



Via email:
East Devon District Council
Donna Best
Carol Hawkins

21 September 2012

Dear Donna

**East Devon District Council (“the Council”)
VAT – Seaton Discovery Centre, Devon**

Further to our recent correspondence, I am pleased to provide our high level written advice in relation to the likely VAT treatment of the Seaton Discovery Centre Project, for your consideration.

Background

It is understood that the Council owns a piece of land in Seaton which is currently used as a car park and upon which a visitor centre is situated. The Council intends to demolish the existing visitor centre and replace it with the ‘Seaton Discovery Centre’ (“the Centre”), a visitor attraction which is intended to comprise an interpretation centre, cafe, restaurant and retail operation.

The demolition of the existing building is intended to be paid for by the Council and construction of the Centre is intended to be funded in part by the Council and in part by Devon County Council (“DCC”).

Following construction of the Centre, the Council intends to lease the property to the Devon Wildlife Trust (“the Trust”), which is a registered Charity. We have not been advised if the land or buildings are subject to an existing option to tax. Our advice is based on the assumption that there is no option to tax currently in place.

Intention

In order to determine if the Council will be required to charge VAT in relation to its supply of the Centre to the Trust, we must first look at the use to which the Council intends to put the Centre. The intended treatment will also affect whether or not the Council is entitled to recover VAT it incurs in relation to its supply of the Centre, as its input tax.

In light of there being no firm intention currently in place, we have provided high level advice in respect of each potential scenario, below.

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Exempt use

The granting of an interest in, right over or licence to occupy land is VAT exempt. This means that the Council will not be required to charge VAT on its rental of the Centre to the Trust. Ordinarily, this would have the corresponding effect of blocking the right to recover any of the VAT incurred in making the exempt supply. However, the Council is allowed to recover all of the VAT it incurs in making exempt supplies as long as the amount does not exceed 5% of the total input tax it incurs during the partial exemption year. If the Council remains below the 5% 'de minimis' limit, then it will be entitled to recover all of the VAT it incurs in relation to exempt supplies.

Taxable use

The Council may choose to 'opt to tax' the Centre, which would involve making a decision to charge VAT on the lease and notifying HM Revenue & Customs of its intention to do so within 30 days. In this circumstance, the VAT liability of the supply changes from VAT exempt to taxable, and therefore permits the Council to recover the VAT it incurs in the making of the supply, as input tax.

Of note, even if the Council opts to tax the building, then this option may still be overridden in circumstances in which the tenant in the property is a charity that uses the building for a 'relevant charitable purpose', other than as an office i.e. the charity uses the building in relation to the making of its non-business supplies. If the Council is notified that its tenant is a charity that meets the criteria above, then the Council's option to tax would be disapplied and the supply would be VAT exempt.

Non-business use

If the Council leases the Centre to the Trust on terms that are not commercial e.g. for a peppercorn rent, then this would likely alter the nature of the supply to non-business and the Council would not be required to charge any VAT on the lease. Ordinarily, any VAT incurred in relation to a non-business activity is irrecoverable as input tax however, a Local Authority is permitted to recover all of the VAT it incurs in relation to its non-business activities.

Input tax

Demolition

We understand that the Council will be wholly funding the demolition of the existing building and we would expect the Council to be charged VAT on demolition and similar services. If the Council intends to put the building to a taxable or non-business use, then we would expect it to be able to recover the VAT it incurs in full, subject to the normal rules.

If the Council intends to put the building to an exempt use, then we would expect the Council to provisionally recover the VAT it incurs as input tax in full. The Council will then need to determine if it is entitled to retain this VAT, subject to it remaining below its 5% de minimis level at the end of the partial exemption year.



Construction

We would expect the Council to be charged VAT on the construction of the Centre as no VAT reliefs are available in relation to this type of construction. If the Council has taxable or non-business use of the Centre, then we would expect it to recover all of the VAT it incurs as input tax, subject to the normal rules.

However, we understand that DCC intends to part fund the construction of the Centre in the sum of circa £500k. Based on the limited information available at this stage of the project, we are not aware of the exact terms of this payment and whether or not it is merely grant funding passed to the Council to spend as it wishes or, if the payment is in return for a share of ownership of the Centre, or any other benefit for DCC.

If DCC is merely passing on funding, which the Council is using to construct the Centre, we would expect the Council to recover the VAT it is charged as input tax, subject to the above. If DCC part funds the construction with a view to receiving a future return on its investment, then any VAT incurred by DCC may be its input tax, and recoverable or not depending on its own VAT position.

Ongoing running costs

We would expect any VAT bearing costs incurred by the Council to be recoverable in line with the VAT treatment outlined above.

Capital Goods Scheme (“CGS”)

The CGS applies to capital expenditure on land and buildings with a value of £250,000 or more (exclusive of VAT) which was subject to VAT at the standard or reduced rate.

Based on the suggested value of the capital expenditure on the Centre, it would appear to fall within the CGS and the Council will be required to monitor the use to which it puts the Centre for the duration of its economic life (10 years).

For example, if the Council intends to use the Centre for taxable purposes and recovers all of the VAT it incurs in relation to its construction in Year 1, and then subsequently puts the Centre to exempt use in any of the succeeding 10 years, then it may be required to repay some of the input tax it originally recovered. However, this should only affect the Council in the event that it breaches its ‘de minimis’ level of 5% in any given year.

Output tax

We would expect the Council to charge VAT on the rental income it receives if an option to tax is made on the Centre. If the Council does not make an option to tax, or its supply is non-business, then we would not expect it to charge VAT on the lease of the Centre. It is recommended that the Council discusses with the Trust if it is able to recover any VAT it may incur on the Centre as its input tax.



Specific questions

In addition to the generic advice above, it was agreed that we would answer the following specific questions:

- i. *Whether opting to tax the site would be beneficial;*

Opting to tax the site will allow the Council to recover all of the VAT it incurs, subject to the normal rules, as its input tax. This should have a beneficial effect on the Council's partial exemption position as it should not have any exempt input tax on the Centre. However, this will also require the Council to charge VAT on its supply of the Centre and consideration should therefore be given as to whether the intended tenant can bear this extra cost, or if it can recover the VAT charged.

- ii. *The VAT liability of the work;*

We would expect the Council to be charged VAT in relation to the demolition of the existing Centre and construction of the new Centre.

- iii. *Whether the part funding of it could potentially impact upon the VAT recovery or create a joint venture with DCC;*

We would not expect the payment of a grant to create a joint venture with DCC. However, further consideration should be given to this once the Council has established what DCC receives, if anything, in return for its funding.

- iv. *How the capital expenditure could impact upon the Council's partial exemption position;*

If the Council makes an exempt supply of the Centre, VAT on the capital expenditure relating to the Centre will impact on the Council's partial exemption position.. Accordingly, the Council should monitor if the VAT it will incur in relation to an exempt supply takes it close to, or indeed breaches, its 5% de minimis limit.

- v. *The VAT treatment of any rental income received post construction, particularly with consideration to a tenant which is a charity or trust.*

Any rental income that the Council receives will ordinarily be VAT exempt. However, if the Council opts to tax, if the Trust intends to use the Centre for a 'relevant charitable purpose', then any option to tax that the Council makes may be disapplied and any rental income will revert to being exempt. We recommend that the Council discusses this with DWT to determine the use to which it intends to put the Centre. If DWT operates the café, restaurant and retail operations at the Centre, we would expect it to have some VAT recovery on its associated costs.

Summary

Based on the information provided, the Council would, initially, be able to recover the VAT it incurs relating to the construction of the Centre. If the lease to DWT is exempt, the Council may breach its de



minimis limit in a given year. This would result in a requirement of the Council to repay an amount of input tax previously recovered. However, it may be possible to structure the project so that VAT is not an ultimate cost, e.g. by the Council opting to tax or granting a non-business (i.e. peppercorn) lease.

Once the Council has a firm intention in place regarding its use of the Centre, we would recommend that more detailed and specific advice is provided to ensure that VAT does not have a negative impact upon the Council's partial exemption position.

Yours sincerely

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