HMRC - VATSC98800 - Direction Of Supplies: Memorandum Of Understanding With CIPFA

Contents

Introduction

This memorandum of understanding sets out how VAT is to be applied to the various supplies that can arise in the provision of local authority leisure services. The contents have been jointly agreed by HMRC and the Chartered Institute of Public Finance (CIPFA) and Accountancy. The primary purpose is to identify the types of supply that will normally be encountered and to confirm their correct VAT treatment. It should be noted, however, that the contents will be subject to review from time to time to reflect changing commercial practice and any VAT Tribunal or court decisions in this area of the tax.

Background

Local authorities may deliver leisure services in a number of ways:

a direct service organisation (DSO) within the local authority’s own leisure services department;

a non-profit distributing organisation (NPDO), such as a trust or industrial and provident society, in which the authority may have a degree of representation;

a wholly independent “for profit” leisure management contractor.

The authority may be driven to choose one of these options by a number of factors, including the compulsory competitive tendering process, a decision to tender voluntarily, a desire for enhanced service delivery or perhaps even for financial reasons.

In the case of a DSO all supplies continue to be made by the local authority and the VAT accounting position continues as before. Otherwise the various arrangements that flow from the contracting out process can give rise to a number of potential supplies for VAT purposes.

Who is making the supply of the leisure facilities?

Who is actually making supplies to the users of the leisure facilities is perhaps the single most important aspect to be established. The appropriate VAT treatment is largely dependent on this factor. All the relevant documentation (including the invitation to tender and the final contract/agreement) should be consistent with the intentions of the parties in this respect. These intentions should also be reflected in the operational arrangements that are adopted.

Non-profit Distributing Organisations

Where operation of the leisure facilities is to be taken over by a non-profit distributing organisation (NPDO), it is normal practice for the relevant premises to be leased to it by the local authority in return for the payment of a peppercorn rent. Thereafter, the NPDO will act as a principal in making supplies to users of the facilities.

Independent contractors

An independent contractor will in most cases be engaged to run the leisure facilities as a principal. However, there can be instances where the contractor will agree to act as an agent of the authority in running certain facilities. This has led to uncertainty over the status of some independent contractors, due to ambiguity or conflicting indications within many existing written agreements. In many cases, such agreements have failed to make the position clear that it was always intended by both parties for the contractor to act as a principal in making supplies to the general public and other users.

Future agreements should clarify the status of the contractor and fully reflect the arrangements under which the parties are to operate. In the meantime it has been agreed that, in the absence of express provisions that the contractor is to act as an agent of the local authority, existing contracts can be accepted as establishing the contractor as a principal in making the supplies.

Liability of supplies to users of the leisure facilities

Where supplies are made by a local authority

The supply of leisure activities will continue to be made by the local authority in circumstances where a direct service organisation (DSO) is set up or where an independent contractor is brought in to run the facilities as an agent of the authority. In these circumstances the local authority is liable to account for VAT on the takings at the standard rate for all supplies other than those that may be exempt under the VAT Act 1994:

Schedule 9, Group 1(m) (note 16) (single lets for over 24 hours and a series of single lets to the same person - see Notice 742) and

Group 6 (education - see Notice 701/30).

Where supplies are made by a non-profit distributing organisation (NPDO)

The liability to account for VAT on the takings at the standard rate rests with the NPDO.

Some supplies are eligible for exemption under the VAT Act 1994, Schedule 9, Groups 1(m) (note 16) and 6 - see above.

Other supplies may be eligible for exemption under Group 10 (sporting services supplied by non-profit making organisation and competition entry fees) - see Notice 701/45.

Where supplies are made by an independent contractor

Where the contractor acts as a principal, any supplies made to the users of the leisure facilities will be liable to VAT at the standard rate unless exempt under

the VAT Act 1994, Schedule 9, Group 1(m) (note 16) (see above) and

the VAT Act 1994, Schedule 9, Group 10 (Item 1) competition entry - see Notice 701/45.

Further supplies to users

There may be further supplies made in the course of operating leisure facilities such as room hire, crèche facilities and catering franchises. The liability of these will vary and may include additional exempt supplies.

Other supplies

Non-profit distributing organisations

Normally NPDOs receive annual funding from the local authority. However, the nature of these payments can vary and their VAT treatment depends on the circumstances in which they are paid. In some cases they are simply a grant and are therefore outside the scope of VAT. In other cases, such amounts can represent consideration for a standard-rated supply by the NPDO of undertaking to operate the leisure facilities under the terms of a contract with the authority. Each case, therefore, will have to be decided on its own merits.

Independent contractors

Arrangements with independent contractors can give rise to various additional supplies depending on whether the contractor is acting as an agent of the local authority or as a principal.

Agency agreements

The contractor is liable to account for VAT on its supply of agency services to the local authority. Consideration for this supply will comprise of any amounts paid to the contractor by the local authority and any amounts retained by the contractor from the takings.

The VAT charged by the contractor to the local authority will be attributable to the supplies which the authority makes from that facility. It must be apportioned between taxable and exempt supplies in accordance with the authority’s section 33 refund method (ie its partial exemption method), and will be recoverable subject to the authority’s partial exemption position.

Any amounts paid over by the contractor to the local authority normally will be in respect of the takings collected on behalf of the local authority. Where this is the case they are outside the scope of VAT so far as the contractor is concerned. The liability to account for VAT on the takings remains with the local authority (see above).

In some cases the contractor may incur operating expenses as agent for the local authority. Where the supplies are subject to VAT, any entitlement to input tax deduction rests with the local authority. However, if the contractor acts in its own name in relation to the expenses there is a requirement under section 47(2A) of the VAT Act 1994 in the case of goods, for the supply to be treated as being made to and by the agent. Where this applies the contractor may recover the VAT involved as input tax (subject to the normal rules) and is required to account for output tax on the onward supply to the authority. Supplies of services may (if the parties wish) be treated in the same way under section 47(3).

Principal agreements

It is normal practice under principal agreements for the local authority to make payment to the contractor in the form of a set management fee. This represents the consideration for a standard-rated supply by the contractor of agreeing to operate the leisure facilities in accordance with the terms of the contract.

In addition to the management fee, the agreement may provide for payment of a further variable amount, sometimes referred to as a “contractor’s deficit”. This normally is intended to make good any overall shortfall between the takings and operating costs. Where such payments are an addition to the management fee, they will be taxable at the standard rate.

Where, however, any monies paid over by the local authority to the contractor are directly linked to prices charged to users, then such payments may represent third party consideration for use of the facilities. The contractor is therefore obliged to account for VAT on the same basis as the normal takings and this cannot be recovered as input tax by the local authority.

Otherwise, any VAT charged to the local authority by a contractor acting as principal in respect of the management fee or deficit funding will be recoverable in full by the authority subject to the normal rules. VAT charged by the contractor in these circumstances is not attributable to any lease or licence to occupy granted by the local authority to the contractor.

There will be a liability on the part of the authority to account for output tax, (subject to an option to tax having been exercised) on any amounts received in respect of the grant to the contractor of a tenancy or a license to occupy the leisure facilities. However, where there is no rent payable by the contractor, the grant of the tenancy or licence to occupy will normally represent a supply for no consideration.

Where there is no monetary payment or non-monetary consideration from the contractor to the local authority for a lease or licence to occupy, this is seen as a non-business transaction for the local authority. Any VAT which the authority incurs on costs attributable to the premises will be recoverable under section 33 of the VAT Act 1994 subject to the normal rules.

In some circumstances a contractor may be obliged to repay some of the gross/net profits to the local authority if, for example, they exceed an agreed level over a period of time (a “contractor’s surplus”). These payments normally will represent a reduction in the management fee payable by the local authority and VAT credit note procedures will apply.

Under some arrangements the contractor is obliged, as a condition of taking over the running of the leisure facilities as a principal, to periodically pay an agreed fee to the local authority. Provided this is not rent payable in connection with the granting of a tenancy or licence to occupy the leisure facilities, it will normally represent consideration for a standard-rated supply of the granting of the right to operate the facilities by the local authority to the contractor.

Further advice

This memorandum covers only the basic arrangements that can apply to the operation of contracted-out local authority leisure services. Those involved should consult their local VAT Offices if they require further guidance on any of these aspects, or if there is anything not covered specifically.

Previous page