

VAT Cost Sharing Exemption to go ahead



The Finance Bill 2012 confirms the introduction of the VAT cost sharing exemption in the UK

What is the VAT cost sharing exemption

The VAT cost sharing exemption (CSE) is a mandatory exemption set out in the principal EU VAT directive. It has not yet been implemented in the UK. Several other EU member states have implemented the exemption with varying degrees of success. As a result the UK has been slow to bring the exemption onto the UK statute books. However, after lobbying from several groups that would benefit from the exemption, the Government have proposed to make the exemption UK law when the Finance Act 2012 is enacted next summer.

Essentially, the CSE is a VAT exemption on services shared between VAT exempt bodies such as charities, insurance companies, banks and universities via a cost sharing group (CSG). A CSG allows such organisations to join forces as a group to benefit from economies of scale, reducing costs and allowing them to work more efficiently by sharing costs and resources.

Background

After several years of lobbying for the implementation of this exemption the Government announced in Budget 2011 that they would consult on its implementation. A consultation document was published this summer and 6 December 2011 saw responses to the consultation and draft legislation published, confirming the Government's intention to introduce the CSE into UK law in 2012.

This has been a very welcome move for many organisations within the charities, higher education and financial sectors, with 154 responses being received by HMRC. Whilst the majority of respondents welcomed the exemption, there was a concern over how the cost sharing vehicle should be set up and whether or not it should be an independent entity. These concerns have been addressed by HMRC in the draft legislation and response document.

Key issues

Conditions

As currently drafted, a supply made by a CSG will be exempt from VAT if 4 conditions are met:

- Each member of the CSG is to a qualifying extent exempt for VAT purposes i.e. they make a minimum of 5% of supplies of goods or services that they are unable to charge VAT on
- The supply made by the CSG is **directly necessary** for the exempt activities of the members e.g. charitable activities
- The CSG only claims an exact reimbursement of its costs for those services; and
- Relief from VAT is not likely to cause distortion of competition.

Form of CSG

The consultation document initially suggested that the CSG should be an independent single entity. However, concern was raised by charities and registered providers/housing associations as to the need for the CSG to be independent. The main issue for these groups was the potential lack of control over their staff and resources, which could be a real blocker to these organisations taking advantage of the CSE.

The Treasury and HMRC have listened to these concerns and have confirmed in their response document that a CSG must be a separate entity but it can be owned and controlled by its members. Ownership does not have to be in equal proportions and can be just one member.

This should be a welcome change for charities and registered providers/housing associations as well as members of the financial services sector who felt the original proposal was too restrictive for corporate groups to use.

HMRC are in the process of drafting detailed guidance with key stakeholders which will put flesh on the bones of the draft legislation. This will include guidance as to the type of body or entity that can be used to form a CSG.

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Membership of CSG

To be eligible for a CSG an organisation will have to make a minimum of 5% of exempt or non-business supplies over a prescribed period of time. A VAT group can be a member of a CSG, but it is not clear as yet how that will work in practice. HMRC are to confirm in their guidance.

'Directly necessary'

Concerns have also been raised around the condition that expenditure by the CSG must be "directly necessary" for the exempt activities of its members. Much concern was voiced over whether "back office" costs would fall within this condition. HMRC have neither confirmed nor denied in their recent documents whether such costs are considered to be "directly necessary". However, they have confirmed that for those costs, including back office costs that are not directly necessary, a CSG member will only be able to take advantage of the exemption to procure such services if 85% or more of their activities are "exempt or non-business" activities for VAT purposes.

Again, the devil will be in the detail of the guidance that HMRC are to produce in due course.

Next Steps

Finance Act 2012

The Finance Act 2012 will introduce the CSE into UK law and the exemption will be effective from the date of enactment of this Act.

Guidance

As we have mentioned, HMRC are in the process of engaging with stakeholders to draft clear guidance as to how the CSE will be implemented in practice. They have stated that this will be available before the exemption becomes law and it will be drafted on the principles set out in the response document.

HMRC have in the meantime produced a short technical note that addresses some of the practical issues for those organisations looking to implement a CSG, or who are already a member of a CSG relying on the premise that the EU VAT Directive containing the exemption has a direct effect in the UK such that they can claim the benefit before the Finance Act 2012 is enacted. Please click [here](#) for the full note.

How we can help

We await the guidance from HMRC to determine exactly how the CSE will be implemented in practice and we will update you as and when we have further information.

However, if your organisation is considering setting up or entering into a CSG arrangement please contact your usual Osborne Clarke contact or one of our experts.

"Introducing the exemption could facilitate efficiencies for educational institutions, charities and housing associations, tentatively estimated at £100 million in cost savings for businesses (excluding VAT savings)."

HMRC, Overview of Legislation in Draft Finance Bill 2012, 6 December 2011



Alexandra Casley

Associate, Tax
alexandra.casley@osborneclarke.com



Mark Woodward

Partner, Tax
mark.woodward@osborneclarke.com



Philip Moss

Consultant, Tax
philip.moss@osborneclarke.com

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