



VAT: Cost Sharing Exemption

Consultation document

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2011

Subject of this consultation: The VAT Cost Sharing Exemption is a provision in European law that allows businesses and organisations making VAT exempt and/or non-business supplies to form groups to achieve cost savings and economies of scale. Once formed the groups are relieved of a VAT charge on their supplies if all the conditions of the exemption are met.

Scope of this consultation: This consultation invites comments on a possible model for a cost sharing exemption that could be introduced in the UK. It also asks specific questions to enable HMRC to assess the impacts of implementing the exemption.

Who should read this: All independent businesses and organisations which have VAT exempt and/or non business activities that may wish to set up cost sharing arrangements with other independent businesses and organisations.

Duration: The consultation will start on 28th June 2011 and end on 30th September 2011.

Enquiries: For enquiries about the content or scope of the consultation or requests for hard copies, please contact:

David Bond HMRC VAT Directorate VAT Projects Team 3C/10 100 Parliament Street London SW1A 2BQ	Mark Hampson HM Treasury VAT and International Excise Team 2/35 1 Horse Guards Road London SW1A 2HQ
Tel. 020 7147 0058	Tel. 020 7270 6188
Email: david.bond2@hmrc.gsi.gov.uk, or mark.hampson@hmtreasury.gsi.gov.uk	

How to respond: Postal address and email address to which written responses can be submitted.

David Bond
HMRC
VAT Projects Team
3C/10
100 Parliament Street
London
SW1A 2BQ

Email: david.bond2@hmrc.gsi.gov.uk

Additional ways to be involved:

HMRC and HM Treasury are contacting groups representing the sectors that could benefit from the exemption, offering to attend meetings and workshops that they may want to organise for their members.

HMRC and HM Treasury are also happy to meet with and speak to other interested parties. Contact details are as above.

After the consultation:

A summary of responses will be published in the Autumn.

Getting to this stage:

There is currently no domestic legislation that allows the exemption to be used by UK taxpayers. HMRC and HM Treasury have met with interested parties to discuss options about how the exemption could be implemented in the UK.

Previous engagement:

- In the Budget in June 2010 it was announced that existing discussions with relevant sectors, to consider how the exemption could be implemented, would continue and that a formal consultation would take place in Autumn 2010.
- HMRC and HM Treasury met with and received and responded to representations from a variety of sectors engaged in exempt and non-business activity including the financial services and charity sectors.
- Also, during January and February 2011 there were meetings with a number of potential users of the exemption, arranged through representative bodies across many sectors, to begin to evaluate the impacts and revenue costs of implementing the exemption in the UK.
- It was announced in the March 2011 Budget that the consultation process would continue.

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1. Executive Summary

1.1 The purpose of this document is to examine how the VAT cost sharing exemption might be introduced into UK legislation and to develop a framework for its implementation - Stage 2 of the tax policy development and implementation framework. In preparing it HMRC has taken into account representations received from interested parties over the past 12 months. The principles that have guided HMRC in developing the options for the way the exemption might be implemented are that it:

- Could be used by a wide range of sectors.
- Is straightforward to operate, minimising compliance and administrative burdens.
- Does not create opportunities for abuse or avoidance.

1.2 The principal benefit of the exemption is that by removing a VAT charge, it will facilitate efficiency savings for certain organisations wishing to work together. It is designed for use by businesses and organisations unable to recover all of the VAT they incur on their purchases, such as:

- Charities
- Universities and Further Education Colleges
- Housing Associations
- Residential care homes
- Banks
- Insurance companies

1.3 The exemption is however a complex legal provision impacting on a wide range of organisations and HMRC will need to consider the responses to this Consultation Document carefully.

1.4 Implementation will not be straightforward as there is no standard EU implementation that can be followed. Each Member State has implemented the exemption in a unique way.

1.5 The Commission have recently started infraction proceedings against some Member States in relation to the way they have implemented the exemption and have indicated that they will be issuing some detailed guidance for Member States later this year.

1.6 The exemption is a longstanding provision of European VAT legislation. Chapter 2 explains some background to the exemption and includes the European legislation.

1.7 Chapter 3 sets out how HMRC will define an 'independent group of persons' and asks a series of questions based on that stated definition.

1.8 Chapter 4 explains the requirement for members of cost sharing groups to carry out exempt and/or non-business activity and asks whether there should be a

requirement for them to have a certain level of exempt and/or non-business activity before they can become members of CSGs.

1.9 Chapter 5 offers HMRC's preferred method of defining 'directly necessary' supplies. The approach taken to defining the services qualifying for the exemption is likely to have a significant effect on how it is used. HMRC would like to understand the impact of the suggested approach on organisations' ability to use the exemption. Alternative approaches are suggested and comments and suggestions are invited from respondents about any other method(s) they believe should apply.

1.10 Chapter 6 explains how HMRC believe the 'direct reimbursement of costs' condition could apply, inviting comments and alternative approaches.

1.11 Chapter 7 explains, using European case law, in what circumstances the 'distortion of competition' condition would apply and asks respondents for specific examples.

1.12 Chapters 8 and 9 set out HMRC's position regarding, respectively, cross border issues and process and compliance matters.

1.13 Chapter 10 details generally the impacts that would result from introducing the exemption into UK legislation and asks a series of questions to validate or otherwise the various impact assessments. In particular it seeks to identify whether or not there would be any equality impacts.

1.14 HMRC expect that many qualifying cost sharing arrangements will have no impact on VAT receipts because the affected services are currently provided in-house. However, where taxable outsourced services are brought in-house using the cost sharing exemption there will be an impact on tax receipts. HMRC's current estimate is £200m: however, HMRC hope to refine this using information obtained during the consultation process. HMRC will also seek to obtain information to prepare an assessment of the wider economic benefits that the exemption will facilitate. These details are also set out in chapter 10.

2. Introduction

Background

2.1 Businesses and organisations looking for cost efficiencies may work with others to share costs and resources. Under UK legislation many of these arrangements result in VAT being charged between the participants. In most cases there is no impact as the VAT can be reclaimed. However VAT can become an obstacle to the arrangements if the payer is for example a charity or a university that is unable to recover the VAT in full. The cost sharing exemption, allowed for in European legislation, may provide a solution to the problem by removing the VAT charged. It cannot however relieve all forms of shared service arrangements from VAT.

2.2 The cost sharing exemption, contained in Article 132 (1) (f) of the Principal VAT Directive (PVD), is a mandatory exemption that has not been implemented in the UK.

2.3 There is considerable uncertainty as to the scope and purpose of the exemption and it is also not clear how the various conditions of the exemption should be applied. This uncertainty is reflected in the variety of ways in which the exemption has been implemented in other Member States. Some Member States have, for example, limited its use to bodies performing public interest activities such as charities or to those with very high levels of exempt activity, whereas others have not sought to restrict its use.

2.4 The European Commission has become increasingly interested in ensuring that there is a consistent approach to the operation of the exemption throughout Europe.

2.5 Some (although not all) cost sharing arrangements, that fall within the scope of the exemption, will result in an Exchequer revenue cost because services previously bought in from commercial providers and therefore subject to VAT will become exempt when provided at cost by a cost sharing group. Earlier this year an exercise was undertaken to get a better understanding of the potential revenue cost. The results are included in Chapter 10 - Impacts.

Objectives of the Consultation

2.6 The objective of the consultation is to develop a model for the cost sharing exemption that:

- will be used by a wide a range of sectors;
- reduces a VAT barrier to businesses collaborating with each other;
- is straightforward to operate and;
- does not create opportunities for abuse or avoidance.

Conditions of the Exemption

2.7 The terms of the cost sharing exemption are set out in Article 132 (1) (f) of the PVD:

The supply of services by independent groups of persons, who are carrying on an activity which is exempt from VAT or in relation to which they are not taxable persons, for the purpose of rendering their members the services directly necessary for the exercise of that activity, where those groups merely claim from their members exact reimbursement of their share of the joint expenses, provided that such exemption is not likely to cause distortion of competition.

2.8 From the European legislation HMRC considers that there are five basic conditions that have to be met before the exemption can apply.

These are:

- There has to be an 'independent group' (a "cost sharing group (CSG)") supplying services to persons who are members of it. Chapter 3 sets out how HMRC will define an 'independent group of persons';
- The members have to make exempt and/or non-business supplies. Chapter 4 explains the requirement for members of cost sharing groups to carry out exempt and/or non-business activity and asks whether there should be a requirement for them to have a certain level of exempt and/or non-business activity before they can become members of CSGs;
- The services supplied by the CSG must be 'directly necessary' for the exercise of the members' exempt or non-business activities. Chapter 5 offers HMRC's preferred method of defining 'directly necessary' supplies. It also offers an alternative and invites comments and suggestions from respondents about any other method(s) they believe should apply;
- The services must be supplied at cost ('exact reimbursement'). Chapter 6 explains how HMRC believe the 'direct reimbursement of costs' condition could apply, inviting comments and alternative approaches; and
- Use of the exemption must not cause or be likely to cause distortion of competition. Chapter 7 explains, using European case law, in what circumstances the 'distortion of competition' condition would apply and asks respondents for specific examples.

2.9 Article 131 of the PVD allows Member States to attach conditions to the exemptions, where such conditions ensure the correct and straightforward application of the exemptions and/or to prevent any possible evasion, avoidance or abuse.

3. What is an ‘Independent Group of Persons’ for the purposes of this exemption?

3.1 The exemption applies to services supplied by an “independent group of persons” to its members. It is therefore necessary to determine what is meant by an “independent group of persons “. The following paragraphs set out some design principles.

Number of persons

3.2 For the purposes of this document an independent group of persons is referred to as a cost sharing group (CSG). A CSG must have more than one person. There is no upper limit. New members can join at any time and existing members can leave at any time. Any related administrative arrangements are a matter for the group to decide. HMRC would expect suitable records to be kept.

Membership Group - Definition of “persons”

3.3 Article 132 (1) (f) states that the exemption is available to “persons”. In HMRC’s view persons will include:

- Natural persons e.g. individuals;
- Legal persons including corporate entities.

Form of the CSG

3.4 The CSG must be a coherent structure with a separate identity that distinguishes it from its individual members so that it is capable, if it were to make taxable supplies, of being registered for VAT in its own right.

3.5 A body acting as the CSG could therefore take the following forms:

- Corporate entity including an LLP;
- Partnership;
- Joint venture;
- Unincorporated association; or
- A European Economic Interest Group (EEIG).

This list is not exhaustive.

3.6 In HMRC’s view a CSG would normally be an entity which is owned, managed and controlled by its members.

3.7 In the event that a CSG makes taxable supplies (in addition to its VAT exempt cost sharing activity) and is required to register for and/or pay VAT, responsibilities must be clearly understood by all members.

Question 1. Are there any other bodies or entities that could be used to form a cost sharing group?

Definition of Member

3.8 Having identified the form that the CSG can take, it is necessary to determine how its members should be identified. In HMRC's view they would be:

- The owners of the body that forms the CSG; or
- Where legal ownership of a CSG is not necessarily held by its constituent organisations the members would be those that hold control and management of its activities.

Independent Group - What is meant by "Independent"?

3.9 CSGs must be 'independent groups of persons'.

3.10 There are a number of ways an 'independent group of persons' can be defined. HMRC's position is that members should be independent of each other and third parties and the CSG should operate independently from its members and third parties. To achieve this requirement it follows that no one member or a third party can control the CSG.

3.11 On this basis, in the event that the CSG is a corporate entity the exemption will not apply where one member controls the CSG as defined by section 416 ICTA 1988. In summary a person is deemed to control a corporate entity where they are able or entitled to exercise direct or indirect control over that entity's affairs, in particular where they hold:

- The majority of voting rights or issued share capital; or
- The majority of the distributed income; or
- The majority of the assets on a winding up.

HMRC also regard the right to appoint the majority of directors as being evidence that the CSG was under that person's control. The overall test will be whether the affairs of the CSG are conducted in accordance with one member's wishes.

3.12 In determining whether one party controls the CSG HMRC will take into account the interest held by all connected parties as well as interests held by unconnected parties as nominee.

3.13 A connected party for this purpose will be determined in accordance with section 839 ICTA 1988. A person is connected with:

- Another individual if they are their spouse or civil partner, a relative or spouse or civil partner of a relative of a spouse or civil partner; and
- A company if they control it or if they with persons connected with them control it.

3.14 HMRC propose that the definition will not include the provisions of s 839(7) ICTA 1988 which connects two or more persons acting together to secure control of a company. If this condition applies, a CSG could never be regarded as being independent of its members. HMRC will, however, need to monitor arrangements to ensure that this relaxation was not abused.

3.15 Where the CSG is an unincorporated body such as a partnership HMRC considers that the issue of control should be determined by whether a person (individual or corporate) has the right to a share of more than half of the assets or to more than one half of the income from any trade (the issue of income should only arise where the CSG makes taxable supplies to third parties as well as exempt supplies to its members).

3.16 The independence condition distinguishes a CSG from a VAT group. Companies under common control and who are not independent of each other are able to form a VAT group. If the VAT group included a shared service entity the supply of its services to fellow VAT group members would be disregarded for VAT purposes.

3.17 HMRC recognise that a VAT group itself may have a need for certain targeted services for its exempt or non-business activities which cannot conveniently be provided for within the VAT group and HMRC see no reason why a VAT group cannot itself be a member of a CSG for this purpose. This could be achieved by one member of the VAT group joining a CSG on behalf of the others.

3.18 The VAT group, as a whole would have to satisfy CSG membership conditions.

Question 2. Does the proposed definition of ‘independent group of persons’ provide any practical problems or barriers to using the exemption?

Question 3. What practical problems or difficulties could occur if a VAT Group was a member of a CSG and how could these be resolved?

Can a person be a member of more than one CSG at a time?

3.19 There is no proposed restriction in this respect. Although multiple memberships, depending on the governance and administrative arrangements established by each group, may place greater burdens and create additional costs for businesses and organisations that are members of more than one CSG.

Question 4. Are there any difficulties or problems that may arise from multiple memberships?

The Extent of the Exemption

3.20 The exemption applies to supplies made by the CSG to its members. For this purpose HMRC assume that the CSG members are equivalent to the persons who have formed the “independent group”.

3.21 Where members of a CSG supply services to each other (e.g. Member 1 to Member 2) these will not qualify for the exemption and will be subject to normal VAT rules.

3.22 A CSG can make supplies to non-members but they would, obviously, not benefit from the cost sharing exemption. They would be subject to normal VAT rules.

Annexe D contains an illustration of a Cost Sharing Group structure.

Transparency

3.23 The cost sharing exemption is designed to be used by independent persons working together for their joint benefit. It cannot be operated on a commercial, with profit, basis. The Taksatorringen (C-8/01, [2006] STC 1842) case established that transparency in ownership and operation of the CSG is important for its proper function and compliance with the exemption's conditions.

3.24 Taksatorringen was a Danish CSG formed by a number of insurance companies to provide them with claims handling services. The disputed point was whether or not the arrangement breached the distortion of competition condition as such services were also provided by commercial, with profit, suppliers.

3.25 The Advocate General in the Taksatorringen case stated;

Paragraphs

121. There are two fundamental requirements that must be met in order to qualify for an exemption. First, the independent external service provider must consist only of operators carrying out an activity which is exempt from, or not subject to, VAT. Secondly, it is essential that the group does not exist for purposes of gain, in the sense that it only charges its members for expenses incurred by it in order to meet their requirements, and makes no profit whatsoever out of doing so.

122. This means that the group must be entirely transparent and that, from an economic point of view, it must not have the characteristics of an independent operator seeking a customer base in order to generate profits.

3.26 While it is not possible to determine precisely how a CSG should operate HMRC would expect it to have some or all of the following characteristics:

- A common valuation basis for services supplied.
- Members have access to contracts for the supply of goods and services by and to the CSG.
- The benefits of the CSG's operations flow to the members and not a third party.
- Strategic decisions are taken by the members.
- The CSG does not market its exempt services outside its membership.
- Members have access to CSG financial statements.

- The majority of the Executive body managing the CSG comprises individuals appointed by the members.
- Minutes of executive meetings are made available to members
- The CSG acts independently in appointing and discharging suppliers

Question 5. Are these characteristics appropriate?

CSGs and Third Parties

3.27 HMRC consider that independence of the group from any one member or third party control will prevent a commercial operator from using a CSG as a vehicle, primarily, to obtain a commercial advantage for itself, this being contrary to the purpose of the exemption as a CSG is intended to be run for the benefit of its members. Such use is therefore abusive and will also, very probably, give rise to a distortion of competition resulting from the exemption itself.

3.28 However, it is acceptable for a CSG, acting independently, to engage a third party supplier to provide, for example, management and administrative services to the CSG, the independence of the CSG being demonstrated by its ability to replace them with alternative providers.

Question 6. Do you agree that independence is a necessary safeguard against abuse and distortion?

4. Exempt or Non-Taxable Activity

Exempt / Non - taxable activity

4.1 The members of the CSG must carry on an “activity which is exempt from VAT or in relation to which they are not taxable persons”.

4.2 In HMRC’s view this includes:

- Supplies of the following goods and services falling within Schedule 9 VATA 1994
 - Certain land supplies
 - Insurance
 - Postal services
 - Betting and gaming
 - Finance
 - Education
 - Health and welfare
 - Burial and cremation
 - Trades Unions, professional and other public interest bodies
 - Sport
 - Charity fund raising
 - Cultural services
- A charity or similar body carrying out non-business activities to meet its objectives

4.3 Some Member States have restricted the types of exempt activities which the members must carry on even though European legislation does not appear to permit the cost sharing exemption to be limited in this way. Some of these arrangements are being challenged by the European Commission.

Should members be required to carry on exempt and/or non business activity on a regular basis?

4.4 HMRC would expect all members of a CSG to engage in exempt and/or non-business activity at some time. Members who have no immediate need for exempt services from the group, because they are not currently engaged in exempt or and/non-business activity, would also be eligible to be CSG members if they have a clear intention to make such supplies at sometime in the future.

4.5 In order to prevent avoidance or abuse that might arise and to facilitate the correct and straightforward application of the exemption HMRC could introduce a specific test. HMRC could, for example specify that all members have to engage in a minimum level

of exempt and/or non-business activity over a set period of time to qualify as group members (e.g. more than 5%, 25% , 50% or 75% over a 12 month period).

4.6 This could prevent fully taxable businesses and organisations creating de minimis amounts of exempt and/or non-business activities to gain membership of a CSG for tax avoidance purposes.

4.7 It would also prevent fully taxable businesses and organisations becoming CSG members on the basis of insignificant one-off exempt and/or non-business activity.

4.8 A specific test would require entry and exit thresholds and processes.

Question 7. Do you think HMRC should introduce a specific test? If your answer is yes please indicate the threshold and timescale you think should apply

Members that are not required to be VAT Registered

4. 9 An organisation which is not VAT registered does not automatically qualify to be treated as a "non-taxable person" for the purposes of the cost sharing exemption.

4.10 Membership of CSGs is restricted to businesses and organisations that engage in exempt and/or non-business activities. Therefore, businesses and organisations that are not VAT registered will only be eligible to be members of a CSG if they are able to satisfy that condition i.e. they have exempt and/or non-business activity. For example, if a number of non-VAT registered taxi drivers wanted to form a CSG, they could only do so if they had exempt and/or non-business activities in addition to their taxable taxi services.

5. What does 'Directly Necessary' mean?

5.1 Article 132 (1) (f) requires that supplies made by the group to its members be 'directly necessary' for their exempt and/or non-taxable activity. Therefore, any supplies that are not 'directly necessary' cannot be within the scope of this exemption.

5.2 The precise scope of the concept of 'directly necessary' is very difficult to determine in the absence of guidance from the CJEU (the European Court). However HMRC is keen to develop an approach to applying the concept which is, as far as they can determine, compliant with European law, clear, workable and pragmatic.

5.3 The word 'necessary' used alone might indicate that any supplies used for a CSG member's exempt and non-business activities would be entitled to exemption. However, as 'necessary' is qualified by the use of the word 'directly', clearly not all supplies used for these purposes will be entitled to be treated as exempt.

How to define Directly Necessary

5.4 During the informal consultation period a number of ways of defining 'directly necessary' were identified that could either be used singly or in combination.

HMRC's Preferred Approach

5.5 HMRC's preferred approach is to accept that all supplies received by members from CSGs can be treated as 'directly necessary' where those businesses and organisations have wholly exempt and/or non-business supplies or negligible levels of taxable supplies. In these circumstances negligible taxable supplies might be defined as being where members' exempt and non taxable supplies exceeded for example either, 85% or 90% or 95% of total supplies by value or as similar percentages of irrecoverable VAT (as determined by their partial exemption, business/non-business methods).

5.6 Where businesses and organisations do not fall into those categories the partial exemption methodology would apply in determining whether the supplies they receive from CSGs are directly necessary for their exempt and/or non-business activities.

5.7 This involves identifying the VAT on expenditure that is wholly used, or is intended to be used in making taxable supplies or wholly used, or intended to be used, in making exempt supplies. Only expenditure that can be directly attributed to the member's exempt supplies will qualify for the exemption

5.8 The same principles would apply in respect of non-business supplies and the member's business/non-business 'attribution'.

5.9. This approach would result in a more straightforward application of the exemption and provide a simpler and more efficient way of operating a cost sharing group and

minimise disputes and disagreements. HMRC believe that this combination is the simplest way to apply and administer this condition and uses established concepts in relation to the use of partial exemption and business/non-business principles that are familiar to the sectors concerned.

Other Approaches

5.10 The approaches, suggested above, are not intended to be exhaustive. HMRC is happy to consider other models for dealing with this issue.

5.11 For example, another approach could be to create a list of services that would be regarded as being 'directly necessary' for the exempt and/or non-business activity of members. This approach offers a straightforward and readily applicable test of what is 'directly necessary'. However, it could lead to certain services that were more general or contained more general elements such as Payroll, HR and IT not qualifying as 'directly necessary'.

5.12 Annexe E contains an illustration of how the 'Directly Necessary' condition might work in practice.

Question 8. Do you have a preference for any of the approaches described above? Please explain why.

Question 9. Do you prefer another approach? If you do, please outline your ideas.

6. The Exact Reimbursement of Costs

6.1 For the exemption to apply the consideration for supplies made by the CSG to its members has to be an 'exact reimbursement' of the members' share of the joint expenses.

6.2 This means it may only charge its members for expenses incurred by it in order to meet their requirements and it must make no profit whatsoever in doing so.

6.3 An expense could normally be defined as a cost incurred to generate revenue and would include:

- Cash payments or liabilities
- Costs incurred but not yet invoiced (accruals)
- Amounts required to meet anticipated future expenditure
- Depreciation in the value of the CSG's assets.

6.4 HMRC does not want to prescribe how each member's share of the joint expenses should be calculated. It would be acceptable, for example, for the specific costs (with or without an allocation for overheads) to be invoiced to each member based on use.

Overheads

6.5 General overheads must also be subject to 'exact reimbursement'. This can be achieved in a number of ways, for example; by reference to each supply or through an annual membership subscription.

Timing Differences

6.6 HMRC accept that there may well be timing differences between when the expenses are incurred by the group and the income it receives for the supplies it makes to its members. Consequently, at any point in time, expenses incurred and the income received are unlikely to match exactly. However the group must demonstrate that the 'exact reimbursement' rule has been complied with, over a reasonable period of time.

Surpluses and Deficits

6.7 It is clear that at any one time a CSG can carry either a cash surplus or a deficit. A CSG may need to build up a cash balance as a reserve or to be held for contingencies. HMRC do not believe that such arrangements would necessarily contravene the 'exact reimbursement' condition.

6.8 For example, a CSG may receive payments from members greater than the cost of services directly supplied to them. This is acceptable provided any surplus is held for future use by the CSG for the specific benefit of members. For example, so that the

CSG can purchase capital items for the use and benefit of members or held as a credit in respect of future purchases by the relevant member. In effect HMRC would see such amounts as advance payments. Provided no profit element is factored into the price the CSG charges to its members, the exact reimbursement condition should be met.

Management and Similar Charges

6.9 However, where management charges, rent or similar charges made to the CSG or members are used as a mechanism to artificially inflate its costs, depending on the circumstances, the CSG may fail to meet the 'exact reimbursement' condition.

6.10 If the 'exact reimbursement' condition cannot be met no part of the value of the relevant supply or supplies will be covered by the exemption.

Impact of Transfer Pricing adjustments

6.11 As a result of the application of the independence rule, explained above, it is not possible for a CSG to be under the control of one member (taking into account the interests of connected parties). Therefore, the Transfer Pricing rules affecting the value of services for corporate tax purposes do not apply to services supplied by CSGs.

Question 10. Do you agree with this approach to 'direct reimbursement of costs'? If not please explain why and indicate the approach you would like to see adopted.

7. The Distortion of Competition Test

7.1 The Taksatorringen case dealt with this condition and stated quite clearly that the exemption can only be denied when it is the relief from VAT that it provides (and not any other condition of the exemption) that gives rise to a distortion of competition.

The CJEU in Taksatorringen put it as follows:

Paragraph 58

It is necessary at the outset to state that it is the VAT exemption in itself which must not be liable to give rise to distortion of competition on a market in which competition will in any event be affected by the presence of an operator which provides services for its members and which is prohibited from seeking profits. It is thus the fact that the provision of services by a group is exempt and not the fact that this group satisfies the other conditions of the provision in question, which must be liable to give rise to distortions of competition in order that this exemption may be refused.

7.2 A CSG cannot fail the distortion of competition condition simply because it fulfils other conditions of the exemption. The commercial advantages accruing from operating under those conditions (e.g. the provision of services at cost) are irrelevant. It must be the application of the exemption itself that leads to an actual or potential distortion of competition for it to be an issue.

7.3 In other words a CSG providing a service, at cost and VAT free, which is also supplied by a business required to charge VAT, would not necessarily lead to a distortion of competition.

Question 11. In what circumstances do you think the 'Distortion of Competition' condition would apply?

8. Cross Border Issues

8.1 HMRC has no objection in principle to CSG members not being established in the UK or, therefore, to CSGs making cross border supplies within the EU provided other conditions for the exemption are met. Similarly, UK businesses and organisations can be members of CSGs based in other Member States.

9. Process and Compliance

9.1 Generally, HMRC's approach will be to provide full and comprehensive guidance for businesses and organisations on their website, setting out the conditions for the exemption and how potential users should interpret and apply them, particularly in respect of issues such as those identified above. As with other VAT exemptions HMRC will not be introducing any bespoke notification or clearance requirements, as this would impose unnecessary administrative burdens on business.

9.2 VAT is a self-assessed tax and HMRC's priority will be to work with stakeholders to ensure the guidance they provide is as clear as possible and meets customer needs.

9.3 HMRC will provide rulings in line with its standard policy, where organisations require confirmation that their cost sharing arrangements satisfy the conditions of the exemption.

9.4 In terms of compliance activity, HMRC deploys its resources according to risk and use of the VAT cost sharing exemption will be built into their risk profiling in the same way as other aspects of the VAT regime.

Question 12. Are there any process and compliance aspects of the cost sharing exemption that you think might need to be addressed specifically in guidance?

10. Impacts

10.1 In line with the Government’s Tax Consultation Framework, this chapter sets out HMRC’s current assessment of the impacts of the proposed changes under consideration.

<p>Exchequer impact (£m)</p>	<p>Exchequer costs arise only if externally supplied services are brought into a VAT exempt CSG (ie there is no exchequer cost where in-house functions are moved into a CSG).</p> <p>Implementation of the exemption is tentatively expected to decrease VAT receipts by approximately £200 million in the fifth year after implementation. The estimates are based;</p> <ul style="list-style-type: none"> ▪ for the health, education, charitable and housing associations sector on data provided by small samples of organisations from each sector. The results were then extrapolated across the populations of the each sector, ▪ for the financial services and insurance sectors principally on external (Mintel) and internal HMRC data <p>Material factors underpinning the estimates are the assumptions made of the, difficult to predict, number of businesses and organisations that will use the exemption and the types of services that could be regarded as “directly necessary”.</p> <p>There is a significant risk that the Exchequer cost could be higher than the estimate if, in particular, take-up of cost-sharing arrangements to replace the provision of services by third parties is higher than assumed.</p> <p>A further costing may be subject to scrutiny by the Office for Budget Responsibility at the time of the autumn forecast.</p> <p>HMRC would welcome the views of business on its understanding of the impacts of the proposed change. Questions on this issue are included below.</p>
<p>Economic Impact</p>	<p>Organisations such as charities, universities, Further Education colleges and housing associations are increasingly looking to achieve efficiency savings by sharing services with each other. This process could be facilitated if the exemption could remove the VAT costs of collaboration.</p>

	<p>The financial services and insurance sectors are also likely to use the exemption.</p> <p>HMRC's analysis has so far focussed on the impact on VAT receipts and not on measuring wider benefits.</p> <p>HMRC invite views on these benefits in the formal consultation process.</p>
Impact on individuals and households	<p>The exemption is intended to benefit businesses or organisations that perform exempt and/or non-business activities, such as charities. There is no direct impact on individuals and households, although they could ultimately benefit from greater service provision from the charities sector. The same is also true of the financial services sector.</p>
Equalities impacts	<p>HMRC do not believe that the exemption will have an equality impact. Information will be gathered as part of the consultation process to inform this assessment.</p> <p><i>Question 13. Do you think that the implementation of the cost sharing exemption will have any equality impacts? If yes please indicate what the impacts are and offer suggestions about how they can be eliminated.</i></p>
Impact on businesses and civil society organisations	<p>The exemption can benefit businesses that undertake a VAT exempt activity in the fields of:</p> <ul style="list-style-type: none"> • Financial services • Insurance • Health • Education and research – such as universities • Provision of rented property – such as housing associations • Gambling <p>It can also benefit organisations that have non-business activities such as charities.</p> <p>Where organisations wish to achieve efficiency savings through collaboration it is often cited that a resulting VAT charge is a barrier to such collaboration. The exemption will in certain circumstances remove this barrier.</p> <p>It is expected that the exemption will in particular facilitate efficiency savings by universities, further education colleges and charities.</p> <p>Administrative burdens will only arise if the final model includes bespoke requirements for the operation of this exemption. At the present time HMRC do not anticipate that such requirements will</p>

	<p>be necessary.</p> <p>HMRC has not carried out a full assessment of administrative burdens, but information that can help inform such an assessment is welcomed.</p>
Other impacts	<p>HMRC will consider assessment of other impacts as part of the consultation process. Views are welcomed on any other impacts, especially in relation to competition and small organisations/firms.</p>

10.2 Until a final model is determined it will not be possible for organisations to decide with certainty how they might use the cost sharing exemption. However to help HMRC determine the benefits as well revenue costs of any implementation HMRC would welcome answers to the following questions:

Question 14. On the basis of information in this document do you have any comments on the assessment of impacts?

Question 15. On the basis of this document would your organisation join a CSG?

Question 16. What are the most valuable services (in cost terms) your organisation would want to receive from a CSG using the exemption? Please state the value of at least 3.

Question 17. Of the services listed in question 16 what services are currently supplied by a third party? Please state the annual value of irrecoverable VAT you currently incur when receiving those services.

Question 18. Of the services you have listed in question 16 above what are the annual economies of scale you would expect to make on services currently provided in-house if they were to be supplied by a CSG? Please specify these values separately for each listed services

11. Summary of Consultation Questions

Chapter 3 – What is an ‘Independent Group of Persons’ for the purposes of this exemption?

Question 1. Are there any other bodies or entities that could be used to form a cost sharing group?

Question 2. Does the proposed definition of ‘independent group of persons’ provide any practical problems or barriers to using the exemption?

Question 3. What practical problems or difficulties could occur if a VAT Group was a member of a CSG and how could these be resolved?

Question 4. Are there any difficulties or problems that may arise from multiple memberships?

Question 5. Are these characteristics appropriate?

Question 6. Do you agree that independence is a necessary safeguard against abuse and distortion?

Chapter 4 – Exempt or Non-taxable Activity.

Question 7. Do you think HMRC should introduce a specific test? If your answer is yes please indicate the threshold and timescale you think should apply.

Chapter 5 – What does ‘Directly Necessary’ mean?

Question 8. Do you have a preference for any of the approaches described above? Please explain why.

Question 9. Do you prefer another approach? If you do please outline your ideas.

Chapter 6 – The Exact Reimbursement of Costs.

Question 10. Do you agree with this approach to ‘direct reimbursement of costs’? If not please explain why and indicate the approach you would like to see adopted.

Chapter 7 – The Distortion of Competition Test

Question 11. In what circumstances do you think the ‘Distortion of Competition’ condition would apply?.

Chapter 9 – Process and Compliance

Question 12. Are there any process and compliance aspects of the cost sharing exemption that you think might need to be addressed specifically in guidance?

Chapter 10 - Impacts

Question 13. Do you think that the implementation of the cost sharing exemption will have any equality impacts? If yes please indicate what the impacts are and offer suggestions about how they can be eliminated.

Question 14. On the basis of information in this document do you have any comments on the assessment of impacts?

Question 15. On the basis of this document would your organisation join a CSG?

Question 16. What are the most valuable services (in cost terms) your organisation would want to receive from a CSG using the exemption? Please state the value of at least 3.

Question 17. Of the services listed in question 16 above what services are currently supplied by a third party? Please state the annual irrecoverable VAT you currently incur when receiving those services.

Question 18. Of the services you have listed in question 16 above what are the annual economies of scale you would expect to make on services currently provided in-house if they were to be supplied by a CSG? Please specify these separately for each listed service.

12. The Consultation Process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

- Stage 1 Setting out objectives and identifying options.
- Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.
- Stage 3 Drafting legislation to effect the proposed change.
- Stage 4 Implementing and monitoring the change.
- Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stage 2 of the process. The purpose of the consultation is to seek views on the detailed policy design and a framework for possible implementation

How to respond

A summary of the questions in this consultation is included at chapter 11.

Responses should be sent by 30th September 2011, by e-mail to david.bond2@hmrc.gsi.gov.uk or by post to:

David Bond
HMRC
VAT Projects Team
3C/10
100 Parliament Street
London
SW1A 2BQ

Telephone enquiries: 0207 147 0058 (from a text phone prefix this number with 18001)

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from the HMRC Internet site at <http://www.hmrc.gov.uk/consultations/index.htm>. All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

The Consultation Code of Practice

This consultation is being conducted in accordance with the Code of Practice on Consultation. A copy of the Code of Practice criteria and a contact for any comments on the consultation process can be found in Annex A.

Annexe A: The Code of Practice on Consultation

About the consultation process

This consultation is being conducted in accordance with the Code of Practice on Consultation.

The consultation criteria

1. When to consult - Formal consultation should take place at a stage when there is scope to influence the policy outcome.
2. Duration of consultation exercises - Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
3. Clarity of scope and impact - Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
4. Accessibility of consultation exercise - Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
5. The burden of consultation - Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
6. Responsiveness of consultation exercises - Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
7. Capacity to consult - Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

If you feel that this consultation does not satisfy these criteria, or if you have any complaints or comments about the process, please contact:

Richard Bowyer, Consultation Coordinator, Better Regulation and Policy Team, HM Revenue & Customs, Room 3E13, 100 Parliament Street, London, SWA 2BQ

020 7147 0062 or e-mail hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

Annexe B: List of stakeholders consulted

Banks and Building Societies

Barclays
Barclays Capital
British Bankers Association
Building Society Association
Co-operative Financial Services
HSBC
Morgan Stanley
Saffron Building Society

Insurance

Aon
Association of British Insurers
Aviva
Axa
BIIBA
IOG
LIIBA
Met Life
Willis Group

Charities

Action for Blind
Age UK
Birmingham Rep
Charity Finance Directors Group
Charity Tax Group
Church of England
Citizens Advice
Institute of Advanced Motorists
Norwood
Refuge
RNIB
The Sage Gateshead

Housing Associations

Accent Group
City West Housing Trust
Family Mosaic
National Housing Federation
Thames Valley Housing Association

Universities and Colleges

Association of Colleges
British Universities Finance Directors' Group
City of Sunderland College
Durham University
Universities UK
University of Aberdeen
University College London
University of Cumbria
University of Newcastle
University of Northumbria
University of Sunderland
University of Teesside

Care and Care Homes

English Community Care Association
National Care Forum
Registered Nursing Home Association

Suppliers of Bought-in Services

Capita
IBM
Steria
UPP

Others

Association of IFA's
Baker Tilly
Ciot
Deloitte
Devonshires
Grant Thornton
Investment Management Association
KPMG
PKF
PWC

Annexe C: Relevant (current) Government Legislation

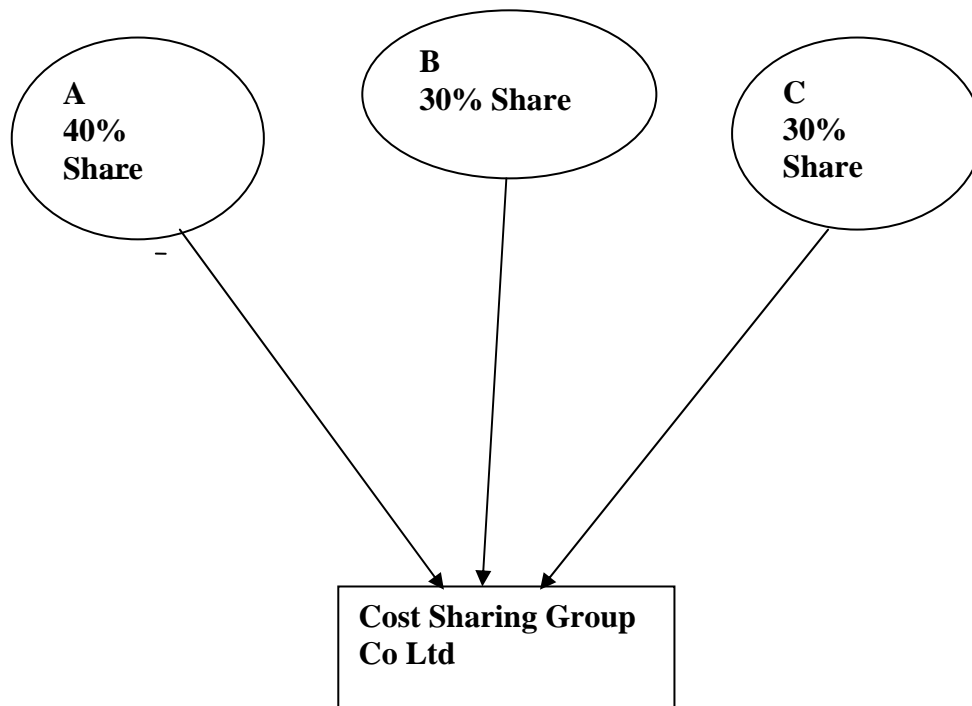
The exemption in Article 132 (1) (f) of the Principal Vat Directive is currently not enacted in UK legislation

Annexe D: Diagrams illustrating the Cost Sharing Group structure

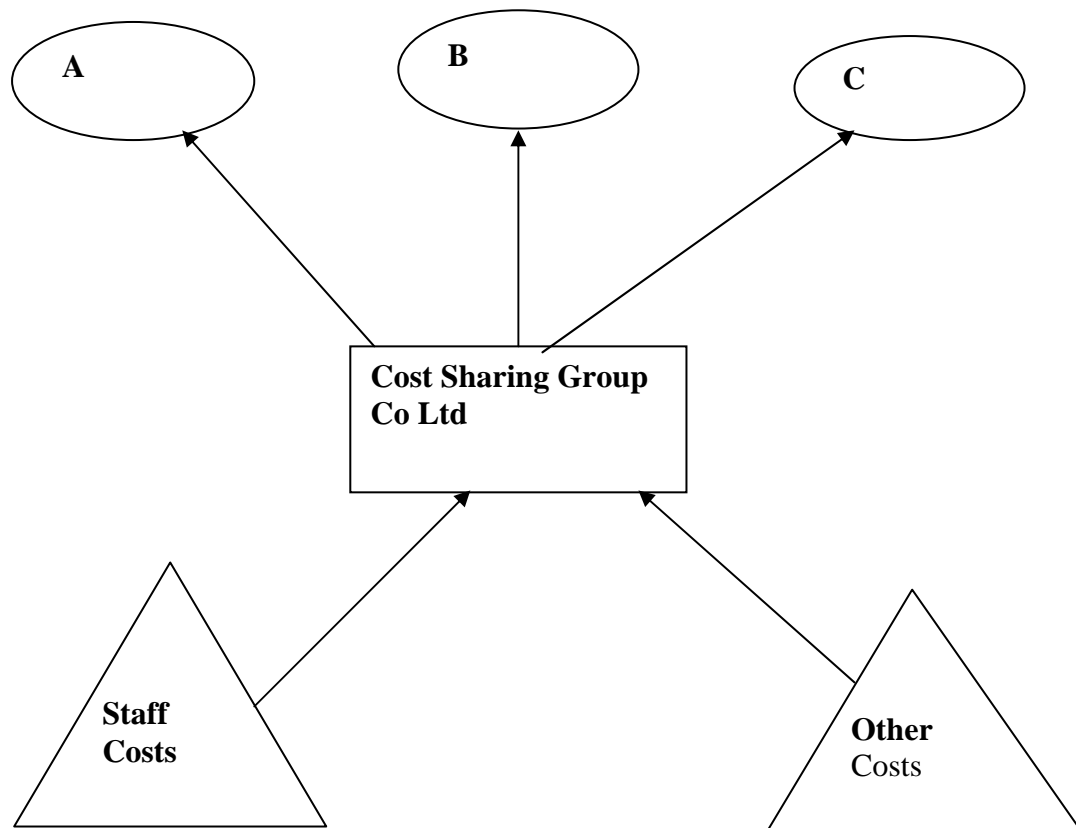
Background

- Three independent organisations with non-business or VAT exempt activities each incur costs of £100,000 per annum (excluding VAT). In each case the majority of their costs (90%) are staff related and 10% are other expenses on which VAT is incurred.
- In order to make efficiencies they enter into an agreement to share their costs. By doing so they estimate that they will reduce their overall costs by 15% to £85,000 (excluding VAT).
- Organisation A has only exempt or non-business activities and is not registered for VAT.
- Organisation B is registered for VAT and 10% of its income is treated as taxable for VAT purposes.
- Organisation C is also registered for VAT and 50% of its income is treated as taxable for VAT purposes.

1. Legal Structure



2. Supplies



Effects under current UK provisions

	A £000's	B £000's	C £000's	Total £000's
CSG supplies	85	85	85	255
VAT charged (20%)	17	17	17	51
VAT recovered	0	-1.7	-8.5	-10.2
Total costs	102	100.3	93.5	295.8
Current costs (incl VAT)	102	101.8	101	304.8
Saving	0	1.5	7.5	9.0

The efficiency savings are almost totally eliminated by the VAT charged on the supplies made by the cost sharing entity.

Impact of introducing the cost sharing exemption

	A	B	C	Total
	£000's	£000's	£000's	£000's
CSG costs	86.7	86.7	86.7	260.1
VAT charged	0	0	0	0
Total cost	86.7	86.7	86.7	260.1
Current costs	102	101.8	101	304.8
Saving	15.3	15.1	14.3	44.7

The efficiency savings are preserved by the application of the exemption.

Annex E: Illustration of how the ‘Directly Necessary’ condition might apply.

- Three independent organisations with non-business or VAT exempt activities form a CSG.
- The CSG’s costs are £300,000 (excluding VAT) comprising staff, 80%, and other taxable costs, 20%.
- Organisation A has only exempt or non-business activities and is not registered for VAT.
- Organisation B is registered for VAT and 10% of its income is treated as taxable for VAT purposes.
- Organisation C is also registered for VAT and 50% of its income is treated as taxable for VAT purposes.
- The services supplied by the cost sharing group to each member comprise:
 - 1) 50% which could be regarded as ‘directly necessary’ to their non-business and exempt supplies and
 - 2) 50% which could be regarded as general overheads.

	CSG Costs £000's
Staff Costs	240
Other Costs	60
VAT Incurred	12
Total	312

Supplies to	£000's	Member A £000's	Member B £000's	Member C £000's
Service 1	(156)	52	52	52
Service 2	(154)	52	52	50
Input tax				10
Input tax recovered	(2)			(5)
Total costs	0	104	104	107

The example has assumed that the CSG has registered for VAT. Its supplies to A and B can be treated as wholly exempt on the basis that A and B have predominantly exempt or non-business activity.

Service 1 to C can be treated as 'directly necessary' to their exempt and non-business activity. Service 2 supplies made to C are wholly taxable and the VAT recoverable is based on its partial exemption method (assumed 50%).