

Made for sharing?

VAT and the cost sharing exemption

HM Revenue and Customs (HMRC) and HM Treasury have been consulting on proposals to implement an exemption from VAT on “shared services” arranged by and for bodies engaged in VAT exempt or non-business supplies. Consultation ended on 30 September. If you would like a copy of our response to the Consultation, please contact us on the details below.

The proposals would implement an exemption which was adopted into EU law in 1977. HMRC has been considering a proposal to implement the exemption in the UK for some time. We ran a joint workshop with HMRC and HM Treasury (HMT) in December 2010 and subsequently participated (with KPMG) in the NHF’s “Roadshow” of workshops earlier this year and are the only law firm named on their consultation list.

At the moment the only certain way of providing services between Registered Providers (RPs) without having to charge VAT is where the RPs are in the same VAT Group. To be in the same VAT Group, the entities also need to be in the same group structure.

What would the exemption do?

The exemption will enable certain businesses to share services where currently this would result in an irrecoverable or only partly recoverable VAT charge.

How would you obtain the exemption?

The businesses would need to establish a cost sharing group (CSG) which supplies the services to its members at cost.

Why is the exemption of interest?

The exemption will allow RPs to work together and with other public bodies like local authorities without having to pay VAT on the services which are being shared. This will have a number of practical applications – for example:

- Shared housing management
- Repairs and maintenance
- DLO style: grounds maintenance etc

- Back office functions, HR and IT but only if “directly necessary”
- Potentially, collaborative procurement services.

The exemption will also be of interest to other sectors engaged in activities which are exempt or non-business for VAT purposes including education, healthcare, care homes, sports and leisure facilities, cultural services and the wider charity sector, trade unions, and professional bodies.

The exemption is not limited to charitable and non profit bodies. It extends to profit making RPs and, more widely, to banks/finance businesses, insurance companies, postal services, betting and gaming. The exemption appears to operate in the same way for profit making and non profit bodies. A CSG is perhaps a more familiar concept for non profit bodies.

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Profit making bodies may however have concerns about the confidentiality implications of sharing resources and information with competitors. Most importantly, because services would need to be shared “at cost”, any private sector body would need to be prepared to work without charging a margin for its services. A private sector body could provide services to a CSG on a profit-making basis but would need to charge VAT on these. The CSG can then re-provide those services to its members without charging any further mark-up, and free of VAT.

There is nothing to prevent bodies from a wide geographical area and/or a variety of sectors coming together to form a CSG. A larger CSG would achieve greater economies of scale though it might be more difficult to manage and political or cultural differences could be an issue.

One area which will need particular care is how a CSG is staffed. There are a number of options here ranging from TUPE transfer (where a corporate vehicle is used) to secondment or joint contracts of employment. Clients we have spoken to are reluctant to commit to a full TUPE transfer, not least because a CSG may not be able to offer staff the same pension arrangements.

Conditions

The exemption will only be available where certain conditions are met. These are, in summary, as follows:

Condition 1: Independent group

Bodies which wish to share costs must do so through a CSG. This must have a separate identity that distinguishes it from the individual members. Whilst it could be a body corporate in its own right (such as a company limited by guarantee or industrial and provident society)

it could also be a partnership, joint venture, unincorporated association or a European Economic Investment Group (EEIG).

As per our response, an unincorporated association is attractive as it avoids the expense and extra administration involved in forming a corporate CSG. However, it brings risks of its own. It is likely that a lead body would need to be appointed which would sign, and so take the front end risk under, the CSG's contracts and pass this to other members through an indemnity.

The participating bodies should be members of the CSG but none of them individually should control it. HMRC suggests that “control” is by reference to either voting or entitlement to income or assets. We have suggested in our response that only voting control should be relevant. Whilst third parties could supply services to the CSG, the CSG should always have the right to replace them and they should not control the CSG.

A VAT group could be a member of a CSG. A single body could be a member of several CSGs. The majority of the CSG's governing board should be appointed by its members. The exemption applies to supplies by the CSG to its members but not between its members.

Condition 2: The members must provide exempt and/or non-business supplies

We have described above the types of activity which qualify.

Condition 3: The services supplied by the CSG must be directly necessary for exercise of the members' exempt or non-business activities

HMRC proposes that where a substantial majority of a member's activities are exempt and/

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or non-business, then all the CSG's services can be treated as directly necessary. If, on the other hand, only part of the members' activity is in this category then a partial exemption method would be followed to determine what proportion of the CSG's service is attributable to its exempt or non-business activity.

HMRC put forward an alternative method whereby certain services provided by a CSG would be ranked as "necessary". The danger here is that some significant activities, such as HR and IT, might be deemed not to be "necessary" and so fall outside the exemption. As per our response, this would be unfortunate, as these are services most likely to be shared.

Condition 4: The services must be supplied at cost (exact reimbursement)

The CSG may not make a profit from providing services to its members. Having said this, the consultation paper allows considerable flexibility for the CSG to deal with "timing differences". For example a CSG may build up a fund to meet anticipated expenditure and there is flexibility as to how costs are apportioned.

Condition 5: The cost share exemption must not lead to distortion of competition

Profit-making businesses may argue that the CSE puts participants at an unfair advantage and potentially reduces their market, as CSGs take services in-house.

Participants in a CSG can argue that:

- The effect of the exemption is not to put them at an advantage to businesses whose supplies are subject to VAT; rather it reduces an additional VAT burden which would otherwise fall on them.
- Profit-making (and VAT charging) businesses have the opportunity to sell their services to CSGs.
- It is unlikely that any single CSG will reach a dominant market position. This may need to be monitored.

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