4.1 Overview of the Cost Sharing Group VAT Exemption

VAT on Sharing Equipment and Capital Assets

VAT has always been seen in the sector as a barrier for sharing assets between partly exempt[1] organisations such as universities. This is because, in most circumstances, when an asset is supplied from one party to another VAT must be levied on that charge. The VAT charge will be, at best, only partly reclaimable by the recipient, thereby introducing a worst case 20% cost to asset sharing, which could negate the one of the reasons for sharing - financial efficiency.

VAT exemption for "Cost Sharing Groups"

In autumn 2012, HMRC introduced the VAT exemption, enacting a piece of European VAT legislation which has been in place since 1978. Unfortunately the legislation is drafted in such a manner to be ambiguous. HMRC's guidance on interpreting the legislation is helpful in that it seeks to make the best of the exemption within the restrictions placed upon it by EU law.

Use of a CSG

In order to test its validity, both from a VAT technical perspective and also from a practical perspective, N8 engaged Deloitte (through the University of Sheffield) and set up a sub-group of University Tax & VAT Managers (from all N8 universities). The workstrand lead from Sheffield drafted guidance for implementing the CSG structure. This was peer reviewed and then reviewed by Deloitte. Having completed the guidance in May 2013 an approach was made to HMRC to gain sign off that it met the criteria, this being new legislation. Finally, in November 2013, after a lengthy exchange of correspondence, HMRC Policy consented to a meeting in which they expressed approval of the model.

What legal form should the separate legal entity take?

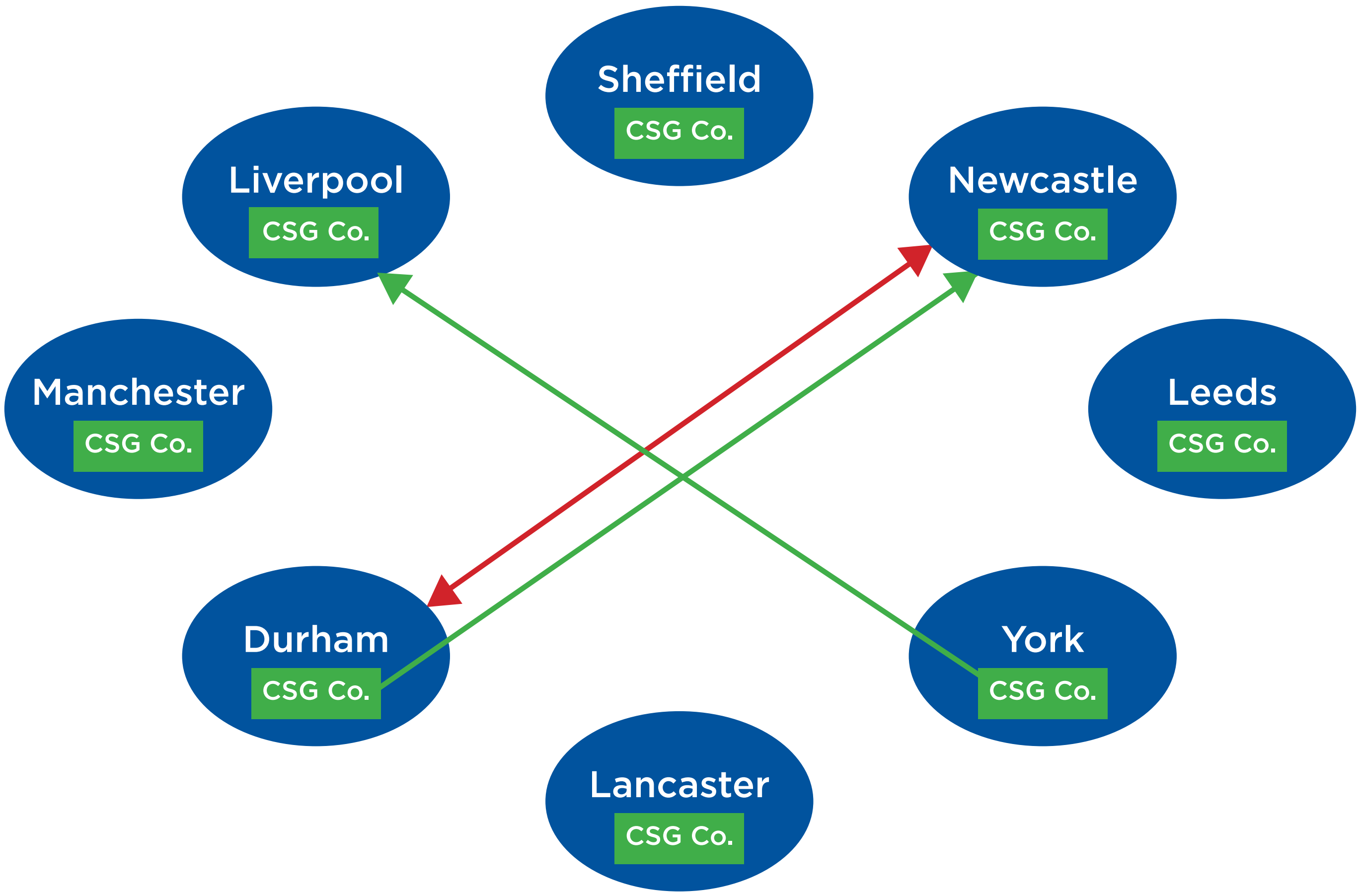
The legal entity may take any legal form, for example, it could be a company limited by shares, a company limited by guarantee, an LLP, etc. The proviso is that it must have a membership structure so that members can influence its activities. Initial thinking from the legal advisors is that a CLG will be the most appropriate legal form for the company.

Corporation Tax position

Where the CSG trades only with its members (and this trade has to be at cost to satisfy the Cost Sharing Exemption rules) then this is exempt from corporation tax. Therefore trade amongst the N8 members will be exempt. The transfer pricing rules will need to be considered where the host university and the CSG interact, but these will not create any cost implication. However, where trade occurs outside of the N8 membership then VAT will be levied on the transaction and it will be liable to corporation tax on any profits/ surpluses arising. A CSG may make a profit, but not on any transactions which it wishes to fall under the cost sharing exemption. An N8 university will need to decide its stance on whether to extend membership to other universities (or similar non-profit making organisations) and how it wishes to trade with industrial partners. For example, it may wish to trade with industrial partners from the main university or through its CSG. Trade with non-members is subject to tax in the university CSG or as non-charitable trade in the universities.

1 "Partly exempt" organisations are those which have a mix of activities for VAT purposes. Some activities are exempt from VAT (e.g. fee charging education), some are taxable (e.g. consultancy) and some are "non-business" (e.g. grant funded research). The net result is that most universities can only claim less than 10% of the VAT they incur back from HMRC, meaning 90% of VAT incurred is a real cost.

Diagram 1-N8 - Sharing Equipment with VAT Cost Sharing Groups - full model



Key:

University VAT Group

Company controlled by University — CSG Co.

Notes:

- All Universities must be Members of all CSGs
- A VAT exempt supply can be made through a CSG
- A supply by a University to another University is subject to VAT

If the research is commercially funded then the member will be charging VAT on its supply to its customer meaning that although the CSG should charge VAT to it on equipment access it will be able to claim this VAT charge from HMRC making the overall transaction VAT neutral.

VAT Cost Sharing Exemption - Alternatives

Alternative structures have been considered for satisfying exemption criteria. However, the selected structure has been deemed most appropriate for the asset sharing project. The full N8 structure is shown in diagram 1. It demonstrates that where an N8 university has an asset to share with other members it needs to create its own CSG entity. This will then allow the VAT exempt use of assets around the N8 members, which should facilitate the sharing in excellence and growth agenda.

Process

Each N8 university will create a CSG which it will have 'control' over. This will allow the CSG to be included within the university's VAT group registration. This will allow the VAT exempt movement of staff and assets between the university and its CSG. Where all N8 universities create their own CSG it will allow further VAT exempt supplies to be made. For example if a member of staff from a different university to that of the host university was required to provide technical input to a project for a third N8 member, this technical advice should also be provided VAT exempt through the structure.

Conclusion

Our work has now proven that existing assets and new assets can be shared in a VAT efficient manner between N8 universities. Clearly there are administrative hurdles to overcome to satisfy the CSE criteria, but we are confident that once CSGs are established and operated as part of a normal working practice that they will become second nature to operate and deliver significant VAT savings, helping to further enhance the sharing agenda. Where new equipment or medical equipment is being purchased other structures may be more efficient and individual universities will need to determine their preferred mode of operation. There is a real cost to implementing the Cost Sharing Exemption, but if it is not operated through such a structure there will remain a real VAT cost to sharing assets. This VAT cost is likely to significantly outweigh the administrative costs. N8 universities must therefore be prepared to commit additional resources to facilitate the successful operation.N8 universities must therefore be bold and prepared to commit additional resources to facilitate the successful operation of CSGs in order to reap the much wider financial and collaborative benefits stemming from sharing equipment and ideas.

Complying the with VAT exemption criteria

Once a CSG is established it will need to invite membership of other N8 universities. In order to prevent VAT being chargeable by the host university on its supply to the CSG, the CSG needs to be included in a VAT group registration with the host. To qualify for inclusion in a VAT group the CSG must be >50% owned by the host university. For VAT grouping purposes this is not simply owning >50% of any shares, etc it is having controlling rights of the CSG.

Does the CSG need to have an 'exclusive interest' in the asset?

The CSG needs to have a 'right' of access to the asset in order to be eligible make an onward supply of the asset to CSG members. We would expect in most cases that the host university will purchase the asset (using any grant funding as applicable, etc) and then only the use by CSG members will be licensed to the CSG. This means that the hosts own use of the asset will not be charged out to the CSG and then recharged back again. The host university will reclaim any VAT charged to it subject to its 'normal' VAT reclaim position when purchasing such an asset. Most universities would expect to partly reclaim the VAT charged under their partial exemption methods. The CSG is therefore only placing the host university in its normal position.

HMRC Policy insist that in order to meet the terms of the CSE there must be a 'qualifying supply' made to all members, including the host. A qualifying supply is one that the recipient uses in order to make its own exempt or non-business supplies. Therefore for the CSG members other than the host university, the qualifying supply is of research equipment, which will be used in non-business research or exempt education. However, for the host university it will not buy in the equipment from the CSG.

What services will the CSG provide to its host University?

The CSGs will be established to provide a resource management service to the host. It will primarily have responsibility to:

1) Disseminate best practice for meeting the CSE criteria for the host's staff.
2) Manage and monitor asset use by members, report annually to the host University.
3) Locate assets to share to reduce costs of research for members.
4) Licence access to a database for members, of host University's assets.
5) Populate and maintain the database with host University's assets.
6) Facilitate sharing of the host University's assets amongst members.

Membership fee

It is suggested that each university charges a membership fee to enable it to cover the administration costs of running its own CSG. A nominal sum is suggested, say £500, which should provide initial working capital to cover day to day administration.

Key points to be aware of with the VAT Cost Sharing Exemption

- It does not remove VAT on purchases of equipment. i.e there is no improvement on normal VAT costs associated with equipment purchases.
- Not all services made by the CSG automatically qualify for exemption.

The second bullet point introduces another condition of the CSG exemption legislation, namely that the services supplied must be 'directly necessary' for the recipient of the service to carry out VAT exempt or non-business activity. For the asset sharing project this will not present a major obstacle. HMRC has stated that providing a university's overall VAT recovery position is that it reclaims 15% or less than the VAT which it incurs, all services supplied to it will benefit from the exemption. However, if a university reclaims more than 15% of the VAT it incurs through its partial exemption and business/ non-business apportionment methods then it must look directly at the service being provided and how the recipient uses the service. The member will need to ensure that when it buys in the use of assets from another CSG that it uses the assets in a discrete area which is >85% exempt/ non-business. This should not be difficult to achieve with the vast majority of research being publicly funded (which is non-business).