

Spilsby Sessions House Initial VAT Advice

Introduction

This note summarises the initial VAT advice provided to Spilsby Sessions House Ltd (“SSH”) in relation to the restoration of Spilsby’s Grade II listed former courthouse and police station. This advice is covered under Chiene + Tait LLP’s agreement with the Heritage Trust Network (“HTN”). We offer HTN members a free, initial consultation on VAT, providing a written summary of the advice provided.

Background

The building is currently under the ownership of The Dandelion Trust (“DT”) which ran The Spilsby Theatre, however this closed in 2015 due to the condition of the building. DT has been downsizing and did not have the capacity to maintain the building. SSH is in the process of establishing a conditional purchase agreement with DT to purchase the property once funding has been obtained.

The preferred option from the Viability Study undertaken is for Spilsby Sessions House to become a centre for the whole community, providing a broad programme of live performances and cinema as well as community activities and including rentable workspaces. The Viability Study was jointly funded by the Architectural Heritage Fund (AHF) and the Heritage Lottery Fund (now National Lottery Heritage Fund, NLHF). It is estimated that the capital works project will cost £3.4m.

SSH began in 2014 as a local community group. The organisation Incorporated as a Community Interest Company (CIC) in December 2016. A new organisation, Spilsby Sessions House Ltd (charity registration pending), has now been established to lead the heritage restoration project and operate the envisaged community arts facility. It is intended that the CIC will become the trading subsidiary of the charity.

Both SSH and The Sessions House CIC are not registered for VAT.

VAT Liability of Works

When reviewing projects of this nature one of the first considerations that should be addressed is the VAT treatment of any capital and restoration works. This will then determine the total expected cost of the development. In the main, property and building renovations are subject to VAT at the standard rate (20%), however there are some reliefs available for construction work which can reduce the VAT charged in certain circumstances.

The zero-rating VAT provision that related to approved alterations to listed buildings used as residential and charitable buildings was removed from 1 October 2012, so this unfortunately is no longer available.

There are also other reliefs available for the construction of new buildings used for charitable purposes that we do not consider would be available here as it is our understanding that no new buildings are being constructed.

There are also reliefs available for the construction of/conversion to dwellings. We have not considered these as we do not think this is relevant in this case.

If any works are for the specific purpose of enabling access or movement within the building for disabled people (i.e. ramps and lifts), these can be zero rated for VAT purposes.

It is our view that the majority of the works associated with the renovation of the Spilsby Sessions House will be subject to VAT at 20%.

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In order to reduce this VAT cost from the project, SSH and the trading subsidiary would have to consider VAT registration.

VAT registration

Any business or organisation can register for VAT on a voluntary basis if it is making taxable supplies (or there is an intention to in the future). Taxable supplies are supplies of goods and services made in return for a consideration (form of payment) which are not exempt supplies.

There is a legal requirement to register for VAT if taxable turnover is greater than £85,000 in a 12-month period or if taxable turnover will exceed £85,000 in the next 30 days.

We understand that the CIC is currently making taxable supplies, however income is currently well below the registration threshold.

As outlined, it is possible for any business or organisation to register for VAT voluntarily if it receives taxable income or indeed has an intention to receive taxable income in the future. Therefore, once the project structure is decided upon, the entities would be eligible to register for VAT. This will then allow the VAT being incurred on expenditure to be considered for recovery. When VAT registration is applied for, it is likely that HMRC would request evidence that taxable supplies are to be made by the entity in the future so sufficient evidence should be held at this point (business plan etc.).

As we will go on to explain in the review, VAT registration does not guarantee full VAT recovery. VAT recovery would be determined by the taxable income received by the SSH/trading subsidiary.

We recommend that the structure of the project is analysed before any VAT registration applications are made. This will be important to the VAT recovery position.

VAT Recovery

When an entity is VAT registered, it is required to determine how much VAT it can recover on its purchases. A VAT registered entity can recover VAT to the extent that it receives taxable income. If all activities generate income which is subject to VAT (either at 0%, 5% or 20%) the organisation can recover all the VAT it incurs on expenditure. Some types of activity often create problems for organisations in terms of VAT recovery. One of these is where it receives VAT exempt income or outside the scope of VAT income. This can include cultural and education services and also lease, rental or licence of property (if the property is not opted to tax).

Another area which restricts VAT recovery is where there are “non business” activities which are commonly where goods, services or facilities are provided free of charge. This can often impact certain heritage projects, if free access is granted or activities are undertaken for no charge.

The following table outlines the VAT recovery position based on the liability of the income.

Income Stream Liability	VAT on costs directly relating to the activity
Taxable supply	Fully recoverable
Exempt supply	Not recoverable (subject to partial exemption <i>de minimis</i> rules)
Non-Business Income	Not recoverable

If costs cannot be attributed directly to a specific supply made by the business, they are classed as overheads and the VAT recovery on these particular costs is partially recoverable based on a specific calculation method.

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Option to Tax

The basic VAT rule for land and buildings is that the grant of any interest within that land is exempt for VAT. For example, a lease or licence of a building is usually VAT exempt.

Exempt supplies of land and buildings cause problems as the VAT incurred on costs related to the buildings will be irrecoverable. Whenever there is an exempt supply of land or buildings, the owner or leaseholder has the option of changing the liability of the supply to be subject to VAT. This is called the "option to tax".

The benefit of making this decision is that, once opted, any related VAT can be recovered in full because the supply being made of the building will be taxable.

It is not possible to opt to tax part of a building or a particular floor so the option would cover the whole building in question. The option to tax lasts 20 years so all rents and licences in that period would have to be subject to VAT (subject to a few limited exceptions).

The option to tax can be a double-edged sword for entities undertaking heritage projects. On one hand, it enables the entity to maximise VAT recovery on capital projects and general overheads; however, this does mean that the entity needs to build in a 20% VAT cost to rents and licences for use of the land/building. This should always be considered when making decisions whether opting to tax is the correct route.

Non-Business Activities (Free Activities)

Any free of charge activities is a non-business activity for VAT purposes. Normally this means that no input tax can be reclaimed in relation to these activities.

If any free of charge activities are undertaken, the entity would have to factor these into its VAT recovery method and this would lead to some form of restriction in VAT recovery on project costs and ongoing overhead costs. This is likely to include any free access granted to the police cells and perhaps some small events.

Business/Non-Business & Partial Exemption

Where an organisation has exempt or non-business activities it will have to determine on a quarterly and annual basis how much VAT on expenditure (input tax) it can reclaim.

Initially the business/non-business position must be reviewed. An organisation is unlikely to be able to treat all the tax it incurs as input tax if it undertakes both business and non-business activities. Any VAT which relates:

- To goods or services obtained solely for the purposes of the business activity is input tax; and
- Solely to the non-business activity is not input tax.

VAT on goods and services that relates to both activities must be apportioned to identify the part that is input tax. An example of this would be tax paid on overhead costs. This business/non-business calculation should be undertaken before the partial exemption calculation is made. There is no prescribed apportionment method, but it must be fair and reasonable, reflect the extent to which the residual purchases are used by business and non-business activities, and be capable of being checked independently.

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The residual VAT apportioned to non-business activities cannot be recovered. The residual VAT apportioned to business activities goes forward into the partial exemption calculation. Business/non-business methods are commonly based on the levels of business and non-business income, the numbers of or cost of staff working in each type of activity, floor area or direct expenditure.

Following the business/non-business apportionment, a business must undertake a partial exemption calculation if it undertakes both taxable and exempt supplies. This calculation is based on the percentage of taxable income to total income. This percentage is then applied to the overhead costs (following any business/non-business apportionment) to determine the level of VAT incurred on the overheads that can be claimed.

Capital Goods Scheme

Where a building project costs more than £250,000 plus VAT, the taxable use of the building needs to be monitored over a 10-year period under the Capital Goods Scheme (“CGS”). Any fluctuations in taxable activity in future years (based on taxable activity in Year 1) will result in a repayment of VAT to or from HMRC. This scheme ensures the correct VAT has been recovered over a 10-year period.

Based on the proposed plans for Spilsby Sessions House the renovation works will exceed the £250,000 threshold for the scheme and therefore the CGS will apply to this project.

If the level of taxable/exempt/non-business activities fluctuate in the future this may create positive or negative CGS adjustments in future years.

We can provide further information in relation to this if required.

Grant Income

In most projects of this nature, grant funding will be received to assist with the capital project and refurbishment works. Grants can be made by a number of bodies including central government, local government and the National Lottery. Grant funding is outside the scope of VAT, however, sometimes grants can have an impact on the VAT recovery position of an organisation. If a grant is received to add to funding for a capital project this will have no impact. If a grant is received to pay for an activity an entity will undertake free of charge, this would be regarded as “non-business” and would need to be included in the organisation’s VAT calculations which would result in a reduction in its VAT recovery.

Therefore, the receipt of outside the scope income does not automatically mean that an activity is non business or lead to apportionment of input tax. Each grant funded activity should be looked at separately to determine the correct position.

We do not consider that SSH or the trading subsidiary will receive any grants to undertake a specific activity free of charge, therefore all capital grants received will have no impact on the VAT recovery of the project. The grant funding which is to be received will assist with undertaking the business activities which it makes for a consideration, it should therefore be treated as outside the scope. This would not constitute a non-business activity and therefore does not need to be taken into consideration when determining the income, the entity has received. It can therefore be ignored when calculating the input tax recovery available.

Income Sources

The intention is for Spilsby Sessions House to become a centre for the whole community, providing a broad programme of live performances and cinema as well as community activities and including

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rentable workspaces. Based on our review of the business plan and income and expenditure figures along with our conversation with David Start, Bruce Knight and Lorraine Watkinson, we understand that there are a number of activities which will be undertaken. These activities will be critical to the VAT position of SSH/trading subsidiary. We have outlined the VAT treatment of the different types of activities and the impact these would have on the VAT recovery.

Earned Income Sources

Heritage Events/Arts Events

Where charges are made for entry to events this would be a taxable supply with VAT liable at 20% unless the cultural exemption applies.

Admission charges to museums, galleries, art exhibitions and zoos and theatrical, musical or choreographic performances of a cultural nature qualify for the cultural exemption. HMRC states that each event has to be judged on its individual merits. However, where live performances of stage plays, dancing or music are considered to be cultural (as they generally are) they'll qualify for exemption.

For the admission charges to be exempt, an organisation must, as an eligible body, satisfy all of the following conditions:

- be a non-profit making organisation;
- apply any profits made from exempt admission fees to the continuance or improvement of the facilities; and
- be managed and administered on an essentially voluntary basis, and by people who have no direct or indirect financial interest in the activities of the body.

If the above conditions are not met, the admission charges would be standard rated for VAT (20%).

If no charge was made for entry, the activity would be free and would fall to be a non-business activity.

Cinema

A recent case has confirmed that cinemas are not regarded as "cultural" for purposes of the exemption therefore entry tickets to the cinema will always be taxable (VAT at 20%).

Events Hire/Community Hire

The hiring out of a building/space for a fee is normally exempt from VAT (do not charge tenant VAT but restriction on VAT recovery by SSH/trading subsidiary). But, as outlined above, if the property owner or leaseholder has opted to tax the building it must treat the fees received as standard rated.

Opting to tax the Spilsby Sessions House building will mean that any charges made for rental space within the building will be subject to 20% VAT and this is common practice where owners/leaseholders have incurred costs and wish to ensure that the VAT on these costs is recoverable. The option to tax lasts for 20 years and it can be made at any time. If this was exercised, all subsequent leases and licences made of the specific rental areas in the next 20 years would be subject to VAT.

Opting to tax the building would allow SSH/trading subsidiary to maximise the VAT recovery on the costs incurred in relation to the project. This however would need to be a commercial decision.

One point to note is that if a rental agreement is set up with a charity, it is possible for that charity to disapply the option to tax and therefore the supply to the charity would revert to an exempt supply which would impact the VAT recovery position.

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Café/Bar Sales

Catering is a business activity, normally liable to VAT at the standard rate. Certain food supplies may fall under the zero-rate concession for certain foodstuffs if the food is taken off the premises to consume for VAT however these are both regarded as taxable supplies. All supplies made will therefore be taxable for VAT purposes.

Workspaces

If an identifiable area of the building is rented as workspace on which the customer has an exclusive right to occupy during the period of the licence this would fall to be a supply of land. This would therefore fall to be exempt where there is no option to tax or standard rated (20%) if an option to tax has been exercised over the building.

Voluntary Income/Fundraising Sources

Donations

Donation income is not consideration for a supply of goods or services so this falls outside the scope of VAT. This is because this income is freely given with no requirement on the recipient of the income to provide anything back in return for the donation. A donation can sometimes have certain conditions attached to it as to what it can be used for; but the conditions do not necessarily make it consideration for a supply because nothing specific is being provided to the funder in return for the payments. Donation income therefore does not need to be taken into account when determining SSH's income for VAT purposes. It can also be ignored when calculating the input tax recovery available.

Small Grants & Capital Project Grants

As outlined above, where grant funding is to be received to assist with undertaking the business activities which it makes for a consideration, it should therefore be treated as outside the scope. There only needs to be a restriction in VAT recovery if a grant is received to pay for an activity an entity will undertake free of charge.

'Friends' Membership

Where sponsorship or some other sort of funding (for example a "Friends Scheme") is received this will normally be treated as a taxable supply if a benefit is provided to the sponsor in return for payment.

This is similar to a donation in that persons sponsoring a charity are usually motivated by a wish to support it, however where the sponsor also receives something in return, this may have VAT implications.

Therefore, what is given in return to the 'Friends' should be analysed to determine the correct VAT treatment.

All Income Sources

From a VAT recovery perspective, it is best to maximise the taxable income. The higher the taxable income the higher the VAT recoverable from HMRC in relation to the project. Therefore, to maximise this, we would recommend opting to tax the building to ensure all rental income is exempt and also ensuring the conditions for the cultural exemption are not met to ensure events income falls to be taxable (VAT at 20% on tickets).

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Activity	VAT Treatment	Comments	Positive (+) or Negative (-) Impact on VAT Recovery
<i>Earned Income</i>			
Heritage Events/Arts Events	Taxable at the standard rated (20%) / Exempt if conditions met for cultural exemption	The cultural exemption conditions should be reviewed to determine whether the events income will fall to be exempt. Exempt income is negative for input tax recovery. It would be possible to break one of the conditions if required to ensure taxable income received.	+ / -
Cinema	Taxable at the standard rated (20%)	Does not fall into "cultural" definition.	+
Events Hire/Community Hire	Standard rated (20%) if opted / Exempt if not opted	"Opting to tax" the land would maximise VAT recovery; however, VAT would need to be added at 20% to the rental charges.	+ / -
Café/Bar Income	Taxable	Catering and bar income are specifically standard rated supplies. Any cold take-away food supplied would fall to be zero rated.	+
Workspaces	Standard rated (20%) if opted / Exempt if not opted	Assuming an identifiable area of the building is rented.	+ / -
<i>Voluntary Income</i>			
Donations	Outside the scope of VAT	Provided that nothing is given in return for the donation.	N/A
Small Grants & Capital Project Grants	Outside the scope of VAT	Provided received to assist with capital project and therefore to assist with undertaking the business activities which it makes for a consideration.	N/A
Friends Scheme	Taxable/Outside the scope of VAT.	Depends on whether benefits are given in return for the payment made	+ / N/A

We outline in Appendix 1, a very simple example of how VAT recovery is determined based on income levels for the above activities.

Project Structure

We understand that the Sessions House began in 2014 as a local community group and the organisation Incorporated as a Community Interest Company (CIC) in December 2016. A new organisation, Spilsby Sessions House Ltd (charity registration pending), has now been established to lead the heritage restoration project and operate the envisaged community arts facility. It is intended that the CIC will become the trading subsidiary of the charity.

Care needs to be taken here as to what entity is undertaking what supply/activity. The entity which is incurring the VAT on the refurbishment works (which we presume here will be the charity) needs to analyse its supplies to determine the VAT which can be claimed. However, it is possible to set up

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a lease to the trading subsidiary for the areas of the Sessions House building which it will be operating which would be taxable at 20% if an option to tax was exercised by the Charity. There may be a requirement for two VAT registration here or possibly consider registering the charity and the trading subsidiary as part of a VAT group. A VAT group is treated in the same way as a single taxable entity registered for VAT. The registration is made in the name of the 'representative member', who is responsible for completing and submitting a single VAT Return and making VAT payments or receiving VAT refunds on behalf of the group. All the members of the group remain jointly and severally liable for any VAT debts.

VAT grouping would mean that any supplies made between the group members would be outside the scope of VAT which means that these supplies are disregarded for VAT purposes and there is no requirement to account for VAT on supplies made between the two. It will also limit administration costs and time as you would only be required to submit one VAT return to HMRC (if both entities were separately VAT registered).

Therefore, we recommend that the project structure is reviewed and each entity's supplies/activities are looked at separately. The advantages of a VAT group should be considered.

Summary

- The works to develop Spilsby Sessions will be subject to 20% VAT unless there are specific works which will enable disabled access which would include lifts and ramps (these would qualify as 0%);
- In order to reduce the VAT cost of the project, the SSH/trading subsidiary (or both) would have to register for VAT. This can be done on a voluntarily basis when VAT bearing costs in relation to the development start to be incurred. Consideration could be made to registering as a VAT group;
- We recommend that consideration should be made as to what entity is undertaking what supply/activity. This will impact the VAT recovery of the project and any required charge between the charity (SSH) and its trading subsidiary;
- If registered for VAT, the activities undertaken by the SSH/trading subsidiary will determine the amount of VAT that can be recovered on any capital works and general costs going forward. This will be impacted by the liability of supplies made (partial exemption) and any non-business (free of charge) activities undertaken;
- Consideration and a review should be undertaken to determine whether heritage and art events meet the cultural VAT exemption. Steps can be taken to "break" this exemption which would improve on VAT recovery, however VAT would have to be charged on admissions to music and heritage events;
- We would recommend that a more in-depth review is undertaken of the project to quantify the VAT recovery position more accurately to assist with more detailed planning etc.

We can also assist SSH with the VAT registration process and provide assistance in setting up their systems to deal with VAT accounting. We have provided a quote for further work in Appendix 2.

Chiene + Tait LLP
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Appendix 1

Income & VAT Recovery Example (for explanatory purposes only)

This is an example of how to calculate VAT recovery of a project

Activity	VAT Liability	Income	Example 1	Example 2
Heritage Events	Taxable or Exempt (if cultural exemption applies)	£2,200	Taxable	Exempt
Art Events	Taxable or Exempt (if cultural exemption applies)	£37,506	Taxable	Exempt
Cinema	Taxable	£18,122	Taxable	Taxable
Events Hire	Taxable or Exempt (if option to tax in place)	£4,000	Taxable	Exempt
Community Hire	Taxable vs Exempt (option to tax in place)	£28,000	Taxable	Exempt
Café	Taxable	£3,000	Taxable	Taxable
Bar Sales	Taxable	£22,521	Taxable	Taxable
Workspaces	Taxable vs Exempt (if option to tax in place)	£5,674	Taxable	Exempt
'Friends' Membership	Taxable	£5,500	Taxable	Taxable
Donations	n/a	£6,000	n/a	n/a
Small Grants	n/a	£10,806	n/a	n/a
Capital grant funding	n/a	£10,000	n/a	n/a
Free Access to police cells	Non-Business	N/A	Non-Business	Non-Business
Total		£153,329		

In Example 1 above, all business income is taxable (as cultural exemption not applicable and option to tax in place) therefore there would be no VAT restriction due to exempt supplies. There is, however, still an element of non-business so there would need to be a slight restriction in VAT recovery for this activity however based on the level of business activity this would be low. The non-business adjustment is calculated on a fair and reasonable basis.

In Example 2 above, there is a mixture of taxable and exempt income (as the cultural exemption applies and no option to tax has been exercised). There is still an element of non-business so there would need to be a slight restriction in VAT recovery for this activity however based on the level of business activity this would be low. The non-business adjustment is calculated on a fair and reasonable basis. Following the non-business adjustment, a partial exemption calculation would be required as follows:

$$\frac{\text{Taxable Income}}{\text{Total Income}} = \frac{£49,143}{£126,523} \times 100 = 39\%$$

Please note both Example 1 and Example 2 require a level of non-business adjustment to account for any free of charge activities however the comparison on partial exemption is 100% VAT recovery on overheads in Example 1 with only 39% VAT recovery in Example 2.

Please note these examples assume there is only one entity. As we know there will be a charity and a trading subsidiary there may also be interaction between the two.

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Appendix 2

Further VAT work – Quote

Description of Work	Quote	Notes
Discussions with the SSH to review main points of report and answer key questions.	Free of charge	
In depth review quantifying VAT recovery after discussions with the SSH.	£4,500 plus VAT	
VAT Registration application and submission to HMRC.	£850 plus VAT	This includes dealing with any HMRC enquiries which we consider may be applicable.
Assistance with first VAT return and reclaim.	£450 plus VAT	HMRC often will review the first VAT return submitted by a new organisation or business, particularly where this will result in a refund. We highly recommend that the first return submitted is reviewed to ensure that it is correct and that there is no significant delay in receiving the refund from HMRC.
<i>Ad hoc</i> VAT queries going forward	£85 per hour	On a time on line basis