

SUBJECT: VAT Management Arrangements

MEETING: CABINET

DATE: 19th September 2019

DIVISION/WARDS AFFECTED: ALL

1. PURPOSE:

- 1.1 To determine the impact that any planned investment at the authority's leisure facilities will have when combined with the decision for the Council to adopt the Ealing VAT ruling on the overall right to recover VAT on all Council costs.
- 1.2 This review models the potential level currently estimated and advised of VAT likely to be incurred on the proposed leisure redevelopments in the context of other known or budgeted VAT spending to support the delivery of current service plans across the Council.

2. RECOMMENDATIONS:

- 2.1 To submit retrospective claims in respect of the Ealing VAT ruling.
- 2.2 That the Council's processes and systems are amended to allow Ealing Ruling to be adopted from the 1st of November 2019.
- 2.3 That an appraisal of outsourcing the Caldicot leisure investment to a third party be undertaken.
- 2.4 To continue to closely monitor VAT costs, especially costs spent in VAT exempt areas, and where necessary to identify and advise on options using a "look forward" approach and that would mitigate any future likelihood of losses of irrecoverable VAT that might arise through the breach of the Council's partial exemption calculation and 5% threshold.

3. KEY ISSUES:

- 3.1 **Ealing Ruling** - Following the decision of the Court of Justice for the European Union (CJEU) in London Borough of Ealing, HMRC accepts that certain supplies of sporting services made by local authorities can be treated as exempt from VAT. The sporting exemption only covers supplies made to individuals participating in a sporting activity.
- 3.2 This gives the opportunity for the authority to submit retrospective claims for reimbursement of significant historical VAT overpayments – the VAT that it has already passed across on its leisure services income.

- 3.3 In addition the ECJ ruling opens the potential for a council to increase income streams by 20% on their net position for sporting services currently being charged with standard rated VAT covered by the exemption. Effectively the pricing structure remains the same to the service user but the value that would have been treated as VAT payable to HMRC is no longer passed over to the tax authority.
- 3.4 In April 2019 when Council agreed at its meeting not to progress with externalising tourism, culture, leisure and youth services but to retain services in-house it also agreed to adopt the Ealing ruling and treat VAT on sporting facilities as exempt.
- 3.5 The key concern for the council is that to safeguard our continuing ability to recover all the VAT we incur on our costs we need to ensure that the level of Input Tax we incur in relation to our VAT exempt supplies remains under a figure of 5% of ALL the Input Tax we incur in the year, the calculation the authority undertakes to support this is called the “de minimis” level and the parameters are set by HMRC.
- 3.6 If we exceed the 5% Input VAT figure, we would potentially lose all that value in VAT recovery not just the VAT value over the 5% figure.
- 3.7 The most damaging effect will therefore be present where, having adopted the Ealing ruling to treat the leisure income as VAT Exempt, capital investment at these sports centres is then undertaken. For example, capital spend of £5 million net of VAT at a centre where 75% of income generated is VAT Exempt, will contribute £750k of Exempt VAT costs to add to the calculation an addition of approx. 5.5 % points.
- 3.8 To safeguard the authority’s vat recovery position a number of scenarios were modelled in respect of the Partial Exemption calculations going forward to identify potential breaches of the 5% level and how they could be overcome. These models covered the period 2012-13 to 23-24 inclusive.

4. EQUALITY AND FUTURE GENERATIONS EVALUATION (INCLUDES SOCIAL JUSTICE, SAFEGUARDING AND CORPORATE PARENTING):

- 4.1 This report considers the Council’s future VAT management arrangements. No equality and future generations evaluation is required as there are no implications that would arise directly from this report and the recommendations contained therein.

5. OPTIONS APPRAISAL

- 5.1 Due to the authority’ position of adopting Ealing retrospectively and submitting the claims which would result in triggering breaches of the 5% VAT limit, an adjustment to the model needed to be identified to identify options which could offset these breaches.
- 5.2 It was decided to appraise the effect of outsourcing the build of the major potential leisure investments at Abergavenny and Caldicot in tandem or in isolation to a third party.
- 5.3 **Outsourcing the Abergavenny and Caldicot Investment – Adopting Ealing and submitting retrospective claims.** This option did resolve the early partial exemption

breaches but by committing to the outsourcing of both schemes this would put significant pressure on the partial exemption calculation for the next 25 years.

This approach left little contingency in terms of headroom for unforeseen events that could impact adversely on the partial exemption calculation. Under this model there is still a breach of the 5% limit in 20-21 and 23-24.

5.4 Outsourcing the Abergavenny Investment in isolation – Adopting Ealing and submitting retrospective claims

The approach produced positive results from a partial exemption perspective with a small breach in 20-21 due to the Caldicot build which could not be managed by the seven-year average but would likely to be overcome by robust VAT management of the capital programme.

The negatives were the headroom for future partial exemption breaches due to the repayments being based on a 25-year term.

5.5 Outsourcing the Caldicot Investment in isolation – Adopting Ealing and submitting retrospective claims.

This approach also produced positive results from a partial exemption perspective with a small breach in 21-22 due to the Abergavenny build which could not be managed by the seven year average but would likely to be able to overcome by robust VAT management of the capital programme.

It also provided a greater contingency in terms of headroom for future partial exemption breaches in comparison to the other outsourcing models.

It is recommended that this option is pursued and that an appraisal of outsourcing the Caldicot leisure investment to a third party be undertaken in furtherance of the decision made by Cabinet in July 2019 to commission a feasibility study for refurbish of the site.

6. EVALUATION CRITERIA

- 6.1 This report considers the Council's future VAT management arrangements. A key recommendation from this report is for the Council to continue to closely monitor VAT costs and for the reasons outlined in the report.
- 6.2 Evaluation will there consist of more robust VAT management arrangements than previously and to ensure that action is taken to mitigate any future likelihood of losses of irrecoverable VAT that might arise through the breach of the Council's partial exemption calculation and 5% threshold.
- 6.3 Whilst the partial exemption calculation is formally undertaken on an annual basis there will be an ongoing need to monitor costs spent in VAT exempt areas, notably capital investment, as well as the capital programme as a whole.

7. REASONS:

- 7.1 To provide clarification and seek approval from Cabinet to proceed with its VAT management arrangements in the way described in the report and upon adopting the Ealing ruling earlier in the year.
- 7.2 To ensure that any future risk of losses of irrecoverable VAT that might arise through the breach of the Council's partial exemption calculation and 5% threshold is mitigated.
- 7.3 Based on potential investments in Caldicot and Abergavenny leisure sites, being considered as part of a MonLife report to Council on 19th September, to advise Cabinet on the preferred route of undertaking an appraisal to outsource the Caldicot leisure investment to a third party. This approach would produce the optimum outcome for the Council's partial exemption and require an ongoing need for robust VAT management of the capital programme.

8. RESOURCE IMPLICATIONS:

- 8.1 Submitting retrospective claims in respect of the Ealing ruling to HMRC, and if successful, could lead to a significant reimbursement of historical VAT overpayments of up to £2.2m.
- 8.2 Adopting the Ealing ruling also allows for Council to increase income streams by 20% on their net position for sporting services currently being charged with standard rated VAT. This will create circa £270k that can be reinvested back into services and that are necessary to support delivery of the Monlife business plan going forward.
- 8.3 As the report outlines there will be a need to maintain robust VAT management arrangements going forward and to ensure that any likelihood of losses of irrecoverable VAT that might arise through the breach of the Council's partial exemption calculation and 5% threshold are suitably mitigated. Mitigating options include:
 - a) Flattening the level of VAT spikes in capital spend in-house by using third parties to develop the assets which would be leased into the council to run.
 - b) Scheduling in-house delivery of leisure capital projects over a longer time period to reduce the seven-year average impact.
 - c) Reviewing the TOGC (Transfer of a Going Concern) options to identify if investment purchases need to follow this path.
 - d) Robust VAT management specifically in respect of the capital programme and potential exempt income generating schemes. This includes early intervention and appraisal of the VAT implications of future schemes before commitment to those schemes can be given.
- 8.4 The Council has a good working relationship with HMRC and is consistent in its approach to take all reasonable care in ensuring it achieves a compliant VAT management position which would not risk challenge by HMRC.

8.5 Further information to support the modelling and sensitivity analysis is contained in appendix 1.

9. CONSULTEES:

Senior Leadership Team
Cabinet

10. BACKGROUND PAPERS:

Appendix 1 – Future impact of leisure investment and adoption of Ealing ruling

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