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LOCAL COUNCILS AND VAT

Introduction

1. Value Added Tax (VAT) is a tax that is levied on the supply of goods and services in the course of business. 'Business' activities are concerned with making supplies to others (i) for any form of payment or other consideration, (ii) which have a degree of frequency and scale (iii) continue over a period of time and (iv) are within the scope of VAT which is currently levied at 3 different rates. Business transactions which attract the tax are called 'taxable supplies'. A person making such supplies is a 'taxable person' and must normally be registered for VAT with HM Revenue & Customs (HMRC). 'Non-business' activities involve the supply of goods and services without charge or without competition in the private sector and these are outside the scope of VAT. Further guidance in respect of the non-business activities undertaken by local councils is given at paragraphs 45 to 47 below.
2. The supply of goods and services are either exempt, or outside the scope of VAT, or taxable. If exempt or outside the scope of VAT, no VAT is charged on the supply and, in general, no VAT may be recovered on expenditure incurred in relation to the acquisition of goods or the provision of the services.
3. Different rates of VAT are levied on taxable supplies depending on the nature of the goods or services provided. The rates are:
 - standard - 20 %. This is the rate that is charged on most goods and services in the UK.
 - reduced - 5 %. An example of a service taxed at the reduced rate is domestic fuel and power.
 - zero - 0%. This is not the same as being exempt or outside the scope of VAT. An example of goods which are taxed at zero rate is children's clothes and shoes.

4. VAT takes two forms: 'output tax' and 'input tax'. Output tax is the VAT charged and collected by a taxable person on the value of the taxable supplies he makes. Input tax is the VAT payable by that person on the goods and services he receives for his business. In general, input tax can be set against output tax. If the latter exceeds the former the balance is paid to HMRC; if vice versa the HMRC makes a refund to the taxable person on receiving a properly completed application.

Registration

5. The registration limit for businesses changes annually (as at April 2010, this is £70,000) does not apply to local councils. Strictly, a local council must register with HMRC if it makes any taxable supplies, unless it makes only infrequent or minimal taxable supplies.
6. An explanation and examples of the taxable supplies arising from a local council's business activities are contained in VAT Notice 749 'Local authorities and similar bodies'. The usual types of activities undertaken by councils are listed, together with their VAT treatment. VAT Notice 749 contains useful commentary in respect of :-
- Cemeteries
 - Letting or hire of premises for leisure/ recreation and sport
 - Car parking charges
 - Village halls
7. Every local council should obtain a copy of Notice 749, which can be accessed from HMRC's website using the following link:- <http://customs.hmrc.gov.uk> in order to ascertain whether or not it is making, or is proposing to make, taxable supplies.
8. When making a taxable supply, a registered local council must charge VAT at the appropriate rate. If it fails to do so, it will nevertheless be treated by HMRC as having done so and will have to account to HMRC accordingly. Where the appropriate rate is zero, in practice the council does not charge VAT but in this case the difference between a zero-rated supply and an exempt supply is important; with a zero-rated supply, not an exempt supply, it will be possible to offset any input tax the council has paid.

Exempt Supplies – introduction

9. An exempt supply is a supply of goods or services by way of business that is declared by VAT law not to be chargeable to VAT. An exempt supply should be distinguished from a taxable supply and from a non-business supply (which is outside the scope of VAT- see paragraphs 45 to 47 below).
10. As explained in paragraphs 2 and 8 above, the vital difference between a taxable and an exempt supply is that, in principle, no input tax can be recovered on expenditure incurred in relation to an exempt supply. However insignificant amounts may be reclaimed as explained in paragraph 17 below
11. The major area of activity where a local council, in the course of its business, is likely to be making exempt supplies is in relation to the sale or letting of land or buildings. A supply of land or buildings arises when a council makes a grant of an interest in, or right over land in return for a payment or consideration. This includes the sale of a freehold, the grant of an easement, the grant or assignment of a lease, a surrender of an interest in land to the person who granted it or a licence to occupy land.

Letting of Land or Buildings

12. With a lease or a tenancy of land or buildings, the landlord grants the tenant exclusive occupation of the premises for the term of the lease in exchange for a payment or other consideration. A lease or tenancy, which in VAT terms constitutes the supply of land, is **normally** exempt from VAT. Councils may give up the right to the exemption and charge VAT at the standard rate instead. This allows the councils to reclaim input tax when otherwise they would not be able to. See also paragraphs 20 to 26 below.

Licence to Occupy Land or Buildings

13. A licence to occupy land or buildings in exchange for a payment or other consideration where the licensee is granted occupation of a clearly defined area for a specific purpose to the exclusion of other people is an exempt supply. Thus the licence of office space or the hire of a hall or a room for an event or a meeting on terms which give the licensee or hirer exclusive control over a specific area for the duration of a period is an exempt supply. By contrast, granting the public a right of entry to e.g. a fete, theatre, village hall, or a sports facility does not give any one person exclusive occupation rights and the supply is therefore taxable.
14. VAT Notice 742 'Land and Property' deals generally with the sale of land and the grant of leases and licences of land or buildings and this can be accessed from HMRC's website using the following link:- <http://customs.hmrc.gov.uk>

Use of Sports Facilities

15. There are special rules, detailed in VAT Notice 742, which relate to the use of sports facilities which are normally standard rated supplies. Premises are sports facilities if they are designed or adapted for playing any sport or taking part in any physical recreation. Such facilities include swimming pools, football pitches, dance studios and skating rinks. Each court or pitch (or lane in the case of bowling alley, curling rink or swimming pool) is a separate sports facility.
16. The following supplies are, however exempt:-
 - a. A letting or hiring for a continuous period of more than 24 hours where the hirer has an exclusive use of the facilities throughout the period.
 - b. A series of 10 or more lets, whether or not exceeding 24 hours in total if the following conditions are met:
 - i. each let is for the same activity in the same place, and
 - ii. the interval between lets is not less than one day and not more than 14 days, and
 - iii. payment must be for the whole series of the lets and is so evidenced in writing, and
 - iv. the lessee/hirer has exclusive use of the facilities, and
 - v. the lessee/hirer is a school, a club, an association or an organisation representing affiliated clubs or constituent associations.

Exempt Supplies – reclaims of VAT

17. As explained in paragraph 2 above, in general VAT incurred on purchases for exempt business activities cannot be reclaimed. However it can be reclaimed if the amount of VAT incurred (input tax) is 'insignificant', e.g. –
- less than £625 a month on average (£7,500 a year), **or**
 - less than 5% of the total VAT incurred on all purchases, including those for non-business activities
18. Local councils that do not grant leases of or licence occupation and use of halls, sporting facilities and the like will normally be below these limits and will therefore be able to reclaim the VAT on their purchases for exempt business activities. This “Partial Exemption Rule” can have quite a serious effect on the financing of a village hall or community centre, and for a refurbishment or major repair project of a building with a number of different uses including some that are VAT exempt. The limits include all expenditure, whether revenue or capital, so that a major build or refurbishment is likely to produce input tax attributable to exempt supplies in excess of the limits – and therefore not open to reclaim. In one case, a council paid some £9,000 in VAT on expenditure to refurbish a hall. Its claim for a refund was disallowed (save for £60) on the ground that the use of the hall was for exempt purposes, namely letting or licensing of land or buildings as described in paragraphs 12 and 13 above, and the amount of VAT was not 'insignificant'.
19. Where a local council has some supplies that are taxable and some that are exempt, it can reclaim all the input tax on supplies which are solely for taxable matters, none of the input tax on supplies which are for solely exempt matters (subject to the 'insignificant' provision above) and a proportion of the input tax on supplies that are not identifiable as solely for either type. There is a standard method of calculating this latter reclaimable element. Details can be found in VAT Notice 706 'Partial Exemption' which can be found at:- <http://customs.hmrc.gov.uk/>.

Exempt Supplies – Option to Waive Exemption (Option to Tax)

20. The Finance Act 1989 altered the law, so as to provide landlords with an option to charge VAT on what would otherwise be exempt supplies of interests in or rights over land (which includes buildings on it). The option does not apply to a dwelling or a

group of dwellings (e.g. a block of flats), residential homes or the like, pitches for residential caravans, moorings for residential houseboats or a building used by a charity for a non-business purpose (other than as an office). These rules have been further amended by the Finance Act 1997. Detailed guidance is to be found in VAT Notice 742A 'Opting to tax land and buildings' which can be accessed from HMRC's website using the following link:- <http://customs.hmrc.gov.uk>

21. Otherwise, the option applies to the sale, letting or licensing of building and land and to the grant of rights over land (e.g. an easement), provided that the transaction is for money or money's worth. A transaction without any payment or other consideration is a non-business activity and outside the scope of VAT.
22. There is no time limit within which the option has to be exercised. The vendor/landlord simply gives notice (preferably written) to the purchaser/tenant of his intention to charge VAT on the sale price or rent under the lease. Having exercised the option, written notice must be given to the local VAT office within 10 days. A local council which is unregistered and has exercised the option must register in any event (see paragraph 5 above).
23. These rules apply to buildings which are not 'new' (see paragraph 28 below) and to existing leases/licences, unless the lease/licence specifically provides that VAT cannot be charged on the rent.
24. The option to charge VAT may be exercised in relation to particular buildings (including land within its curtilage) or areas of land; it does not have to cover all council property. Once exercised, an option is irrevocable and only lapses when the freehold of the land or buildings is disposed of or, in the case of a building, where it is completely demolished; if however, a new building is constructed on the site of the demolished one, the Option to Tax remains in force.
25. Conversely, where the freehold of land or buildings is acquired, a council is not bound by an option exercised by the previous owner.
26. Where the Option to Tax is exercised, VAT must be charged on ALL supplies relating to that property – the previously 'exempt' supplies detailed in paragraphs 11 to 13 will become chargeable to VAT at the standard rate.

Anti-Avoidance

27. There are complex rules covering supplies between connected persons. For most local councils this will mean in practice that where a building is erected under 'sale and lease-back' arrangements, the Option to Tax cannot be exercised.

Sale of New Buildings

28. A building is 'new' either for the period up to three years from the day it is completed, or until the date the building is fully occupied, whichever is the sooner. The sale of the freehold of a new building, is a standard-rated supply e.g. VAT must be charged at the standard rate on the selling price except for the following,:
- i. a dwelling, or
 - ii. a group of dwellings, or
 - iii. a residential home or the like, or
 - iv. building which is to be used by a charity for a non-business purpose,
29. The grant of a long lease (over 21 years) or the assignment of an existing lease, with more than 21 years to run, of a new building is also a standard rated supply: VAT must be charged on any premium payable by the tenant or assignee.
30. Whilst local councils may perhaps only rarely dispose of 'new' buildings, they are more likely to acquire such buildings and thus have to pay VAT on the price. The VAT will be recoverable in the normal way (see paragraph 48 to 52 below).

Construction of Buildings

31. Generally speaking, the materials and services provided in the construction of a new, or the reconstruction of an existing, non-domestic or non-charitable building are standard rated for VAT.
32. In relation to paragraphs 18 to 29 above, VAT Notice 742 contains detailed information.

Should a local council opt to charge VAT on sales of buildings and rents and licence payments?

33. Paragraph 17 above indicates the sort of problems which can arise in relation to expenditure on an exempt business activity. This can be avoided by ensuring that VAT is charged on appropriate rents or licence, or fees for the use of council-owned land or buildings.
34. In relation to the sale of a building which is not 'new' (as defined in paragraph 28 above), the exempt business activity trap will not apply, and the transaction is neutral in a fiscal sense.
35. The disadvantages on charging VAT on rents etc. are:-
 - i. The council will have to register for VAT and thus comply with the administrative procedures involved.
 - ii. The tenants/licensees will have to pay 20% more than would otherwise be the case and, if not registered for VAT, will not be able to recover the extra sum.
36. With regard to (i) above, many councils are already registered for VAT and bear the administrative burden (which is not very great). Detailed guidance on the necessary accounting procedures are to be found in 'The VAT Guide' (VAT Notice 700) which can be accessed on HMRC's website using the following link: <http://customs.hmrc.gov.uk/>. A council which is considering exercising the option to charge VAT should study the Guide first. The savings available by avoiding the exempt business activities trap can be substantial. As to (ii) above, in cases where the letting/licensing is to a voluntary organisation or the like, the council can exclude the relevant building from its Option to Tax; grant-aid the VAT element in the rent/fee, or simply not collect it and thus absorb the cost itself.
37. On balance, the Association thinks that the advantages of charging VAT outweigh the disadvantages and recommends councils to act as follows:-
 - i. To opt to charge VAT on the sale, grant and assignment of leases and interests over in or over non-domestic and non-charitable buildings which are not 'new' (defined in paragraph 28 above);

- ii. To opt to charge VAT on rents and licence fees on such buildings, especially where expenditure on repairs or improvements can be expected to be incurred by the council;
 - iii. To opt to charge VAT on rents and licenses on non-domestic and non-charitable land, where expenditure on repairs etc. is likely to be incurred. It would probably not be appropriate to charge VAT on rents for tenancies of agricultural land or on allotment rents, where expenditure by the council is insignificant or is the responsibility of the tenant.
38. If a council decides not to opt to charge VAT on rents etc. it can try to mitigate the effect of the exempt business activities trap by attributing the VAT it incurs in the following order:-
- i. To non-business activities;
 - ii. To taxable business activities;
 - iii. To exempt business activities.
39. In relation to village halls etc. a council can try to avoid the trap by:-
- i. letting facilities free of charge (a non-business activity); or
 - ii. letting facilities free of charge but charging separately for particular services (e.g. catering, cloakroom facilities); or
 - iii. letting facilities on terms which do not give exclusive control of the premises to the lessee (see paragraph 13 above).
40. Although letting of premises may be an exempt activity, the provision of a separately identified service is a business activity and therefore taxable. However, any separate service must be a genuine one and not adjunct to the letting. Thus the provision of ordinary electric lighting in a hall could not be treated as a separate supply for VAT purposes, whereas the provision of extra spot lights could. In practice it may be difficult to adjust letting terms as suggested because lessees may be unwilling to take premises without having full control for the period of the lease term.

Fuel and Power

41. As from 1st July 1990, the supply of fuel and power is standard rated unless it is for domestic use or for use by a charity in relation to a non-business activity.

42. The following supplies are always for domestic use (even if the consumer is not in fact the occupier of residential or charitable premises)
- i. Not more than one tonne of coal or coke held out for sale as domestic fuel.
 - ii. Peat, wood or charcoal not intended for sale by the recipient.
 - iii. Piped gas not exceeding 150 therms a month.
 - iv. Liquid petroleum gas in cylinders weighing less than 50kg where fewer than 20 cylinders are supplied or the gas is not intended for sale by the recipient.
 - v. LPG not in cylinders where the recipient cannot store more than two tonnes of the gas at the premise.
 - vi. Not more than 2,300 litres of fuel oil, gas oil or kerosene.
 - vii. Electricity provided at a rate not exceeding 1,000 kilowatt hours a month.
43. There is provision for apportionment where supplies are partly for domestic/charity use and partly not.
44. Local council consumption of fuel and power will often fall within the above categories. If not, the council will be able to recover the VAT in the appropriate way.

Non-Business Activities

45. A non-business activity is either:-
- i. One which is neither actively nor potentially in competition with a similar activity in the private sector, or
 - ii. a free provision of goods and services.
46. Most of the ordinary administrative and procedural activities of a local council are within (i) above. This means that expenditure on running the council is for a non-business purpose and the VAT can be reclaimed. Such expenditure includes the purchase of stationery, telephone, copying and similar charges, office machinery, hire of meeting rooms, street lighting and maintenance of a council's own offices (pursuant to section 33, VAT Act 1994).
47. A local council may claim a refund of the VAT incurred on non-business activities provided that it;
- i. places the order for the goods or services, and

- ii. receives the supply, and
- iii. receives a tax invoice addressed to it, and
- iv. makes payment from its own funds (but see paragraph 54 below for conditions to this proviso in respect of donated funds); and
- v. keeps all appropriate records

Accounts and Claims

48. A council should keep its accounts in such a way as to be able to identify the VAT element in every transaction and should obtain a VAT invoice for all taxable supplies received. A VAT-registered trader Council should also provide a VAT invoice when it makes a taxable supply.
49. Where a purchase has to be made in the name of the Parish Clerk (such as anti-virus software downloaded from the internet) the invoice details may be the Parish Clerk's c/o the Parish Council citing the council's address. This along with supporting evidence available from minutes showing approval should be sufficient for HMRC to accept it as a VAT invoice to the Parish Council.
50. A council which is registered for VAT claims a refund in respect of non-business activities by including the amount in the appropriate section of its VAT return.
51. A council which is not registered for VAT must apply in writing for a refund to:
- Banking/GABS
HM Revenue and Customs
7th Floor SW
Alexander House
21 Victoria Avenue
Southend-on-Sea
SS99 1AU
52. The first application is made by letter, setting out the details. The refund will be made by BACS bank transfer or by payable order and a Form VAT 126 will be sent for the next claim. Further claims should be made on this form. HMRC may require production of tax invoices before paying a claim. VAT already repaid can also be subject a claim for repayment by HMRC if, after investigation, the repayment to the Council was incorrect.

53. The claim must relate to a period of at least one calendar month (or at least 12 months if it is for less than £100) ending on the last day of a calendar month and be made within 3 years after the end of the month in which the supply, acquisition or importation was received.

Helping Other Bodies

54. As a general rule, a local council cannot use its right to a refund of VAT to benefit other bodies by acting as their agent. It is thus an unlawful evasion of VAT for a council to purchase something on behalf of a charitable village hall committee, claim the VAT and obtain reimbursement from the committee (whether before or after the purchase). It is worth noting that a charity has no general power to make a gift of money to a local authority; the cash paid over is consideration for the supply of goods. There are two exceptions to the rule:-

- i. Where a council is given funds for specified purposes (for example where a grant has been claimed by the Council from a third party) it may reclaim VAT on purchases provided that;
 - it makes the purchase itself and
 - it retains ownership of the purchase and uses it for own non-business purpose; and
 - it keeps sufficient records of the purchase and the purpose for which it is made, to be easily identified.

An example is the purchase of goods and services for a play area owned and managed by the council which are paid for with donations from a fund-raising committee which obtains no direct benefit from the donation.

- ii A council may purchase goods or services and donate them to a voluntary body, but without receiving any reimbursement. The donation is a non-business activity and is therefore eligible for a refund of VAT.

Parish and Community Meetings

55. Parish and Community Meetings without councils are not local authorities for the purposes of the VAT legislation and cannot therefore claim refunds of VAT.

Further Reading

56. This Note is necessarily a summary of the legal provisions. Detailed guidance (in clearly written English) is given in the HMRC's VAT Notices. Every council should have a copy of VAT Notice 749 'Local Authorities and similar bodies'. Councils which let premises or deal in land or make other exempt supplies should read the aforementioned HMRC guides.

- VAT Notice 749 'Local Authorities and similar bodies' (<http://customs.hmrc.gov.uk/>)
- VAT Notice 742 'Land and Property' (<http://customs.hmrc.gov.uk/>);
- VAT Notice 706 'Partial Exemption' (<http://customs.hmrc.gov.uk/>);
- VAT Notice 700 'The VAT Guide', a general guide to the VAT legislation (<http://customs.hmrc.gov.uk/>).
- VAT Notice 742A 'Opting to tax land and buildings' (<http://customs.hmrc.gov.uk/>).

57. All VAT Notices are obtainable free of charge from HMRC (addresses and contacts are in the telephone directory under HM Revenue & Customs) or on HMRC's website at: <http://www.hmrc.gov.uk/vat/index.htm>.

Warning

58. VAT is a very complicated subject and this Note only gives a bare outline of the areas likely to be relevant to local councils. It cannot be stressed too strongly that a council should seek advice before it takes any irrevocable decision which has VAT consequences. This is especially the case where a council contemplates operating the 'option to tax' provisions described in paragraphs 20 to 26 and 33 to 40 above.

Your Local VAT Office

59. If a council has any queries about VAT, it should consult its local Revenue & Customs VAT office. HMRC staff are often willing to give advice, but ensure that it is in writing. In the more complex areas of VAT, particularly the 'Option to Tax', local VAT offices have been known to give wrong or conflicting advice. Provided that the advice was given in writing, if subsequently HMRC decide that the advice given in writing was wrong, they cannot demand repayment of any VAT refunded unless it is found that the information supplied to HMRC was wrong or incomplete.

Other Legal Topic Notes (LTNs) relevant to this subject:

LTN	Title	Relevance
21	Local Council Help for Village Halls	Sets out the ability of councils to reclaim VAT paid for goods and services paid for on behalf of others.
40	Local Councils' documents and records	Sets out the documents to be retained for VAT purposes.

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