

VAT, charities, refurbishment and the performing arts

4 Eyes Ltd provides VAT advice on property issues to the construction sector.

This article concerns a client of 4 Eyes Ltd. The client is a charity which is dedicated to promotion of the performing arts.

The charity is based in a large 1930s building, comprising offices, meeting rooms, studios, practice rooms, a theatre and a café. The charity lets the facilities to performing artists and provides management, training and mentoring services to artists, as well as distributing bursaries on behalf of other institutions such as the Arts Council.

Over time, such an historic building has become less suited to the needs of a contemporary organisation and its artists. The building was not designed to allow disabled people to access it easily and generally it is in need of substantial refurbishment. Considerable funding has been obtained to fully refurbish and extend the building and to acquire the lease of adjacent premises which will be incorporated into the building.

The funding is capped and cannot be increased for unforeseen expenses such as VAT. This means that for this project as for so many others involving the not for profit sector, any irrecoverable VAT will directly reduce the funds available for the necessary improvements, resulting in compromise and missed opportunity.

VAT liability of the refurbishment

The refurbishment of a non residential building for non residential use is standard rated. This means that, prima facie, the charity will have to pay VAT at 17.5% on all the works.

Ability to recover VAT on the refurbishment

Faced with being charged VAT at 17.5% on the refurbishment, the charity went to its auditors for advice on how to recover this. The auditors in their turn approached HM Customs & Excise for a written ruling. Unfortunately, in this process there was a breakdown in communication and understanding.

Customs advised that the refurbished facilities would be used in the business of the client and as such, any VAT incurred on their refurbishment would be residual for VAT purposes meaning that it would be recoverable as an overhead expense. (This calculation would itself be subject to a non business apportionment). Unfortunately, however, Customs did not understand the client's business and the extent of taxable supplies made by the charity. Customs ruled that the majority if not all of the input VAT incurred on the refurbishment would be blocked. Following this ruling, Customs also attempted to revisit earlier VAT returns with a view to raising assessments for over-claimed input VAT in earlier periods and immediately restricted input VAT recovery on the current VAT return. The charity was now in a difficult position. Not only did it appear that it would suffer irrecoverable VAT on the refurbishment (with a serious consequence to the

work it could achieve), but it also faced a future assessment and on-going cash flow problems brought about by restriction of input VAT.

At this point, the charity approached us. As a first step, we agreed with the builders' analysis that VAT on the majority of the works would be due at 17.5%, but drew its attention to the availability of zero rating for the installation of new lifts in the building. (Note - the availability of this particular relief has since been further restricted).

The next step was to understand the activities of the charity and their VAT treatment.

When the charity's activities were analysed it became apparent that in VAT terms the principal activities are management services and property rental. When we analysed this activity in terms of taxable supplies, we discovered that there was a *de facto* option to tax already in place, with the charity charging VAT on all rental income, making this a taxable supply for VAT purposes. Other activities were either taxable or outside the scope of VAT (e.g. the grant distribution) with a very small amount of exempt supplies. This understanding of the charity's activity profile gave us a basis upon which to challenge Customs' ruling.

We worked closely with the charity and with Customs to explain the true position and formalised the option to tax, by notifying it in writing to the Option to Tax Central Unit.

Once Customs confirmed the VAT treatment of the charity's activities, in light of the exempt supplies and supplies outside the scope of VAT, we had to agree a partial exemption method and non business apportionment method for use going forward. It was only then that we could discuss VAT recovery on the refurbishment.

Using the agreed partial exemption method, the charity could in fact recover the majority of VAT incurred on the refurbishment. The refurbishment is a capital item for the purposes of the capital goods scheme meaning that it will be necessary to review the VAT treatment going forward for the next ten periods but unless activities change dramatically, it is not anticipated that this will result in any substantial repayment of input VAT.

Conclusion

In order to address the VAT consequences of any development the advisor must have a sound understanding of the activities of the client and the law applicable to the area. A significant amount of VAT will be saved in this instance.

Often where VAT recovery is an issue, there are steps that can be taken to minimise the initial VAT liability (such as identifying zero rating for the new lifts), but this alone is not enough. The advisor must begin by challenging the assumption that a client cannot recover its VAT.

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