



PSTAX is a trading style of  
LAVAT Consulting Ltd.  
The Nucleus Business & Innovation Centre  
Brunel Way  
Dartford  
Kent DA1 5GA

**t** 0345 6861321  
**w** [www.pstax.co.uk](http://www.pstax.co.uk)

West Berkshire Council  
Council Offices  
Market Street  
Newbury  
RG14 5LD

FAO: Gabrielle Esplin

02 May 2018

Dear Gabrielle

**Tax Advice on the Proposed Joint Venture between West Berkshire Council and Sovereign Housing**

Thank you for asking PSTAX and Wilkins Kennedy to provide tax advice to West Berkshire Council ('the Council') on its proposed Joint Venture ('JV') with Sovereign Housing ('Sovereign'). As per the Brief that the Council kindly provided, this advice note is limited to the tax implications of the general operation of the JV and does not extend to specific projects carried out within the JV.

**Background**

Please note, this section is reproduced from the Brief to provide some context to the advice note.

*West Berkshire District Council and Sovereign Housing Association (via its development arm, Sovereign Westinghouse Development Ltd), wish to work together in partnership. They intend to establish a joint venture (JV) vehicle with the main aim of increasing the delivery of housing and in particular affordable housing in West Berkshire to meet the needs of the residents of West Berkshire.*

*These will include a mixture of affordable rent model and shared ownership homes. The joint venture may also provide some residential property for rent or sale at market rates and the activity may generate an income stream for the Council and Sovereign Housing, although the main aim remains to increase the supply of affordable housing.*

*The Council may transfer some of its own land assets to the LLP and may also provide capital funds to the partnership at market rates.*

*The model of partnership currently proposed is a Limited Liability Partnership (LLP) between the Council and Sovereign Housing. The Council currently proposes to enter into the partnership in its own right i.e. not via an arm's length company.*

### **Costs of setting up the partnership**

The costs incurred in setting up the partnership, including preliminary costs (ie those incurred prior to committing to the arrangements) will be borne by, and proper to, the parties individually. The partnership cannot, by definition, incur costs until it exists.

Any VAT on costs incurred by the Council in preparation for and prior to the formation of the JV will be fully recoverable. Should the Council incur a cost as part of the setting up process and seek to recharge all or part of that cost to Sovereign, this will be consideration for an onward supply and will be subject to VAT at the appropriate rate.

### **Limited Company v limited Liability Partnership**

#### *Corporation Tax*

Limited Company - If the JV is set up as a limited company, all profits and capital gains made by the JV will be subject to corporation tax. The rate is currently 19% but is due to reduce to 17% from 1 April 2020.

The tax is due for payment nine months and one day after the end of the accounting period (e.g. for a 31 March 2018 year end, the tax would be payable on 1 January 2019). If taxable profits exceed £1.5m, the company will instead need to pay its tax by way of four equal quarterly instalments.

The company will need to file accounts with Companies House nine months after the year end (the first accounts will be due 21 months after the date of incorporation) and file a corporation tax return to HMRC twelve months after the year end. The profits after tax can be distributed to the shareholders as dividends – the Council would not be subject to tax on the dividends that it receives.

Limited Liability Partnership - It would be more tax efficient for the Council if an LLP was used for the JV. This is because an LLP is treated as being transparent for tax purposes which means that the partners themselves are taxed on their profit allocations and that the LLP pays no tax itself. This is obviously an advantage because any profits allocated to the Council will not be subject to tax as a result of the Council's tax exempt status.

An LLP does have to file accounts with Companies House (the deadlines are the same as for a limited company) and although it pays no tax, it does also have to file a tax return with HMRC. The tax return discloses the income and expenses for the year and records any adjustments that are required to arrive at the taxable profit, and then shows how this profit is split between the partners (the partners then disclose these profit shares on their own tax returns, if they are required to file them).

The tax return is due for filing by 31 January following the end of the tax year (for a 31 March 2018 year end, the tax return would be due by 31 January 2019). Any profits paid out to the Council (as drawings/distributions) will be tax free in the hands of the Council.

There are other forms of partnership that could be used (such as partnership or limited partnership) and the tax treatment would be the same as for an LLP.

Whichever of the structures is adopted for the JV it will be treated as a separate entity for VAT purposes, and normal VAT rules will apply.

Some key issues to be aware of in the difference between the VAT treatment of the JV (whether a company or an LLP) and that of the local authority are:

- JV cannot recover VAT on non-business activities
- JV can only recover VAT incurred in making exempt supplies where this is less than £7500 and less than 50% of VAT incurred.
- JV must complete a partial exemption calculation each time a VAT return is submitted and carry out an annual adjustment calculation
- JV can change a tax point by issuing a VAT invoice within 14 days of a taxable supply (limit is 60 days for a local authority).

### ***General VAT implications***

It is likely that the JV will be making a mixture of taxable supplies (new homes sold either outright or as shared ownership – zero rated) and exempt supplies (domestic rental or sale of pre-owned homes).

The zero-rated supplies will create a right (or an obligation if such supplies exceed the VAT registration threshold of £85,000 per annum<sup>1</sup>) for the JV to be registered for VAT, which will allow VAT recovery on costs directly attributable to its taxable supplies, and an appropriate proportion of its overhead costs. There is generally no right to recover VAT on costs attributable to exempt supplies unless such VAT amounts to less than £7,500 per annum.

### ***Transfer of Land to the JV***

The transfer of land by the Council to the LLP under would be treated for VAT purposes in exactly the same way as the disposal to any other party. Having read the Draft Heads of Terms, we assume that all transfers will be for a consideration, whether or not this amounts to full market value.

The transfer would either be exempt from VAT (dwellings or un-opted commercial sites) or standard-rated (opted commercial sites). If the transfer is exempt from VAT the Council should consider the implications for its section 33 (partial exemption) calculation.

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<sup>1</sup> As at April 2017

Where a site has been opted and VAT is charged, the JV might not be able to recover the VAT, so it will fall as a cost to the project.

The transfer will be subject to SDLT, but partnership relief will apply such that SDLT will not be due on the proportion that will continue to be owned by the Council within the partnership. For example if the Council transfers land to the LLP in which it has a 60% share, SDLT will only be due on the remaining 40%.

***Capital Funding provided to the JV by the Council***

We understand that the Council might provide capital funding to the JV at market rates. The interest received by the Council will be exempt from VAT and should be included in the section 33 (partial exemption) calculation, although associated VAT costs are not likely to be significant.

***Services provided by the Council to the JV***

Any services provided by the Council to the JV for a consideration will be subject to VAT at the usual rate. Again, VAT charged by the Council might be irrecoverable by the JV, so will fall as a cost of the project. In order to be fully tax deductible in the LLP tax return (this will affect the JV partner), the services will need to be provided at a commercial arm's length rate.

***Services provided by the JV to the Council***

Services provided by the JV to the Council for a consideration will be subject to VAT at the appropriate rate. The Council will be entitled to recover VAT that it is charged subject to the usual section 33 (partial exemption) provisions.

***The Council's share of revenue generated by the JV***

As stated above, an LLP is transparent for tax purposes and will not pay tax on its surpluses. The distribution of surpluses to the individual members is outside the scope of VAT, and each member is responsible for accounting for tax on its share.

As the Council is exempt from Corporation Tax, its share of the surpluses from the LLP will not be subject to tax.

***The Council's share of any capital gains generated by the JV***

As above, each member is responsible for accounting for tax on its share of the gain. The share of any capital gain received by the Council will not be subject to tax.

***Alternative methods of raising capital finance***

The Council can finance the LLP by providing capital contributions and/or loans. Any interest paid is usually treated as additional profit share rather than as a tax deductible expense of the LLP. As the Council is tax exempt there are not likely to be any tax implications arising from the decision to classify the investments as capital or loan. However, there may be legal/commercial implications and separate advice should be obtained in this regard.



I trust that I have set out the tax liabilities and implications clearly, but should you have any questions, please let me know.

Yours sincerely

A handwritten signature in blue ink, which appears to read 'Peter Gladdish'. The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Peter Gladdish  
Managing Director and Head of Indirect Taxes  
PSTAX

Tel: 07977 513735

Email: [peter.gladdish@pstax.co.uk](mailto:peter.gladdish@pstax.co.uk)