



# MELTON PARISH COUNCIL

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FRM(21)56.04

## VAT ISSUES RELATING TO THE PAVILION PROJECT

This note addresses a small but very important aspect of the Pavilion project. Property and building work is one of the most complex and inherently risky areas in relation to VAT. The sums involved are large. If the net cost of the new build is £200k, then VAT will be £40k. It is important, just as it was when the Council purchased its premises at Riduna Park, to be able to recover all the VAT. On that occasion the Council exercised the option to tax the property, so for at least 20 years we charge VAT on the rent from the 1<sup>st</sup> floor tenants and pass it on to HMRC. It has worked well and there are no problems.

VAT will be charged on all aspects of the pavilion build and the right to reclaim the VAT will depend upon the uses of the new building. Where the uses are either non-business or taxable, the Council will be able to recover the VAT. But where the VAT costs are attributable to a VAT exempt activity, the recovery will be subject to the Council's partial exemption position and so might not be recoverable. If for example the pavilion is solely used for Council activities and the communal space never let to third parties then it would be fully a non-business activity and VAT can be recovered in full. However where there are lettings of one sort or another the position becomes complicated and there is a strong risk that VAT on the build will not be recoverable in full.

Because of the risks to the Council's finances I sought advice from the Parkinson Partnership (VAT consultants to the local council sector). The initial advice was free via our subscription to SALC.

I reproduce below Steve Parkinson's advice with my comments in red under each point.

### **Pavilion**

The pavilion will represent a significant capital spend, and VAT will be charged on all aspects of the work (except where a supplier is not registered). Zero-rating does not apply to either demolition or construction work of this kind. **I assume that demolition is a non-business activity so we should be able to recover the VAT.**

The council cannot assume that it will be able to reclaim VAT on the new pavilion, because the right to reclaim depends entirely on the uses that the council will make of the new building. There are several considerations from a VAT point of view, and these are dependent on the council's own circumstances. **That is why I sought the advice.**

Opting to tax is certainly one option to obtain full VAT recovery on building works, but it can easily work out to be an expensive, inflexible and unnecessary choice. The option remains in place for at least 20 years and means that all income is subject to VAT – over 20 years this can add up to a lot of lost revenue. **I don't agree - the office is covered by an option to tax and we charge rent in full + the VAT – there is no revenue loss.**

The clerk describes activities that could range from exempt (potentially VAT-restricted), taxable (potentially requiring VAT registration) and non-business (VAT recoverable). It may be possible to avoid opting to tax through looking at the rules on partial exemption de-minimis limits, non-business apportionment and careful adjustments to trading terms. **If we don't opt to tax officers will be spending a lot of time on detailed calculations and the risk in terms of financial loss if they get it wrong will be considerable. Opting to tax is a safety net. An option to tax would apply to the whole building and any lettings would become taxable supplies. So all activities would either be non-business or taxable, and it would mean there is no impediment to recovery of the whole VAT cost of construction.**

## **Recommendations**

In order to ensure that there is no risk to the recovery of VAT in full on the pavilion build project, it is recommended that Members of FERM Committee agree to exercise the option to tax, and instruct the Clerk and Executive Officer to pursue this option with HMRC.

**William Grosvenor**

**Clerk and Executive Officer**

**7 December 2021**