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Dear Tina

VAT advice for Sandown Town Council

You engaged me to advise the council on the VAT implications of the community building project, along with options to minimise the cost of unrecoverable VAT.

As I understand it, the council has undertaken a project to reconstruct the Broadway Centre (which it owns) to provide a council office, one large and two or three smaller halls for hire, with associated kitchen, toilet, parking and changing facilities. The works started in May 2017 and are expected to be completed around the end of this month. The estimated total cost of the project is £615,000, plus VAT of approximately £123,000.

VAT Implications of hiring the building out

- 1) Around 90% of the use of the building will be hiring parts of it out to local groups, with the rest being for the council's non-business use. The council has set a modest income budget of £6,500 per annum for the building.
- 2) Room hire is a VAT-exempt business activity, carried out in competition with other providers. A council can reclaim VAT incurred on costs relating to such activities if the amount of VAT involved is less than £7,500 in the financial year. If the amount of VAT on these costs exceeds that threshold, none of it can be reclaimed.
- 3) As 90% of the use of the building will be for VAT-exempt business activities, it is likely that 90% of the cost (£553,500) and 90% of the VAT (£110,700) will also relate to these activities. As £110,700 is much greater than £7,500, the council will not be able to recover this VAT if it uses the building for VAT exempt business activities.

- 4) The council should still be able to reclaim the 10% relating to non-business activities.

Options to minimise unrecoverable VAT

- 5) The best option for the council would have been to register for VAT and make an Option to Tax on the building before starting the project. This is a formal decision to charge VAT on all hiring of the building, which would allow the council to reclaim VAT on associated costs. Whilst it is possible to backdate VAT registration by up to 4 years, it is not possible to backdate an option to Tax.
- 6) Because the costs are greater than £250,000 the project is subject to the Capital Goods Scheme (CGS). Under this scheme the council might still be able to change its intentions, make an Option to Tax, apply for backdated VAT registration and recover VAT on the construction costs, but this could take some time and might need HM Revenue & Customs (HMRC) agreement.

This might leave the council having to cover the cost for several months and the council would have to avoid charging for use of the building in the meantime, to avoid making any VAT-exempt sales.

- 7) Given the relatively low level of anticipated income, a simpler alternative would be not to charge for room hire. Allowing free use of the facility would be a non-business activity and the council would be able to reclaim all the VAT involved as part of its end of year VAT reclaim. Under the CGS, if the council started charging within 10 years of the reconstruction, it may need to repay some of the VAT it reclaimed.

The budgeted income over the next ten years is equivalent to around half of the VAT on the initial work. The council would be significantly better off than if it simply chose to pay £110,700 of VAT now. Instead of charging a fee, the council could invite users to make a donation to a local charity or project, but it should avoid specifying the level of donation.

- 8) A third option would be to lease the non-council parts of the building to a charity (either existing or new) for £1. The charity would manage and hire out the facilities, retaining any income to meet the running costs. The council would be able to recover VAT on the construction costs as a £1 lease is treated as a non-business activity by HMRC.

This option has pros and cons. The council would have a lot less control over the building. A charity would benefit from reduced business rates but would be unable to reclaim VAT on running costs, which the council would be able to do. If the charity was less successful in running the building, the council may need to subsidise it, or take back the building, go back to the starting point and look at VAT again.

- 9) Any of the above options would be better than simply accepting an extra £110,700 cost at this point.

I have tried to explain these options clearly, but this is intended as a starting point. The council may want to do detailed calculations of its anticipated costs and income in each case and might require further advice to implement its chosen option successfully.

If you have any questions, please let me know.

Yours sincerely

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

Steve Parkinson
The Parkinson Partnership LLP