5. **VAT PARTIAL EXEMPTION AND OPT TO TAX AUTHORITY LAND AND PROPERTY**

1. **Purpose of the report**

The purpose of this report is to ask Programmes and Resources Committee to approve a programme of opting to tax specific Authority properties with a view to remaining within the annual de minimis VAT exemption (Section 33 calculation otherwise referred to as the Partial Exemption Calculation).

Key Issues

- **There is a need to order the Authority's VAT affairs to maximise tax efficiency whilst ensuring the Authority's operations are compliant with VAT legislation**

2. **Recommendations**

1. **Approve opting to tax properties owned by the Authority on a property by property basis.**
2. **Delegate to the Head of Finance the schedule for which property is opted to tax to coincide with lease renewals in consultation with the Head of Law and Head of Asset Management**

How does this contribute to our policies and legal obligations?

3. It is a legal requirement that the Authority complies with VAT legislation as a VAT registered body. This includes complying with the allowances under Section 33 which means that in order to reclaim input tax on charges which are exempt from VAT the Authority must stay below a de minimis level which is 5% of the total VAT input tax.

Background Information

4. The Authority was registered in its own right for VAT from the 1st April 2019 and as such has to charge VAT on all its business supplies as any other business does.

5. VAT output tax is the tax paid over to HMRC on the Authority's sales, mostly at 20% standard rate (eg sale of visitor centre merchandise, cycle hire charges car park charges etc). Some of our services (land and property sale and rents, post, education supplies) are exempt from VAT so the charges are made without VAT.

6. VAT input tax is the tax charged on all our goods and services supplied to us, which is fully recoverable for the most part. However, the input tax incurred on purchased supplies directly attributable to our exempt charges made to customers is only recoverable if the ratio of this input VAT is less than 5% of total VAT input tax.

7. Since departing from the special VAT arrangement with DCC on 1st April 2019 (sharing VAT Registration) our exposure to the 5% de minimis limit has been impacted as previously we benefitted from a very generous 5% buffer.

8. The consequence of breaching the 5% de minimis limit in any given year is that all VAT input tax relating to exempt activity, previously recovered from HMRC, has to be repaid no later than September following the year end (with the exception of meeting the criteria of the 7 year average rule). The Authority breached the 5% threshold for the 2019/20 financial year and had to repay £59k in reclaimed VAT. This also means that the 7 year average rule is less likely to accepted by HMRC if the Authority continues to breach the de minimis level.

9. The total input tax for the Authority for 2021/22 was just under £855k which means that for that year the annual de minimis limit for input VAT attributable to exempt supplies must be less than £42.7k (the 5% rule). As the Authority looks to balance the Authority's revenue budgets and make reductions in expenditure, this threshold is not likely to increase in the near future. The main areas adding to the figures are commercial and residential property for rent and education supplies, with revenue costs in these areas taking up just over half of the annual limit. Therefore, any substantial capital works carried out on leased Property adds a significant burden to our calculation total, most of which cannot be absorbed.

10. The Finance Officer carries out detailed calculations each year that are refined to ensure that the value of directly attributable VAT is as accurate as possible to ensure that the Authority is as close to the 5% level as possible whilst still being compliant. The Authority also has a VAT reserve at £120k to allow for a one off breaches of the de minimis level, however this is not financially sustainable and this report represents a more sustainable approach to VAT management.

Proposals

11. The main option available to the Authority is to exercise the Option to Tax land, which allows an entity to turn an exempt supply of land (including buildings) into a standard rated supply. The proposal is that we will opt on a property by property basis that a property should be taxable and not exempt. There are 4 conditions in public notice 742A for automatic permission to opt to tax, if any one of these conditions are met there is no need to contact HMRC for written permission. If a property does not meet any of the conditions in full we would need to obtain written permission from HMRC before we can apply the option to tax (www.gov.uk/guidance/opting-to-tax-land-and-buildings-notice-742a). Please note however that residential property is excluded from the option to tax by HMRC.

12. Opting to tax a property allows for the input tax to be fully recovered thereby alleviating the pressure on the 5% de minimis exemption recovery limit. There are three principal disadvantages;

- The customer receives an increased charge of 20% VAT. This includes all rental/licence fee payments for that property. If they are VAT registered they will be able to recover it so the impact would only be felt on a non-registered VAT business unless we chose to absorb the VAT ourselves.

- Once opted for, a property cannot generally be revoked for at least 20 years and thereafter it meets the specific conditions referred to in paragraph 11 above, namely: (1) the land is not a capital item (over £250,000 spent within previous 10 years); (2) within the last 10 years no supply of the land was below market value (i.e. peppercorn); (3) no input tax incurred relates to a supply to be made more than 12 months after revoking the option to tax and (4) the exempt supplies have been incidental to main use of the land or building.

- If the property is disposed of, then VAT must be added to the sale price which may affect its resale potential if the property is not commercial in nature and / or may attract private buyers.

13. Exercising the Option to Tax on property will have a useful effect on reducing the risk of incurring irrecoverable input VAT. A schedule of properties is attached in Appendix 1, showing the order of likely benefit to the tax calculation (high, medium, low). The benefit is linked to the amount of expenditure incurred by the Authority each year, for example if a property with high expenditure is opted to tax then this will reduce the pressure on the partial exemption calculation. This approach has been recommended by the

Authority's professional tax advisor's, PS Tax and we will consult with them on implementation.

14. The consequence of an option to tax is that all supplies charged to the customer from that point will need to include VAT so there is a need liaise with the customers and operational services to achieve this within a mutually acceptable timetable. It is expected that opting to tax will be phased over the next year dependant on the individual lease negotiations. Save for specifically negotiated exceptions, all leases granted since 2020 include the ability for the Authority to charge VAT.

Are there any corporate implications members should be concerned about?

Financial:

15. Contained within the body of the report.

Risk Management:

16. The main risk is the impact of a VAT charge on a future disposal value, but given the exercise will be restricted in the main to commercial properties this is considered to be a lower risk but consideration of the impact of resale will be part of the approval process. There is also a decision risk in not being able to change mind and reverse an option to tax as it applies for a long period (20 years).

Sustainability:

17. This report represents continuing to look after the sustainability of the Authority's budgets and to be able to financially manage VAT obligations.

Equality, Diversity and Inclusion:

18. There are no issues relevant to this report

Climate Change

19. There are no issues relevant to this report

20. Background papers (not previously published)

None

21. Appendices

Appendix 1 - Properties recommended for Option to Tax

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