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Taxation

VAT news for Local Authorities

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VAT is a considerable administrative burden for local government and the onus is on each Local Authority to meet its obligations whilst taking steps to minimise VAT liabilities. Here, we summarise some of the VAT issues currently affecting the sector:

Partial Exemption

Local Authorities can normally recover all the VAT that they incur under the special partial exemption regime for 'section 33 bodies'. This is on condition that VAT on costs relating to exempt business activities (e.g. cremation and burial services, some sports facilities, some land transactions) is not more than 5% of all VAT incurred. In tax years 2007/08 and 2008/09, HMRC applied a moratorium and did not impose the 5% limit - however, from 1 April 2009, it is firmly back in place. Local Authorities will need to ensure they have restored the necessary VAT accounting processes for 2009/10 to demonstrate that the 5% limit has not been breached. It is not just the input VAT in excess of the 5% limit that is at stake, but the entire amount of the VAT on costs related to exempt supplies.

Penalties

HMRC's new Tax Penalty regime took effect on 1 April 2009. For Local Authorities with March VAT quarter ends, the March 2009 return (due on 30 April) will have been the first affected. Under the new regime, the penalty for errors potentially doubles from 15% to 30% if the error is 'careless', i.e. where a taxpayer has failed to take 'reasonable care'. Should the 5% partial exemption limit be breached, an authority's failure to monitor it adequately may well be regarded by HMRC as not taking reasonable care.

Leisure facilities

Uncertainty has surrounded the VAT treatment of Local Authority leisure facilities for some time, particularly the treatment of all-inclusive membership schemes. Historically, Authorities would apportion these fees to reflect the range of VATable and exempt facilities available to members. However, the Court of Appeal's decision in the 2006 *Highland Council* case was that an all-inclusive scheme was a supply of a right to use the facilities and subject to VAT in its entirety, unless the payment only entitled use of exempt facilities. Following other litigation and representations from the leisure industry, HMRC has recently revised its policy, and now accepts that the VAT liability depends on why the "typical customer" would pay for the services. This could result in a single exempt supply, or a single taxable supply. Clearly this is a difficult area and, as a side effect of the changing VAT treatment, may give rise to capital goods scheme adjustments and the possibility of claims for output VAT overpaid in the past.

Local authorities should also be aware of a Memorandum of Understanding between HMRC and CIPFA detailing the VAT position of the contracting out of leisure facilities. The VAT treatment of the various supplies that can arise largely depends on the type of organisation that provides the leisure facilities under the contract. This can be a Direct Service Organisation within the Authority's own leisure service department; a Non-Profit Distributing Organisation in which the Authority may have a

degree of representation; or a wholly owned independent 'profit' leisure management contractor. The Memorandum is highly detailed, and needs careful consideration to ensure that all supplies are identified and the correct VAT treatment applied.

Land and property – option to tax

The option to tax was first introduced in 1989 to allow landlords and property owners to charge VAT on a commercial property, thereby allowing VAT recovery on construction or refurbishment costs. An option may be revoked where more than 20 years has elapsed since it first had effect so a Local Authority which opted to tax a property on 1 August 1989 may now choose to remove it, allowing future sales or lettings of the property to be exempt from VAT. If your existing tenant cannot recover all the VAT it incurs, or you are marketing the property for sale or rent, the ability to remove VAT from the price may be what is needed to secure the deal. Revocation needs careful consideration, however, both of its impact on the Authority's past VAT recovery on that property and on the 5% partial exemption limit going forward.

Compound interest

Most Local Authorities will be aware of the compound interest litigation currently moving through the courts. Whilst the legal action was brought by the motor industry, all sectors which have received or are expecting significant repayments of VAT may be able to make claims for compound interest. Many Local Authorities are in this position in respect of recent *Fleming* VAT claims, such as those made for cultural

exemption or car parking overpayments. They should therefore be actively considering compound interest claims so not to fall foul of the relevant time limits.

Voluntary aided schools

Local Authorities have historically been allowed to contribute funding to the governing body of voluntary aided (VA) schools to help it meet the cost of its capital projects. To date, HMRC has accepted that Authorities can recover the VAT incurred on certain VA expenditure that it funds, even though it is in fact the responsibility of the governing bodies. This policy is likely to be revised later this year (possibly in September) and this VAT may become irrecoverable. Authorities and VA schools may wish to bring forward any qualifying projects to maximise any VAT recovery.

Park and ride schemes

Many Local Authorities operate park and ride schemes. These typically comprise a mix of VATable parking facilities, and zero rated passenger transport. However, comments made during the recent Tribunal case involving *Purple Parking Limited* suggest that this treatment may not be correct, so Authorities should review their treatment of these schemes to ensure that zero rating is still available.

There are many other current VAT issues for Local Authorities - transfers of housing stock, 'Building Schools for the Future' and reverting to a standard rate of 17.5% on 1 January 2010. We can help you to minimise net VAT costs across all these areas.

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