

VALUE ADDED TAX (VAT) EXEMPTION CALCULATION

Introduction

On 16 January 2023, the Finance & Personnel Committee considered a report regarding the treatment of value added tax (VAT) and agree to carry out a partial exemption calculation annually as part of the Council's year-end financial procedures each spring (ref. minute F&P/23/9).

Considerations

Local authorities and similar bodies are subject to HM Revenue and Customs' [value added tax \(VAT\) notice 749](#). That VAT notice differentiates between business activities and non-business activities by local authorities for VAT purposes.

Non-business activities sit outside the scope of VAT because "where a public body is funded by way of public expenditure [...] to do something for the public good, it's unlikely to be engaging in business activities for VAT purposes". Conversely, when a public body pursues activities which are not funded by way of public expenditure and do not deliver public benefit, it's likely to be engaging in business activities for VAT purposes.

VAT Treatment of Business Activities

Business activities are subject to VAT legislation. Advice received via the Devon Association of Local Councils covers the following:

The Council is making a business supply of land (including buildings) when it makes a grant of an interest in, right over or licence to occupy land in return for a payment. This includes leases, rents and room hire. The supply is still a business activity when the rent is below market value.

Supplies of land for payment are, by default, VAT-exempt business supplies. Section 7 of VAT notice 749 explains that councils have limited rights to reclaim VAT on costs relating to exempt business activities. These rights apply both to VAT-registered and unregistered councils.

It is important to understand that the right to reclaim VAT on exempt activities is limited – councils can only reclaim VAT if the amount is 'insignificant', which is generally defined as less than £7,500 per financial year. To be clear, this £7,500 test applies only to VAT incurred on the Council's exempt business activities. It does not affect VAT incurred on non-business activities, which can always be recovered.

£7,500 is a threshold figure – if the total VAT incurred in connection with all of the Council's exempt activities (e.g. commercial leases, room hire, land leases, some sporting lets) exceeds the threshold, then none of it can normally be reclaimed.

The Council's first challenge is to review its activities to confirm which are exempt business activities, and then assess how much VAT it has incurred on those activities. This assessment – known as a partial exemption calculation – is a mandatory, annual obligation.

If this exercise puts the Council below the £7,500 threshold, then it can reclaim that VAT without any further steps. Many councils will remain under the threshold every year, but facilities which have significant running costs and capital expenditure on new or existing facilities can easily leave a Council at risk of being unable to recover VAT.

VAT Advice 2023 / VAT Treatment of the Ingrams Sports Pavilion

On 25 September 2023, the full Council considered a report regarding its future treatment of VAT. As a result, and among other recommendations, the Council resolved to register for VAT with HM Revenue and Customs in-house and to 'Opt to Tax' the Ingrams Pavilion with an effective date of 1 October 2023 (ref. minute 23/165). Despite a timely application having been made, HM Revenue and Customs has not been able to issue a VAT registration number yet.

VAT Treatment of Business Activities at the Younghayes Centre

Looking at the Younghayes Centre, the areas which constitute a land supply are the main hall, the upstairs meeting rooms as well as the GP surgery. Those elements together equate to 64.10% of the floorspace within the whole building.

During the 2023-24 financial year, the Council incurred a total of £172,956.70 in VAT, all of which was reclaimed from HM Revenue and Customs. Of that figure, £7,758.20 of the VAT was incurred on expenditure relating to the Younghayes Centre. If the above percentage is applied, then the VAT incurred in relation to VAT-exempt business/land supply was £4,973.01. This figure falls below the threshold of £7,500, meaning the Council was entitled to reclaim VAT because the amount was 'insignificant'. Records demonstrating the calculation have been retained and can be inspected.

VAT Reclaim 2023-24 – Exempt Land Supply:

Summary of Investigation/reconciliation of exempt land supply for 2023-24

Total VAT Reclaim	£172,956.70
Total VAT Reclaim in respect of exempt land supply	£7,758.20
Apportion element of Younghayes Centre (64.10%)	£4,973.01

Figure of £4,973.01 falls below the £7,500 threshold.

Recommendation

To note the Council's value added tax exemption calculation for the 2022-23 financial year.