

VAT cost sharing exemptions and the '85% directly necessary work' test

You should add this to the existing section on VAT Cost Exemption in your Highway Code folder.

Steve Butcher, Head of Procurement at the Higher Education Funding Council for England, says that he expects several universities to announce their own "cost sharing groups" (CSGs) when rules about VAT exemption are clarified in May¹.

Also, beyond the HE sector, VAT cost sharing exemption groups are likely to begin to appear as shared service vehicles, when the consequences of the new rules in the 2012 Finance Bill come into play this year.

HMRC refers to them as CSG (Cost Sharing Groups) and just to remind you, they are made up of non-vatable organisations who come together to develop shared service activities.

The sectors that probably most interest a Shared Service Architect or Practitioner are :

- Housing
- Further Education
- Higher Education
- Health
- Charities
- Voluntary Groups
- Some Social Enterprises

HMRC makes it clear that a key factor for CSGs is that the services they provide to their members must be 'directly necessary' for their exempt and/or non-business activities.

If they are not, the exemption does not apply and the supplies are subject to normal VAT rules.

Although the brief from HMRC is reasonably clear, it was written back in 2012.

All evolving tax law is subject to clarification and sometime change. So you should seek professional tax advice to ensure you are up to date with the newest interpretation of the law.

How 'necessary' is 'necessary'?

Much of the following detail about what is necessary, is taken directly from the Revenue & Customs Brief 23/12² and explains the addition of the new *Group 16* to Schedule 9 of the VAT Act 1994.

So, what do HMRC say in their briefing note about what 'necessary' means?:

The word 'necessary' used alone could be interpreted on the basis that any supplies used for a CSG member's exempt and/or non-business activity would be entitled to exemption.

However, the word 'necessary' is, in this case, qualified by the use of the word 'directly' meaning that the supplies received from the CSG must relate 'directly' to the exempt and/or non-business supplies made by the CSG member in their own right.

Fortunately, HMRC has adopted a methodology for identifying services that are 'directly necessary' which has been developed with stakeholders during the consultation process in order to provide a simple and pragmatic way of identifying qualifying supplies.

If CSGs wish to suggest alternative methodologies HMRC will give them full consideration but will want to be satisfied that there is a direct and exclusive link with the exempt or non-business activity on which the qualification depends.

HMRC stresses that: ... businesses and organisations considering forming CSGs should note that recently the EU Commission have commenced infraction proceedings against Luxembourg for, among other things, their application of the 'directly necessary' condition, which is similar to the 'simplification' option offered by the HMRC in this guidance³.

The Commission are seeking to establish the principle that 'directly necessary' services are those

Although the brief from HMRC is reasonably clear, it was written back in 2012. All evolving tax law is subject to clarification and sometime change. So you should seek professional tax advice to ensure you are up to date with the newest interpretation of the law.

¹ Times Higher Education, 7th March 2013

² <http://www.hmrc.gov.uk/briefs/vat/brief2312.htm>

³ See Q40, point 2

Here is an example of a checklist that your partnership could co-create with help from a professional VAT adviser to test that each potential member of a VAT cost sharing exemption group is eligible to belong to it.

<p>Example CSG Checklist Questions</p>	<p>All answers are required to be "YES"</p>
<p>Are the supplies of services received from the CSG 'directly attributable' to the member's exempt and/or non-business activities?</p>	
<p>Can they be regarded as 'directly necessary' and therefore qualify for the exemption?</p>	
<p>Is any of the expenditure non-qualifying because it is not linked exclusively to the exempt and/or non-business activities of CSG members?</p>	
<p>Does a member of the CSG have exempt and/or non-business activities that form 85 per cent or more of their total activities?</p>	
<p>Have all the members of the CSG:</p> <ul style="list-style-type: none"> ● made 85 per cent or more exempt and/or non-business supplies in the immediately preceding 12 months or completed partial exemption year end prior to their membership of a CSG (the backward look)? ● or have the intention in the 12 months immediately following joining a CSG to make 85 per cent or more exempt and/or non-business supplies (the forward look)? 	
<p>Will the CSG members maintain their level of exempt and/or non-business supplies at 85 per cent or more?</p>	
<p>Etc....</p>	
<p>Etc....</p>	

This table is provided as an example only and professional advice should be taken on this new area of tax law.