Appendix I – Operating Model Options

Background

There is a £7million budget in the Council's Capital programme for the development of a new Pavilion at KGPF. The MTFP assumes the £7million will be externally borrowed, therefore the MTFP has the interest of this borrowing and MRP (principal repayments) built into the base budget for 19/20 onwards. The Council will therefore build the new pavilion.

In 2018/19 the Council opted to apply the sports exemption, this generated approx. £400k of income to the Council as a VAT refund. The option to tax, has resulted in sporting and leisure services provided by the Council to be exempt from VAT, rather than standard rated.

The Council makes exempt supplies and therefore must carry out an annual partial exemption calculation. Within this period the exempt input tax, should not exceed 5% of the total input VAT incurred by a local authority. If the partial exemption limit is exceeded, the local authority must repay all the VAT it has recovered in relation to its exempt supplies during the financial year.

Currently the Council's partial exemption averages around 4%. As the development of KGPF pavilion is to provide sporting and leisure services, the build costs will form part of the partial exemption calculation and the Council is likely to exceed its partial exemption limit by approximately 30%. The result of this is that the Council would be expected to repay £1.6 million to HMRC, a cost the Council cannot afford.

VAT advice

The Council has sought Professional advice from KPMG regarding the following:

- What are the effects of the development of the new pavilion on Brentwood's partial exemption?
- What is the best suitable option for the management of the facility and the impact of the option to tax?

Brentwood applied the sports exemption to sporting activities last year, as such the supplies in connection with sporting activities from the new playing field development will be exempt from VAT. Supplies that are not connected with sport such as sale of food and drink from the club members bar and lounge will be subject to VAT at the standard rate (or zero rated if there are any cold take away food sales). The letting of any specific areas within the new pavilion will be a right over land and this will be an exempt supply unless Brentwood opts to tax the property, in which case it will be subject to VAT at the standard rate. KPMG summarised the VAT treatment of the primary supplies identified below:

Nature of Service	VAT Liability	Application to the Council
Charges to play or take part in a sporting activity	Exempt	This will be exempt as BC has applied the exemption for sporting services following the Ealing VAT case.
Use of changing rooms, showers and hire of sports equipment	Exempt	On the basis that the use is ancillary to taking part in sports activities. As BC has applied the exemption for sporting services following the Ealing VAT case.
Catering, food and drink sales.	Taxable - Standard-rated or zero-rated	Sales of food and drink are taxable at the standard rate. Cold take away food sales are zero-rated.
Hire of sports pitches/facilities	Exempt or standard-rated if opted to tax	Where facilities are booked for a period of 24 hours or more or meet the 'block booking' conditions, the VAT liability of this supply will change to standard-rated if BC opts to tax. Otherwise it will be exempt.
Letting of a room or a specific area for exclusive use.	Exempt or standard-rated if opted to tax	This is a VAT exempt let on the basis of Schedule 9 Group 1 (i.e. right over land), the VAT liability of this supply will change to standard-rated if BC opts to tax.

The VAT incurred by Brentwood on the development of the KGPF and its operation and management will depend on its future use:

- BC operates the KGPF making exempt supplies of sporting services and taxable supplies from the bars;
- BC operates KGPF making exempt supplies of sporting services and lets the bars and shop to a third party;
- BC contracts the operation of KGPF to an unconnected party (i.e. a separate Leisure Trust) to operate, or
- BC contracts the operation of KGPF to a connected party (i.e. a subsidiary company owned by BC) to operate.

Each of these will have a different impact on BC's partial exemption de minimis limit. Under each option:

- Any VAT incurred on expenditure that is exclusively used to make exempt supplies of sporting services will count towards BC's de minimis limit.

- Any VAT incurred on expenditure that is exclusively used to make taxable supplies (e.g. from the bars and golf shops) will not count towards the de minimis limit.
- VAT incurred on overhead costs relating to both taxable and exempt supplies will need to be apportioned. This can be done by using any fair and reasonable method, with income or expected income (taken from a business plan) being a good starting point. The VAT that, under this apportionment, is treated as relating to exempt supplies will count towards BC's de minimis limit.

Making an option to tax may help to reduce the level of exempt input VAT that will count towards the partial exemption de minimis limit. However, as the recipient of BC's services will most likely be unable to recover VAT, the addition of 20% VAT to the price of the services will increase the cost to the recipient.

Based on the advice sought, options have been investigated and financially modelled to ensure the best financial model for the Council.

Options

All options are under the consideration that the Council will opt to tax the land that KGPF Pavilion and surrounded services will be built upon. By opting to tax the land, this will reduce the level of VAT that will count towards BC's partial exemption de minimis limit. Each option reduces this amount differently.

1. Do nothing – Council builds the pavilion and manages the running of the building

Pros:

- Council keeps control of the building.
- Surplus from the Pavilion goes straight into the General Fund

Cons:

- High Staff Costs, staff employed by the Council to run the Pavilion would have the right to enter into the Local Government Pension Fund, current employer contributions are 17.1%.
- Future partial exemption costs, as exempt supplies and costs would count towards the Council's future partial exemption.
- Partial exemption breached costing the council in cash terms as well as accounting an extra 1.6 million

Build Costs	Amount £
Total Build	7,000,000
Partial Exemption Cost	1,600,000
Total Cost to BBC	**8,600,000**
Total Income of Operations	699,615
Total MRP and Interest	(472,000)
Net Income to BBC (averaged over 5 years)	**227,615**

2. **<u>Invite bids for operation –</u>** Council builds the pavilion and contracts the operation to an unconnected party.

Pros:

- Would receive Commercial rent (if the unconnected party was not a trust)
- Supply would be subject to VAT at the standard rate. In this case, none of the VAT incurred by BC on the development would count towards its de minimis limit

Cons:

- No current trusts that would be able to manage the KGPF pavilion.
- Other large unconnected parties that are not a trust, may not be interested in running the vicinity due to the return on the pavilion.
- With the BLT site still to be determined there could be more than one Leisure provider in the Borough. Ideally the Council would want one operator running all it's leisure facilities.
- Any surplus after commercial rent would go to the unconnected party.
- May not be able to cover VAT or pass VAT causing a negative impact on bottom line.

Build Costs	Amount £
Total Build	7,000,000
Partial Exemption Cost	0
Total	**7,000,000**
Lease Income	400,000
Total MRP and Interest	(394,000)
Net Income to BBC (after MRP and interest)	**6,000**
Net Income to Unconnected party	**144,975**

3. Contract operation to Wholly Owned Company or 3rd party operator

Pros:

- Would receive a commercial rent from WOC – this would cover the interest and MRP costs as a minimum rent. WOC would lease pavilion from BBC
- Other charges to WOC would include back office support provider by the council at market rate, if a service level agreement was required for Council resources
- Keep control of the building for the interim period pending the development of Brentwood Centre site.
- Any surplus would go to WOC, surpluses made in WOC can be paid to BBC as a dividend.
- Supply would be subject to VAT at the standard rate. In this case, none of the VAT incurred by BC on the development would count towards its de minimis limit
- Staff would be employed by WOC, or WOC would sub lease. Staffing costs would reduce as WOC pension costs would not be as high as the Council's 17.1%
- Council would reduce the lease payment by the amount of car parking income as the Council will retain and manage the car park

Cons:

- Net return to WOC may not meet the minimum requirement it requires for investment currently.
- SAIL would have to look to invest in HR policies and Payroll provider/system – supplying staff would be a new venture for WOC
- Income subject to VAT therefore less income received under WOC model

Build Costs	Amount £
Total Build	7,000,000
Partial Exemption Cost	0
Total	**7,000,000**
Lease Income	364,000
Car parking income	116,000
Total Income to BBC	**480,000**
Total MRP and Interest	(394,000)
Net Income to BBC (after MRP and interest)	**86,000**
Average Net Income to WOC	**130,000**