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Dear Andy

VAT advice for the Mountwise building and Killacourt project

You engaged us to advise the council on the VAT implications of the Killacourt open space project and the refurbishment of the Mountwise building, including any options to increase VAT recovery in relation to the projects. This report sets out our assessment of the VAT implications and makes recommendations where appropriate.

Background

- 1) Newquay Town Council has sought funding to undertake an enhancement project at the Killacourt open space, a site that it does not own but intends to lease from Cornwall Council. The project involves a number of separate elements:
 - a. 12 container units to be rented out for business start-ups and community group use, with the aim of increasing footfall and business activity.
 - b. The installation of a café/restaurant, using similar containers.
 - c. Renovation of the existing bandstand, with the addition of portable staging that can be used to extend the performance area.
 - d. Removal of an existing kiosk and replacement with new beach-hut trading units to be used for markets and similar activities.
 - e. General landscaping including the provision of new palm trees with up-lighting installed around them.
 - f. We understand that earlier proposals for a performance amphitheatre for have been removed from the project.

- 2) The council owns the Mountwise building, a former young people's centre purchased from Cornwall Council in 2016. There is a proposal to spend approximately £500,000 to renovate it into a mixed-use community and commercial building, which will include:
 - a. Lower Ground Floor – Town Council storage and services
 - b. Ground Floor – Bookable large rooms x2 (weddings, conferences and events including Town Council and Community Events)
 - c. First Floor – Bookable Hot Desk space (anyone) and Town Council space (likely to be the Town Council's CCTV Control Room)
 - d. Top Floor – Long-term Commercial lettings
 - e. There is also a double garage and parking on site
- 3) The council undertakes several other activities that generate income. Some of these are non-business (public toilets and allotments), while some involve taxable sales of goods and services (advertising, souvenirs and ticket sales). Currently the council has little revenue that is exempt from VAT, except rent (mainly from Cornwall Council) for areas in the council office building.
- 4) The £500,000 Mountwise refurbishment is being funded by the council, while the Killacourt project will be funded from a mixture of sources, primarily a Coastal Communities grant of up to £500,000, plus developers' Section 106 contributions of £140,000, an insurance payment of £20,000 and town council funding (possibly with grant assistance) of £240,000, a total of up to £900,000.
- 5) The potential VAT on the cost of the two projects is £280,000.
- 6) The council is already VAT registered.

Business container unit and beach hut VAT implications

- 7) The council will be hiring these units out as pop-up shops, enabling new businesses to develop and creating opportunities for local craftspeople. The hiring out of facilities in return for payment is a business activity for VAT purposes and this will affect the council's ability to recover VAT on the associated costs.
- 8) At present, it is still unclear whether the container units will be attached to the ground, or simply resting on it and relying on their weight to prevent movement. For VAT purposes, this is an essential point in determining whether the hire of the units will be a VAT-exempt letting of immovable property, or a taxable hire of equipment.
- 9) The European Court of Justice (C-315/00 Maierhofer v Finanzamt Augsburg-Land [2003] STC 564) established that the letting of a building constructed from prefabricated components, fixed to or in the ground in such a way that they cannot be easily dismantled or easily moved, constitutes a letting of immovable property. As such, the rent of such a building would be exempt from VAT.
- 10) In HM Revenue & Customs v UK Storage Co (SW) [2013] STC 361, the Upper Tier Tribunal concluded that storage units that were not fixed to the ground were not immovable property, so the hire was taxable at the standard rate of VAT.

- 11) The nature of the fixing is an essential point because the council's ability to recover VAT will differ, depending whether the hire is taxable or exempt. If it is exempt:
- a. Where a council makes any VAT exempt sales (such as room hire or leases), it is only entitled to reclaim VAT on the associated costs (such as building maintenance) if the amount of VAT is less than £7,500 in the financial year (explained in Section 8 of VAT Notice 749) or less than 5% of the total VAT incurred during the year (if larger).
 - b. This threshold covers all council activities, so if the council makes other VAT exempt sales (such as leases, room hire, market pitches) the council would need to look at the total VAT it incurs across all these activities.
 - c. In any financial year where the council exceeds the threshold, it will not be entitled to recover any VAT incurred on costs relating to its VAT-exempt sales. If the container units were fixed to the ground, the council would need to look at additional VAT planning options to be able to recover VAT on the purchase of the container units.
 - d. If the council exceeds the threshold for exempt activities, it will still be able to recover VAT incurred in relation to its non-business activities (generally those services funded by the taxpayer, or under a specific statutory regime) and in relation to its taxable business activities (where VAT is charged to customers).
- 12) If the hire is taxable (because the units are not immovable property), the council will be able to reclaim VAT on the cost of purchase and installation but will have to charge VAT on any rent. If the target market is business start-ups and local craftspeople, this may result in a reduction in rent income as the tenants may not be registered for VAT and unable to afford 20% higher rents.
- 13) The beach huts are less likely to be sufficiently fixed to constitute immovable property and their hire is more likely to be a taxable supply of storage, or possibly equipment hire or a right to trade. As such, the supply is likely to be taxable and the VAT should be recoverable.
- 14) If the huts are used in connection with a market, the fee for a market pitch will be VAT exempt and use of a hut should be a separate charge.

Café VAT implications

- 15) The VAT treatment of the café will depend on whether the council intends to run it directly, lease it to a third party to run for a reasonable rent, or lease it for a nominal £1 to be run by a community enterprise.
- 16) If the council runs the café, it will be making taxable supplies of catering (mostly standard-rated but including some zero-rated). VAT will be recoverable on the cost of construction/installation of the facility.
- 17) If the site of the café building is let for £1, the council should be able to recover the VAT on this as a non-business activity if the building is fixed to the ground. If the building is not fixed, VAT would be due on the hire charge but the council would still be able to reclaim VAT on the construction of the café.

18) If the café is leased to a third party, the essential question will be whether the building is fixed to the ground (as described in paragraphs 8-10 above). If the building is fixed, the lease will be VAT exempt and the council's ability to recover VAT on installation will be affected (as described in paragraph 11 above).

19) If the building is not fixed, any rent will be taxable. The council can reclaim VAT on installation but may want to ensure the tenant is VAT registered to maximise rent.

Bandstand and staging VAT implications

20) The VAT treatment of the bandstand will depend on the intended use:

- a. If no charges are made in relation to the bandstand, the council will be able to recover the VAT involved as a non-business activity.
- b. If the bandstand is hired out, this will be a VAT exempt business activity and the rules described in paragraph 11 above will apply.
- c. If performances take place where tickets are sold, this is a taxable business activity and the council will be able to recover the associated VAT.
- d. If the portable staging is hired out separately from the bandstand, this will also be a taxable business activity.

21) If a mixture of activities take place, the council may have to apportion the costs if any VAT-exempt hire takes place. This is likely to result in less than 100% VAT recovery.

Landscaping VAT implications

22) If the landscaping simply creates a more attractive open space and is not directly connected with an area for hire referred to above, the council should be able to treat this work as a non-business activity and reclaim the VAT incurred.

23) If any aspect of this work is specifically to allow one of the hiring activities above to take place, it should be treated as part of the cost of that activity.

Mountwise VAT implications

24) Upon refurbishment, the Mountwise building is intended for use for council storage and services, along with rooms for hire and commercial lettings. Hiring out of facilities in return for payment is a business activity for VAT purposes and it seems likely that at least 50% of the floorspace will be used for business activities on a regular basis.

25) Leases of property and room hire are exempt from VAT, as they fall within Group 1 of Schedule 9 of the VAT Act 1994. Undertaking these activities will adversely affect the council's ability to recover VAT on the cost of refurbishing and running the building.

26) As explained in paragraph 11 above, where a 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, or less than 5% of the total VAT incurred during the year, if larger (explained in Section 8 of VAT Notice 749).

27) The council will be able to allocate or apportion any costs between business and non-business activities. For example, decorating the area to be leased out as offices

would be entirely a business cost, fitting out the council's storage would be entirely non-business and work to the roof would need to be apportioned between the two.

- 28) Floor area seems the most reasonable basis for apportioning costs, but the council may also want to split the main meeting rooms between business and non-business, possibly based on hours of use. For example, if the hall is used 2,000 hours a year and 100 of those hours are for council use, 5% of the costs can be apportioned to non-business activity. This will slightly increase the non-business proportion.
- 29) The building will fall into the Capital Goods Scheme, regardless of whether there is an option to tax exercised. This scheme requires the council to monitor the use of the property for a 10-year period, and to alter the VAT initially recovered on refurbishment in line with the actual proportion of exempt and taxable/non-business use.
- 30) The reason for this process is that VAT is recovered during the refurbishment will be based on intentions for how the buildings will be used. In practice, plans change and the proportion of use might be different, so that too much or too little VAT was recovered on construction. The CGS Scheme requires annual adjustments for this.
- 31) Regardless of the allocation of costs, it seems likely that approximately half the refurbishment cost, around £250,000 plus VAT of up to £50,000, will relate to VAT exempt business activities and the council will be unable to recover this VAT, without taking action to address the situation.

VAT planning options

- 32) Together, the two projects may involve a considerable amount of expenditure (£250,000 to £900,000) in relation to VAT exempt business activities, putting £50,000 to £180,000 of VAT at risk of being unrecoverable.
- 33) For the business unit and café proposals, it is essential to clearly establish the nature of the fixings and whether a VAT exempt supply is being made or not. This report assumes a worst-case scenario, with these supplies being entirely VAT-exempt.
- 34) There are several approaches a council could take to avoid being in a position whereby it incurs irrecoverable VAT. Some solutions would not work in this case, but we have listed them here for completeness:
- a. Spreading the work over several years won't work, due to the size of the project.
 - b. HMRC will allow a council to look over 7 years to see if they are below £7,500 on average, but this doesn't work where the total VAT involved exceeds £52,500.
 - c. Allowing free (rather than paid) use of a facility would be an option, where a council is not reliant on income to meet running costs or loan repayments.
 - d. Leasing a building or site to another organisation to run for £1 will allow a council to recover VAT on construction or refurbishment, as HMRC regard a £1 lease as a non-business activity. This arrangement would not generate any revenue for the council and is likely to be impractical for a mixed-use facility.
- 35) This leaves two principal viable options:

- a. The council could make a formal Option to Tax (described fully in VAT Notice 742A) on the Mountwise site (and on part of the Killacourt site if the units are considered immovable property). This is a decision by the council that all future use of a site will become taxable. VAT must then be charged on any lease or hire, so the council is able to reclaim the VAT incurred on works as the costs relate to taxable business activities. A longer explanation is included as appendix 1.
- b. Simply accepting the extra cost of unrecoverable VAT can be the best option where a site will generate a high income compared to the costs involved.

Assessment of options

- 36) For the Mountwise building, making an option to tax would enable the council to recover VAT on the full cost of the works and future running costs. VAT would need to be charged on any leases and hire charges, so it is important to assess whether this would reduce the council's income.
- 37) An option to tax lasts 20 years, so the question is whether taking the step to recover £50,000 of VAT would reduce the council's potential income by £2,500 per annum (before allowing for inflation). The council has indicated a potential rent of £20-25,000 for the upper floor, so it is more likely to be taken by a business that is VAT registered.
- 38) We have no information of potential hire revenue and it is essential that the council looks at this before making a decision. If most hirers are not VAT registered, charging VAT could potentially reduce the income the council could receive by up to 1/6th (for example, £20 out of £120). If potential hall hire income is much greater than £15,000 per annum, the council will need to look carefully at whether an option to tax is better in the long term.
- 39) For the Killacourt site, if the containers and café are fixed and constitute a letting of immovable property, this has the potential to result in substantial unrecoverable VAT.
- 40) The potential cost of the containers is approximately £400,000, resulting in £80,000 of VAT. The council has indicated potential income of up to £60,000 if all units are fully occupied. If they were all used by unregistered businesses, the council may need to make the charges VAT inclusive, rather than putting the rent up by 20%. This would result in 1/6th of income (£10,000 a year) being lost in VAT. Over the 20-year life of an Option to Tax, this could result in lost revenue of £200,000, to save an initial £80,000. However, if annual rental income is significantly less, an Option to Tax may be worthwhile.
- 41) The café unit is estimated to cost £85,000, with potential VAT of £17,000. Running the café directly, or leasing it to a not for profit organisation for £1, would allow full recovery of VAT. If the café is to be leased in return for rent, making an Option to Tax and leasing it to a VAT registered business would avoid any loss of rent income for the council.
- 42) In the event that the council leases the unit to a business that is not VAT registered, the council may need to consider whether an option to tax would be worthwhile in relation to the maximum rent that could be agreed.

Recommendation

- 43) It is essential that the council establishes how the container units will be fixed to the ground, in order to establish the potential VAT liability.
- 44) The council also needs to consider how the café will be run.
- 45) The council needs to estimate the potential revenue from future activities in the Mountwise building, so that an assessment can be made of whether an Option to Tax is worthwhile.
- 46) Having done those things, we can advise on whether an Option to Tax is worthwhile on one or both sites.
- 47) To avoid any VAT implications for the bandstand and landscaping, the council should avoid charging for use of parts of the site and stick to either free use or charging admission to events (where ticket sales are taxable).

Disclaimer

- 48) 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.
- 49) This advice is provided exclusively for Newquay 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 hope that this covers all the initial issues you want advice on, but if you have any questions please let me know. Advice is available through to completion of both projects.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Steve Parkinson', with a stylized flourish at the end.

Steve Parkinson
The Parkinson Partnership LLP

Appendix 1 – The Option to Tax

An Option to Tax is a decision by the council that all future supplies of a building or area of land will become taxable supplies. VAT must then be charged on all room hire and leases, but the council is able to reclaim any VAT incurred as it relates to taxable business activities.

The council would need to make a formal decision to make an Option to Tax, identifying on a map the area of land that will be covered by the Option. HMRC must be notified of that decision within 30 days. Once the Option is in place, the council will need to charge the appropriate rate of VAT on all taxable supplies.

An Option to Tax cannot normally be revoked for at least 20 years, although the council will have a six-month “cooling off” period in which it can change its mind after making the decision. The ability to reclaim VAT will apply to all running costs and any future refurbishment costs of the building, as well as the initial construction-related costs.

Making an Option to Tax would affect hirers of the building, as VAT would be added to all charges for use of the premises. Local groups would not be able to reclaim VAT and the council may wish to consider this when setting its charges.

If rooms are hired to a charity for its non-business activities (other than as a general office) then these charges remain VAT exempt and are not affected by the option to tax (Paragraph 2(2)(b) of Schedule 10 of the VAT Act 1994). This means that the council might still make some VAT-exempt sales. This may not be significant, but the council may need to monitor the level of charity non-business use.

The Option to Tax only affects the supply of premises by the council and has no impact on other supplies such as equipment hire or sale of food within the building. Such supplies are still taxed at the appropriate rate of VAT for those supplies. The option does not affect services provided by anyone who hires or leases the building from the council.

The council should ensure that it follows the guidance in VAT Notice 742A if it decides to make an Option to Tax.