public conveniences has raised £69,000. The money was placed with HCT temporarily and will ultimately be paid across to HTC. *See recommendations below.*
2. The sale of Copt Hall site is expected to raise between £350,000 and £500,000 as it has planning permission for 3 houses. HCT will wind up and pass their monies across to HTC. There were issues with the transfer/distribution of monies in the 1970’s and this was changed again in the 1990’s and will need to be clarified. *See recommendations below.*
3. Football Association Grant is hoped for to assist with the building of the new changing rooms.
4. A £1million loan from an, as yet, unidentified source but possibly the PWLB.

5. Legacies left to the Trusts.
6. Section 106 monies - Tunbridge Wells District Council are holding some funds but will not release the monies until Planning Permission is granted.

Current VAT recovery position

HTC are currently using the VAT 126 claim procedure to make claims for the recovery of VAT incurred on their non-business activities.

See Appendix 4 for more detail of the VAT 126 regime.

VAT issues

The VAT issues falling out of this project are many and varied.

Option 1 - Take no further action to mitigate VAT recovery

If nothing is done to mitigate the VAT incurred on the new village hall, a further £400,000 to £600,000 will have to be found to fund the project from either grants or loans and doing this can take time.

By doing nothing with regard to VAT recovery, it leaves HTC with a VAT paid building, but ongoing VAT recovery would have to be considered on the upkeep of the building.

If the Members decide to accept the current position, VAT of approximately £400,000 plus will be recoverable only to the extent that taxable supplies are made in the building as the majority of the supplies will be exempt room hire and exempt sporting lets.

We cannot see that any taxable supplies would be made in the new village hall ordinarily although HMRC has recently accepted that local authorities need not be forced to standard rate their leisure activities but can now make the choice between exempt leisure (no VAT recovery) or standard rated leisure activities (full VAT recovery). This decision has partial exemption implications that we cover later in this document.

See Appendix 2 for notes on Partial Exemption

Option 2 - A zero rated village hall

A Charity can obtain a zero-rated village hall whereby the main contractor will not charge VAT on his services but, in this instance, HCT2018 will have no money with which to build the hall and moving money from one entity to another can cause serious VAT and legal problems.

There are a number of conditions that must be met primarily in the way the hall is used and operated.

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See Appendix 3 for more detail

Option 3 - HTC manage the building themselves

Once the construction of the new village hall was completed HTC would need to look at the ongoing VAT recovery position.

VAT liabilities of supplies being made in the new village hall are:-

Exempt supplies

If HTC were to manage the village hall itself and hire it out to various users, both the rental of the Centre and the rental of a room is exempt under current legislation *VATA 1994 Schedule 9 Group 1 (Land)* under the same rules as land but the provision of sporting activities is also exempt under *VATA 1994 Schedule 9 Group 10 (Sport)*.

However, for some years local authorities were excluded from the exemption and told by HMRC to charge VAT on their leisure activities. Since the *London Borough of Ealing* took a case to Tribunal HMRC have had to accept that they were incorrect and have now given local authorities a choice.

Standard rated

The rental of the village hall for children's birthday parties and wedding receptions however do not fall under any of the exemptions because there will be further additional facilities rented along with the room such as lighting and acoustic equipment. This makes the supply standard rated for VAT purposes.

HTC would have to VAT register based on these supplies.

Non-business supplies

In addition, a small percentage of the VAT incurred would be able to be recovered if we could show that the new facilities include some own non-business usage ie occupation by HTC. This may be Council meetings or any toilet facilities available to the public as this would also be non-business for VAT purposes.

Option 4 - Opt to Tax the building HTC operates the Centre itself (no third party lease)

HTC could decide to Opt to Tax the new village hall and still manage the bookings itself. This would mean that any room hire would be VATable, and the provision of sporting activities would be exempt or standard rated. Block bookings, however, would become standard rated. Charging an additional 20% VAT to the customer will increase the prices and may mean that the use of the Centre is reduced.

HTC may want to consider holding the prices and only increasing them slowly over a period of time with HTC in effect subsidising the VAT until prices increase to match the additional VAT

charge. VAT would be taken out of the income rather than added to the prices. If HTC held the £400,000 VAT in the bank for the duration of the Option to Tax ie 20 years, HTC could allocate £20,000 per year to supporting the increased VAT costs by which time with price increases the prices plus VAT should have caught up.

Option 5 - Granting a lease to a third party such as HTC2018

If the decision is made to grant a lease to a third party this needs careful consideration. A lease gives the recipient a right over land or buildings for a certain period of time and for a specified charge.

The granting of a lease in VAT terms can either be non-business when granted for a peppercorn by a local authority, exempt under *VATA 1994 Schedule 9 Group 1 (Land)*, taxable and standard rated using the Option to Tax

Non-business lease

HTC could undertake and pay for all the works to the buildings recovering the VAT on the basis that it will grant a non-business lease to an unconnected third party. The rent charged to the third party could be no more than a peppercorn. This strategy would enable HTC to recover all of the input tax incurred. It is important to remember that if a non-business lease is granted NO further monies can be received from the lessee either by way of shared costs or payments for insurance or utilities.

Unfortunately, if there is funding coming to HTC from other third party funders there is no doubt that HMRC would seek to treat this money as further consideration for the lease thus changing the VAT liability of the lease from non-business to exempt business. This is something we would seek to avoid.

There are further options available to HTC and these should be carefully considered by the Members.

We would recommend that you do not extend the Option to Tax out over the recreation ground as little capital expenditure is anticipated in the future other than grounds maintenance.

Option 6 - Leasing to a third party - exempt.

If the Centre is leased by HTC to a third party for any sum in excess of a peppercorn the lease falls to be an exempt business activity. This means that whilst HTC would not add VAT to the rental charge no VAT would be recoverable on the anticipated expenditure or on any landlords works undertaken in subsequent years.

Whilst this is an advantage to the third party lessee it would leave HTC out of pocket by £400,000 approximately.

Option 7 - Opting to Tax a lease – taxable

If HTC granted a lease on the whole building to a third party the granting of the lease is exempt as we mentioned above but there is an opportunity to change this legally by Opting to Tax the lease. In affect by Opting to Tax the building for HPC any transaction relating to the building and the lease itself, is automatically Opted as well and will attract VAT.

An Option to Tax can be made on a building. Opting to tax is a legal process and remains in place for 20 years. The decision to do so is one that is made by Members of the Parish Council and needs careful consideration. Opting to tax changes the supply of exempt land and buildings to standard rated land and buildings. Opting to tax the new village hall will change the VAT liability of activities such as room hire income from exempt to standard rated and will add VAT to all room hire charges.

However, by doing this it will give the result that 100% of the VAT on all the works will become recoverable. This means that HTC will not have to find the extra £400,000 VAT costs which up until now have not been budgeted for. It will give HTC the certainty that for the next 20 years there will be no VAT cost on the maintenance of the buildings.

Whilst it may seem at first to be a bit extreme to Opt to Tax and add VAT to all income, the actual pricing of the room hire charges is still in the control of lessee. The lessee, will have to pay the VAT charge to HTC and this will increase its costs overall as it is unlikely that the lessee will be VAT registerable. This extra cost will have to be passed on to the local community users.

Dis-application of the Option to Tax.

There is a mechanism by which a charity can dis-apply the Option to Tax and therefore avoid paying VAT on the VATable rental charges made to it. However, the rules are fairly narrow and HMRC will only accept such a dis-application from a charity that can prove its only activities within the premises are wholly non-business for VAT purposes (for example envelope stuffing). If there are non-business activities, then a certificate can be issued to the landlord and the VAT avoided.

See Appendix 1 attached for further details on Options to Tax.

NNDR

The third-party operator of the pavilion should be a non-profit making entity (for example a Management Committee or a Charity) to enable it to take advantage of NNDR (Rates Relief). The

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third-party entity would run the new village hall independently from HTC although some HTC Members could be represented on the Board.

Summary

HTC could spend between £2million and £3million plus VAT on a new village hall but by taking any one of the following options the result will be,

1	take no action	Minimal VAT recovery
2	certify a zero-rated village hall	No VAT will be charged by contractor
3	operation of the hall be HTC	Apportioned VAT recovery
4	opt to tax and operate it itself as a taxable activity	Full VAT recovery
5	lease to a third party as a non-business activity	Full VAT recovery
6	lease to a third party as an exempt activity	No VAT recovery
7	opt to tax and lease to a third party as a taxable activity	Full VAT recovery

Recommendations

We recommend that you take further legal advice in respect of items 1 and 2 in the Sources of Funding paragraph. In this instance we would recommend Janet Turner QC who has a wealth of experience in this field. She can be contacted at janet.turner@minervachambers.co.uk

Upon further discussion with HPC we would recommend that HPC register for VAT on the basis that they are making taxable supplies and then take Option 7. This will involve Opting to Tax the new building and adding VAT on the rental charge to HCT 2018.

HPC should hold a Council meeting and Members should agree the way forward and this decision should be clearly included in the minutes of the meeting.

Following the meeting of the Council HPC will have the right to recover any VAT incurred in respect of the new building from HMRC because it has established that there is a clear intention to Opt to Tax the building. Opting to Tax normally takes place once construction commences but it can be done earlier if firm plans are in place and it is deemed necessary.

Until VAT registration is established the old route of VAT recovery via the VAT 126 claim can continue.

It should be noted that this report and its Appendices is only applicable to Hawkhurst Parish Council. The information contained within this report and Appendices can only be relied upon



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by Hawkhurst Parish Council because circumstances may not be the same in every case and must therefore be considered on an individual basis by a VAT professional.

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Appendix 1

Options to Tax

Supplies of land and buildings, such as freehold sales, leasing or renting, are normally exempt from VAT. This means that no VAT is payable, but the person making the supply cannot normally recover any of the VAT incurred on their own expenses.

However, you can opt to tax land. For the purposes of VAT, the term 'land' includes any buildings or structures permanently affixed to it. You do not need to own the land in order to opt to tax. Once you have opted to tax all the supplies you make of your interest in the land or buildings will normally be standard-rated. And you will normally be able to recover any VAT you incur in making those supplies.

The Option to Tax will remain in place for 20 years.

The option to tax cannot be applied to domestic property.

The law

The area of VAT law which specifies the supplies of land and buildings that are exempt from VAT is *Group 1 of Schedule 9 to the Value Added Tax Act 1994*. The law detailing the option to tax is found in *Schedule 10 to the Value Added Tax Act 1994*.

Within *Schedule 10* there is a large amount of anti-avoidance legislation which, although aimed at those seeking to obtain a tax advantage, can also catch innocent transactions. The timing of the Option to Tax may also be critical with regard to the recovery of VAT, although because we are at an early stage in the project there will be time to consider the impact of the option to tax in more detail.

When should I notify the Option to Tax?

The Option to Tax should be notified via the correct forms, of which there are a number to choose from, within 30 days of the decision being made.

If it is decided that the Option to Tax mechanism is appropriate for this building, then to avoid potential problems, the decision to Opt will have to be taken by you at an early stage and that decision notified to HMRC within the statutory 30 day notification period. The notification is normally made on VAT Form 1614. It is usual to submit a plan showing the proposed location of the building to accompany the Form 1614.

Bearing in mind that until an Option to Tax has been made, all VAT incurred will be deemed to relate to exempt supplies, we would prefer that the decision to Opt is made as soon as possible

and if possible, at the next Council meeting and notified to HMRC within 30 days of that meeting. If that is done, then the risk of any challenge from HMRC will be minimised.

As the Option to Tax is made an application for VAT registration needs to be submitted in order that HMRC can capture the VAT charged.

Do I have to ask permission?

A local authority has automatic permission, and this is covered in the VAT1614, but any other person would have to apply for permission first before making the legal Option to Tax.

What is included in my Option to Tax?

You are opting to tax land. For the purposes of VAT, the term 'land' includes buildings. When you opt to tax you can specify an area of land or a 'building'. Commonly, you will specify a 'building' because that is the prominent feature of the land.

- If you specify a building, the option to tax will continue to apply to the land on which the building stood if the building is demolished and to any future buildings constructed on the land.
- If you specify land, the option will apply to any buildings on the land and future buildings constructed on the land.

In both circumstances, you can specifically exclude new buildings from the effect of an option to tax if you wish to.

Usually it will be clear what constitutes a 'building', for instance an office block or a factory. However, in some instances the law treats more than one building as being a single 'building' for the purpose of the option to tax. These are:

- buildings that are linked, or if not yet built are planned to be linked, and
- a complex consisting of a number of units grouped around a fully enclosed concourse, such as a shopping mall.

Will all my Options to Tax always be effective?

There are some Charities who will be able to provide a certificate to dis-apply a landlords Option to Tax. These charities must be able to demonstrate that their activities are purely and *solely* non business. A charity using a room as an office does not qualify for the disapplication of an option to tax.

If there are business activities (as defined by HMRC) being undertaken on the premises, then VAT will still apply to the rent or room hire charge.

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If a charity is able to confirm without any doubt that their activities are non business there may be opportunities for both the landlord and charity to negotiate the position to secure a win/win position for both parties.

Demolition and the option to tax

An Option to Tax covers the whole building, the land underneath and the land immediately around the building. From 01 June 2008 if a building is demolished or destroyed, any option to tax will still apply to the land on which the building stood and to any future buildings that are constructed on the land.

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Appendix 2

Local authorities - VAT registration and partial exemption

In order to do Partial Exemption, it is necessary to identify all your VAT both on sales and purchases.

Firstly you identify the VAT liabilities of all the activities undertaken by the authority ie whether they are non-business taxable or exempt.

Secondly you identify goods and services supplied to the authority and to categorise all input tax incurred on costs. The categorisation of input tax means allocation of the costs to either the authorities' non-business activities or to its business activities. If it falls into the authorities' business activities, then you have to identify whether those activities is taxable or exempt.

If you have both taxable and exempt activities, then you are partially exempt. The taxable input tax is recoverable but the exempt input tax is not subject to certain de minimis limits.

It is the measurement of exempt input tax that has to be monitored quarterly basis provisionally but again on an annual actual basis and is called the partial exemption calculation.

There are specific rules (de minimis rules) that have to be adhered to in order to undertake this calculation and to measure insignificance. If the exempt input tax is seen to be insignificant under this calculation, then all the VAT may be recovered.

Parish and town councils' partial exemption in practice

The authority will have to carry out this exercise in order to decide whether or not it can recover all of the VAT incurred on the new facilities.

Is the VAT incurred on the additional facilities during the year more than £7,500? If it is, the council has a partial exemption problem and that VAT is likely to be an irrecoverable cost. It will be seen below that approximately 95% of the VAT costs will fall into this category and thus not recoverable adding to the overall cost of the project.

What if the town or parish council is not de-minimis?

What can be done to alleviate the problem if the town council does breach its partial exemption limit?

The key, in this context (and typically so with parish and town councils facing this dilemma), is whether the town council can opt to tax the village hall/community centre, thereby 'converting' all lettings thereof from being exempt from VAT to liable to VAT at standard-rate. As the lettings then constitute VATable income, the VAT incurred on the new facilities is fully recoverable under 'normal' rules.

This though results in users of the facilities having to pay VAT on their lettings, VAT which is likely to be a real cost given users are unlikely to be VAT-registered businesses.

The town council thus has a political decision to make which is typical of such scenarios; does it accept the additional cost of irrecoverable VAT in order to keep the charges payable by local community groups as low as possible or does it opt to tax in order to recover the VAT incurred but then have to charge VAT on lettings?

And if the latter, there is a further political decision; whether to increase charges to cover the VAT or rather absorb some (or all) of that VAT in lower charges but at the cost of a loss in real net income to the council?

In fact, there is a further complication in the context of Opting to Tax the facilities, as it is far from certain that an Option to Tax would be fully effective in such circumstances.

This is because local community group users may well be charitable bodies letting the facility for their charitable non-business purposes and so able to block the effect of the option (*under para.7(1) of Schedule 10 to the VAT Act 1994*), so rendering their lettings VAT-exempt with renewed partial exemption implications for the council.

In practice, therefore, the 'safest' solution is for smaller parish and town councils contemplating major capital expenditure to try and restrict VAT thereon to no more than £625 per month or £7,500pa on average. Otherwise, it may well be necessary to factor into the budget for the project the cost of the irrecoverable exempt-attributable VAT incurred as a consequence, and not just on the project itself but all other exempt-attributable VAT incurred, too.

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Appendix 3

Zero Rated Village Halls

Background

Guidance on what ‘use as a village hall or similarly’ means is contained in Public Notice 708 Buildings and construction at Section 14.7.3.

The relief is aimed at situations where the local community forms a charity or uses an existing charity to organise the construction and operation of a building for itself to provide for its social or recreational activities. It is for the community to decide the range and mix of social or recreational activities it wants and how the building is designed and equipped to meet those needs.

Characteristics of a village hall

Where a village is concerned, the local community traditionally organises itself by forming a village hall committee to fund the construction and management of a building to provide for a variety of social or recreational activities. The building is vested in village hall trustees who are usually drawn from representatives of local groups who use the hall.

Such buildings are often small and contain basic amenities, supporting a multi-use hall. It is hired out to the local community for a modest fee for use by a range of local clubs and groups, and also for wedding receptions, birthday parties, playgroups and other leisure interests.

However, the size, and level of provision and facilities will be decided by the local community.

The inclusion of ‘similarly’ provides for communities other than villages that organise themselves in a way that is similar to those in a village in providing a venue for social or recreational activities. Thus, ‘similarly’ means similar to the way a village hall operates and not a building that provides for a range of activities associated with a village hall.

Buildings used similarly to village halls

Examples of buildings that can be seen as being ‘used similarly...’, when the above characteristics are present, can be found at Section 14.7.3 of Public Notice 708, as well as examples of buildings that can’t.

In Sport in Desford (VTD 18914), a committee comprised of members of the local Parish Council and the local community was formed to raise funds for the construction of a clubhouse for use by the local community for a variety of sporting and recreational facilities. The Tribunal confirmed that sporting activities fall within the definition of social or recreational activities: We find that the sporting activities fall within the definition of ‘social or recreational activities. A high degree of sporting use does not make the use dissimilar to the use of a village hall.

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However, a building designed for a particular sporting activity, for example, a swimming pool and ancillary facilities isn't similar to a village hall. A building used similarly to a village hall must be capable of meeting the social and recreational needs of the local community and not simply confined to a special interest group.

In Jubilee Hall Recreation Centre Ltd ([1999] STC 381), the Court of Appeal considered the extent of 'similarly' in this context. Sir John Vinelott rejected the previous High Court approach, which held that 'similarly' meant similarity of function in providing social and recreational facilities and is a building to which the local community engage in social and recreational pursuits. He held that:

In this context the plain purpose of sub-paragraph (b) was in my judgment to extend the relief in sub-paragraph (a) to the case where a local community is the final consumer...in the sense that the local community is the user of the services (through a body of trustees or a management committee acting on its behalf) and in which the only economic activity is one in which they participate directly.

We accept that use of the building can be by people from outside the local community. However, use by a local community can't be extended to a building that is principally used by people that reside outside the locality. Sir John Vinelott in Jubilee Hall Recreation Centre Ltd agreed with the view expressed by the Tribunal in this point, saying:

Like the Tribunal I have 'great difficulty with the notion that the daily influx on working days into an area of the people to staff its offices and shops and to attend its colleges, even if they have a greater attachment than its flocks of visiting tourists, are part of the local community'. It may be claimed by schools and other educational establishments that by offering limited public access to sports halls and other recreational facilities that they qualify as similar to a village hall.

The Court of Appeal rejected this line of reasoning in St Dunstan's Educational Foundation ([1999] STC 381), primarily on the following grounds:

- the use by attendees of the school wasn't as members of the local community, but in their role as pupils
- the sports hall wasn't used solely for a relevant charitable purpose as required under Item 2(a) and Note 6(b), but was intended, in part, also for educational use. Therefore, on a strict liability application the building fails the sole use test, and this will inevitably apply to other educational establishments endeavouring to obtain zero rating for buildings under Note 6(b).

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Appendix 4

VAT 126 claims of “non-business” input tax

Local Authorities can claim a VAT refund as an organisation not registered for VAT

You can use an online service (VAT126) to claim back VAT if you're exempt from it as a local authority, academy, public body or eligible charity.

Who can claim?

You can use this service to claim back VAT for “non-business activities” if your organisation is either:

- a local authority or similar body
- an academy school or multi-academy trust (MAT)
- a charity in palliative care, air ambulance, medical or search and rescue
- a non-departmental body or similar body not registered for VAT

Your claim must be submitted within 3 years after the end of the month in which you received the supply if you're a local authority, but it must be made within 4 years if you're a charity, an academy school or MAT.

What you need?

You'll need:

- your Unique Reference Number - sent to you by HMRC if you've already claimed
- your registered organisation postcode
- the start and end dates for your VAT claim
- a bank statement dated within the last 3 months from your claim to confirm your new address or bank account (if these have changed)

If you're claiming a refund for up to 5 invoices, you'll need to manually enter the following information for each invoice:

- the invoice date
- the supplier's VAT registration

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- the VAT amount
- the name of the organisation receiving goods or services on the invoice
- a brief description of goods or supplies

If you're claiming a refund for more than 5 invoices, you'll need to upload one spreadsheet or document providing the details above for all invoices.

What are non-business activities?

The general rule

Because VAT is a tax on transactions, individual circumstances need to be considered according to their facts. But the general rule is that where a public body is funded by way of public expenditure (such as grant-in-aid) to do something for the public good, it's unlikely to be engaging in business activities for VAT purposes. Such activities are outside the scope of VAT.

Conversely, where a public body supplies goods or services for consideration and by way of business, and it's registered or required to be registered for VAT, such activities are within the scope of VAT. The term 'business' has a wide meaning for VAT purposes. See VAT Manual Business and Non-Business VBNB21000.

The following outlines the main differences between business and non-business activities.

Business activities:

- are mainly concerned with making supplies to other persons, for any form of payment or 'consideration', whether in money or otherwise
- have a degree of frequency and scale
- continue over a period of time – are actively and earnestly pursued.
- are within the scope of VAT and may be standard rated, zero-rated or exempt

Non-business activities are:

- activities you carry out for no charge and no other form of consideration, including leases you grant, or the freehold sale of land and buildings, for the nominal payment of a peppercorn or a pound and where no other form of payment is involved
- activities you carry out for academies or multi-academy trusts in relation to travel for training, childcare vouchers and school trips

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- activities you carry out for a charge but with no degree of frequency or scale, and without continuing over any period of time
- outside the scope of VAT

You can find out more about 'business' and 'non-business' in VAT guide (Notice 700).

Make a claim

Your claim must be for a period of at least one calendar month and must end on the last day of a calendar month.

If you want to make a claim for less than £100, it must cover a period of at least 12 months.

If you have not made a claim before, you'll need to use the print and post so we can send you a Unique Reference Number. You'll be able to use this to submit future claims through the online service.

If you've claimed before, you can use the online service. You'll need a Government Gateway user ID and password. If you do not have a user ID, you can set one up when you claim.

The VAT 126 claim regime cannot be used for claiming VAT on your exempt costs. These would include VAT incurred on land and property transactions and those supplies that are exempt and related to land and property such as room hire.

Additionally, another exempt activity is sport and leisure and the income from block bookings that are taken from clubs and associations. VAT on sport and leisure costs cannot normally be recovered.

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