

PRIVATE AND CONFIDENTIAL

Ms C Barnett
South Devon Rural Housing Association Ltd
Babbage Road
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TQ9 5JA

30 September 2014

Dear Claire

Re: Rural Homes Ltd

Further to our recent discussions, you asked us to set out the VAT implications of the proposed arrangements with Rural Homes Ltd.

Background

In 2010 South Devon Rural Housing Association Ltd ("SDR") established a subsidiary company, Rural Homes Ltd ("RH"). To date RH has not traded but it is now intended to use RH to redevelop a site at Brimhay. The comments below are high level observations based on explanations given to us. We have not at this stage seen any documentation in relation to the proposed transactions.

We understand that SDR already owns the land and the existing bungalows on the site will be completely demolished.

SDR is not currently registered for VAT.

We assume that all proposed developments are self-contained dwellings for VAT purposes and that there is no restriction on their separate use or disposal.

Phase 1 – Affordable Housing

SDR wish to procure a block of 12 social housing flats. The intention is to enter into a design and build contract with RH for the construction of the units.

From a VAT perspective, RH would in principle be able to zero rate the construction of the new flats. This means that RH would be able to recover VAT on attributable costs such as professional fees.

Currently if SDR appoints professionals directly in connection with new build dwellings for affordable rent, it is unable to recover VAT on their fees. Thus use of RH as developer means there are VAT advantages to the arrangement. As such, we would recommend robust implementation of the arrangements to minimise the



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risk of successful challenges from HMRC. For example there needs to be a formal written contract between SDR and RH on normal commercial terms. Suppliers will need to be educated to invoice RH rather than SDR

Phase 2 – Units for open market sale

RH are to build 11 houses for open market sale. SDR owns the land and we understand that a licence will be granted to RH to allow them to come on to the site to construct the units. RH will be responsible for constructing and marketing them. When buyers are identified for each of the units, SDR will sell the land to RH who will then sell on the completed house to the end purchaser.

For VAT purposes, the first grant of a major interest by the person constructing is zero rated for VAT. In this scenario I believe that HMRC would take the view that RH is the "person constructing" thus RH's supply to the purchaser is zero rated for VAT meaning that RH can recover VAT on attributable costs such as marketing, legal fees, professional fees etc.

The sale of land by SDR to RH would be exempt. Thus SDR would not be able to reclaim VAT on any attributable costs, although I would not have thought they would be significant.

Phase 3 – Supported Housing Unit

SDR will sell a parcel of land to QSH, a third party, who will construct a supported housing unit which QSH will then lease back to SDR.

RH will be appointed by QSH to project manage the build and RH will bill them for their project management services which will be subject to VAT at 20%.

For VAT, SDR has not opted to tax so the sale of land will be exempt meaning no recovery of VAT on costs. (SDR could however consider whether there could be any advantage in opting to tax the sale – which would require it to register for VAT)

For RH, their sale is of professional services which will be subject to VAT at 20%.

We obviously are not advising QSH but it would be worth noting that if they grant a major interest to SDH e.g. a lease over 21 years, that would be a zero rated supply giving them right of recovery of VAT on costs. Presumably if QSH had irrecoverable VAT costs that would need to be reflected in the level of rent it charges to SDR.

VAT registration

RH will be making taxable supplies of professional services at 20% VAT, sale of construction services at 0% and sale of new houses at 0%. Thus it will need to register for VAT and it is recommended that this is progressed at the earliest opportunity to maximise the potential benefits of the proposed arrangements and to

simplify administration.

Currently the majority of SDR's income is exempt rents which do not count towards the taxable turnover limit. However SDR does currently have some taxable income from management fees, office services and supplies of fuel so SDR will need to continue to monitor its taxable turnover as the inclusion of management charges etc to RH may mean it goes over the VAT registration threshold (currently £81k of taxable income). It may also make zero rated supplies of houses e.g. the Old Totnes Road site.

To preserve the VAT benefits outlined above it will be important to have separate VAT registrations for each company not one VAT group registration

Costs incurred to date

SDR has already incurred costs in relation to the Brimhay site on surveys, architects etc and has not recovered any of the VAT incurred.


Following the High Court case of Community Housing Association, HMRC accept that where a body novates contracts to another party, supplies them with valuable intellectual property and recharges plus VAT, it has the right to recover VAT incurred. There is a 4 year cut-off.

We would recommend that you quantify the VAT incurred to date by SDR to assess whether it would be worthwhile going through the necessary steps to be able to recover the VAT. That would involve SDR having to register for VAT.

Summary

I hope the above is a helpful high level summary of the VAT issues to consider when moving forward with the proposed arrangements. The VAT advice will of course need to be considered in the round in conjunction other taxes such as corporation tax and SDLT as well as the commercial considerations. Careful implementation will be required to achieve the desired results.

Yours sincerely



Julie Rawlinson-Smith
Senior Manager