

HM Revenue & Customs: VAT: Cost Sharing Exemption**Response by the Wellcome Trust**

September 2011

Introduction

1. The Wellcome Trust and government have a common goal of fostering scientific research in an efficient and cost effective manner. The Trust has made representations to this Government and its predecessor about the barriers current tax regulations present to achieving this goal.
2. We recognise and are grateful for the significant tax reliefs available to the research sector, including zero-rating of buildings and equipment and other reliefs on research expenditure. However, we would suggest that the cost of such reliefs to the Government could be reduced if an environment for collaboration were created that would enable savings by research institutions from economies of scale and shared facilities. This would also result in savings to research funders such as the Wellcome Trust.
3. The current situation, where universities and other research organisations that share services incur irrecoverable VAT, presents an undesirable barrier to collaboration, and a disincentive to pursue efficiency savings through shared services. For example, the Francis Crick Institute (formally UKCMRI) was originally intended to be a collaboration between the scientists of the founding members. The act of collaboration created cross supplies for VAT purposes resulting in irrecoverable VAT. The formation of the Institute and the transfer of scientists to that entity was the only way this VAT impediment could be removed. This solution would not be viable for research institutions wanting to enter short term arrangements.
4. In its recent higher education white paper, the Government suggested that the introduction of the EU VAT cost-sharing exemption, contained in Article 132(1)(f) of the principal VAT Directive, would promote efficiencies by “removing the VAT charge which currently prevents institutions from gaining efficiencies by sharing costs with each other”. While we welcome the current consultation, we are concerned that on its own the EU exemption will not achieve the government’s stated objective of fostering collaboration and sharing of services between research institutions. Article 132(1)(f) is often cited as a solution to the creation of a VAT burden on mutual supplies between charities, as occurs when two or more research institutions wish to collaborate. However, this legislation will have limited practical application as it merely permits the creation of a new special purpose vehicle to act as a conduit for bought-in services and goods. Supplies *between* research institutions arising as a result of collaborative activity will continue to incur irrecoverable VAT.
5. We therefore encourage the Government to continue to look for other ways to address the VAT issues created by collaboration, where Article 132(1)(f) cannot provide the answer. In particular we draw attention to our response to question 2 of the consultation.

Responses to specific 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?

6. Trusts should be included in the list of entities in paragraph 3.5. The economic interest in a trust lies with the beneficiaries who would be the “members” and where the trustees are merely acting as custodian for the “members”. A trust might be preferred by a group of charities as it can be look-through for income tax and stamp duty purposes or register as a charity in its own right. Such a vehicle would be attractive for the acquisition of a property to be occupied jointly by the members.

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

7. We find the proposed definition of “independent group of persons” disappointing as it will not promote collaborative working. Rather than provide a solution for charities working together, which we believe 132(1)(f) is intended to achieve, HMRCs interpretation creates a VAT charge by forcing existing in-house functions to be outsourced to third parties before they can be shared. This conclusion seems perverse.
8. This problem is compounded by the view that a special purpose vehicle is required to represent the independent group. This would preclude short term collaboration in specific programmes, which is a common approach in the research sector.
9. We are also disappointed that HMRC has framed the consultation based on its view that members must be independent of each other as well as the group being independent of third parties. This is a restricted interpretation of the EU legislation and seems to go beyond the natural reading of the phrase ‘independent group of persons’. It would prevent, for example, a company and its subsidiary from both being members of the group.
10. If the conclusion is that Article 132(1)(f) does not permit exempt supplies between members, we would contend that charities sharing resources are not doing so in the course of their business (or economic activity) and therefore should be outside the scope of VAT. We strongly urge the Government to consider this as an alternative means to achieving efficient collaboration between charities for the benefit of research and society in general.

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?

11. We have not identified any problems or difficulties.

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

12. We have not identified any difficulties or problems..

Question 5. Are these characteristics appropriate?

13. We disagree with the prohibition of the CSG making supplies to parties other than its members. As input VAT would be accounted for under a partial exemption method, we do not consider there to be a risk to HMRC.

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

14. We agree that there may be a need for independence with regard to third party suppliers but do not consider this is necessary between members.

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.

15. We see no reason to restrict the application of Article 132(1)(f).

Chapter 5 – What does ‘Directly Necessary’ mean?

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

16. HMRC’s approach seems reasonable, particularly in the case of charities, which are not permitted under charity law to incur expenditure not directly necessary for their purpose. We suggest that HMRC adopts the approach that all charities automatically satisfy this requirement where HMRC has recognised the entity’s charitable status for other tax purposes. The attribution of costs could then be based on the non-business/partial exemption methods already used by the charity. However, we would suggest a pragmatic approach could be to accept a 20 per cent business activity before imposing the requirement to attribute costs to different activities.

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

17. See comments above.

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.

18. The approach proposed by HMRC appears acceptable. The fact that charities can make a margin provided it is recycled for further charitable work will be welcomed by charities. This concept is already accepted for research organisations qualifying as eligible bodies within VATA 1994 Sch9 Group 6.
19. We disagree with the comment that transfer pricing will not be an issue as no member can own more than 50 per cent of the CSG. TIOPA 2010 s.160 states that transfer pricing will apply where two joint venture partners own more than 40 per cent each. Transfer pricing would also be an issue if HMRC is able to accept that more than one entity in a company law group can be members of the CSG. We recommend that for the purposes of Chapter 6 all adjustment made for transfer pricing purposes should be ignored.

Chapter 7 – The Distortion of Competition Test

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

20. We do not consider that the condition would apply, because the restrictive requirement in Chapter 6 to only achieve reimbursement of costs would not be attractive to commercial outsourcing suppliers.

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?

21. Reverse charges do not apply on imported services for wholly non-business organisations. If such services were to pass through a CSG a reverse charge on non-EU services would have to be accounted for by the CSG. This cost would then be passed on to the non-business member.

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.

22. We are not aware of any potential equality impacts.

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

23. Economic impact is noted as creating “VAT savings for charity collaboration”. For reasons stated above, and as a result of HMRC’s interpretation of Article 132(1)(f), we do not believe there will be substantive benefits for collaboration between existing charities.

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

24. We already belong to a buying consortium (see below) and would look to modify the existing arrangements to comply with 132(1)(f). However for practical and legal reasons we could not consider moving staff into a CSG and therefore this resource would not be available for cost sharing under the current proposals.

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.

25. We belong to a buying consortium through which we spend £3m to £4m per annum on office equipment and professional services. The consortium consists of 65 charity and higher education members. Our annual subscription is £10,000 plus VAT and therefore the savings made by the implementation of 132(1)(f) would only amount to £2,000.

26. Our expenditure on external goods and services is relatively low compared with our staff costs. However, we would expect research institutions with high levels of consumables to gain significantly from forming a CSG. These benefits will be more significant if the proposed definition of ‘independent group of persons’ is amended as proposed in our response to question 2 above, as this would enable staff costs to be shared.

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.

27. Not applicable.

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.

28. Not applicable.

The Wellcome Trust is a global charitable foundation dedicated to achieving extraordinary improvements in human and animal health. We support the brightest minds in biomedical research and the medical humanities. Our breadth of support includes public engagement, education and the application of research to improve health. We are independent of both political and commercial interests.