
Opening Schools for Community Use

A guide to overcoming the potential VAT issues of community use of school sports facilities

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1 Introduction

In 2007 PwC prepared a detailed report outlining the issues facing BSF projects in the event that the facilities were made available for fee paying community use.

Since 2007, there have been a number of changes that impact upon the issues originally identified, not least of which is the scrapping of BSF itself.

This document seeks to provide an up to date analysis of the risks associated with opening up any school facility for community use along with the steps that can be taken to mitigate the risk of a VAT liability arising.

Many of the issues are relevant whether the facilities have been developed under BSF or any other capital programme. The original BFS structures are contained in sections 9 to 12 of this document.

The main developments since 2007 which impact upon the original report can be summarised as follows:-

- Withdrawal of the Lennartz mechanism
- New VAT refund scheme for academies
- Changes to the conditions for issuing relevant charitable use certificates
- Changes to Local Authority partial exemption methodology
- Clarification on the liability of extended schools services
- Clarification on HMRC's views regarding DCSF funding for VA Schools

This updated report incorporates all of the above and replaces the previous version.

2 Executive Summary

There is a common misconception that opening schools facilities for community use will result in a significant VAT cost. While this may be true in some circumstances, the reality is that with careful planning it will not be the case in the majority of instances.

In all LEA and Academy schools the issue is not the introduction of community use that causes a potential VAT problem, it is the introduction of exempt community use.

However, with careful planning the benefits of opening the facilities for wider community use and the income this will generate has the potential to minimise or negate any irrecoverable VAT resulting from the introduction of exempt community use.

Different issues arise for the different types of school, i.e. LEA, Academy, VA but by understanding the issues at an early stage and appropriately managing the capital development, the VAT issues associated with community use can often be managed and the benefits felt by the community as a whole.

For LEA schools the VAT issues relating to the introduction of exempt community use revolve around the Local Authority's VAT partial exemption position. For LEA schools the aim is to manage the level of exempt activity undertaken at the facilities so that the Local Authority's VAT partial exemption de minimis limit is not exceeded. The issues and possible solutions are considered in sections 4, 7 and 8.

For Academy schools there are two potential situations. Firstly there are some Academy schools that occupy their facilities under a peppercorn lease from the Local Authority, with no unitary charge and who have not incurred any VAT on capital costs; and secondly there are those Academy schools who incurred VAT on capital costs relating to the facilities or who receive a VATable unitary charge.

For those Academy schools in the first category, i.e. those who occupy their facilities under a lease from the Local Authority, the issues relating to the introduction of exempt community use are limited to the potential for irrecoverable VAT on operating expenditure that relates to exempt activities. There is no risk of irrecoverable VAT in relation to capital costs incurred by the Local Authority. The issues and possible solutions are considered in sections 6, 7 and 8.

For those Academy schools in the second category, i.e. those who incur a unitary charge or their own capital costs, the issues of exempt community use can potentially impact on the recovery of VAT in relation to both revenue and capital expenditure. However, unlike LEA schools, there is typically no liability created outside of the development itself. Furthermore, under the new Academy refund scheme, it should be possible to keep the potential irrecoverable VAT down to a minimum. The issues and possible solutions are considered in sections 6, 7 and 8.

For VA schools, there are limited options for managing the VAT issues which arise as a result of introducing fee paying community use (whether it is exempt from VAT or otherwise), as they are specifically excluded from the Academy refund scheme. The ability to mitigate the VAT costs arising does exist however, through careful planning and the use of a number of measures including the issue of an appropriate zero rating certificate. These options are considered in Section 13 and Case Study 2.

Failing to understand the issues or appropriately manage the programme could result in a significant VAT cost that would not just be limited to the VAT incurred on the capital costs, thereby negating the benefits of opening the facilities up to wider community use.

While the purpose of this document is to set out the likely key VAT issues arising from opening up schools for community use, it should not be taken as a substitute for obtaining VAT advice. For Local Authorities, Academies or VA schools that are considering community use, it is always recommended that specific advice should be sought in connection with the relevant circumstances. The PwC Public Sector VAT team has considerable experience in managing the VAT issues associated with education and leisure capital

developments and would be happy to assist. If you would like to discuss your particular issues, please feel free to contact the author of this document, Mark Eastwood on 0113 289 4556 (0774 0923499) or any other member of the PwC Public Sector VAT team.

3 *Beyond Building Schools for the Future*

Building Schools for the Future (BSF) was the biggest single Government investment in improving school buildings for over 50 years. The aim of the programme was to provide all secondary schools with 21st Century facilities by 2020.

It was intended to rebuild or renew every secondary school in England over a 10-15 year period, in a scheme that would involve early consultation, planning and ultimately the completion of new buildings at hundreds of school sites across England.

The BSF programme was officially launched in February 2004 with the announcement of phase one comprising 13 participating Local Authorities to complement the original 6 pathfinder authorities. Phases two and three added a further 9 and 10 Local Authorities respectively.

The building needs of primary schools and secondary schools in areas not receiving early investment from BSF continued to be met from existing successful capital programmes.

Clearly, this could only be achieved through considerable capital investment and Local Authorities needed to recognise and be aware of the VAT issues that BSF created, not only for themselves but for the additional legal entities that BSF involved.

The BSF programme was scrapped in 2010 resulting in over 700 planned redevelopments being cancelled.

However, 2010 also saw the introduction of free schools and the expansion of the academy schools programme thus paving the way for the future delivery of education.

4 VAT treatment of envisaged activities outside of normal school use by Local Authorities and Academies

Provision of sports facilities for individuals

Local Authorities are specifically excluded from the exemption under VAT Act 1994 Schedule 9 Group 10. As such, all supplies by Local Authorities to individuals of the provision of facilities for taking part in sport of physical recreation are subject to VAT at the standard rate.

However, Academies may qualify for the said exemption providing they meet the conditions necessary to be considered an eligible body – see section 5. Where an Academy qualifies as an eligible body then certain supplies of sports related services will be exempt (again see section 5) otherwise, like a Local Authority, the supplies will be subject to VAT at the standard rate.

Provision of sports facilities for clubs etc...

The supply of sports facilities is normally subject to VAT at the standard rate. However, when the supply is made to clubs, associations, schools or organisations representing affiliated clubs or constituent associations and

- a) the supply is for a period of continuous use exceeding 24 hours; or
- b) the supply is for a series of 10 or more periods where the following are satisfied
 - i. each period is for the same activity carried on at the same place;
 - ii. the interval between each period is not less than 1 day but no more than 14 days;
 - iii. the consideration is payable by reference to the whole series and is evidenced by a written agreement; and
 - iv. the customer has the exclusive use of the facilities

Then the supply becomes exempt from VAT.

It should be noted that where the option to tax has been exercised in respect of the facilities in question, the exemption is no longer available and VAT should be charged accordingly.

This also applies to Academies. Furthermore, if the Academy is entitled to treat its supplies of sports services as exempt, then it will also be able to exempt supplies to clubs (of any number of sessions) where the club itself exists for the benefit of its members and is not-for profit.

Coaching

As a Local Authority is an eligible body for the purposes of the VAT Act 1994 Schedule 9 Group 6 coaching supplied for a fee is exempt from VAT. Coaching supplied free of charge is a non business activity. Similarly, if an Academy qualifies as an eligible body for either education or sports services (see Appendix I and section 5) its supplies of coaching will also be exempt. If an Academy does not qualify as an eligible body (in either instance) then its supplies of coaching will be subject to VAT at the standard rate.

Education (free)

Where education is provided totally free of charge it is generally considered a non business activity for both a Local Authority and an Academy. However, care should be taken when establishing whether fees exist but are simply met by a third party.

Education (fee paying)

A Local Authority is an eligible body for the purposes of the VAT Act 1994 Schedule 9 Group 6 and as such any education which is supplied for a fee is exempt from VAT. Similarly, if an Academy qualifies as an eligible body (see Appendix I) its supplies of education will also be exempt. If an Academy does not qualify as an eligible body then its supplies of education will be subject to VAT at the standard rate.

Catering (provided to students)

Catering supplied to under 19 year old non-fee paying students is typically treated as a non business activity providing it is supplied at or below cost. Catering supplied to fee paying students is exempt from VAT. This is the case for Local Authorities and Academies alike.

Catering (general)

Catering supplied to non-students will be subject to VAT at the standard rate although there may be some scope for zero rating certain cold take-away food. This is the case for Local Authorities and Academies alike.

Hire or letting of space/rooms (for a fee)

The hire or letting of space or rooms for a fee is normally exempt from VAT. However, if an option to tax (Appendix D) is made then the supply (subject to minor exceptions) becomes subject to VAT at the standard rate. This is the case for Local Authorities and Academies alike.

Hire or letting of space/rooms (no charge or a peppercorn)

The hire or letting of space or rooms, where no charge is made or where the charge is on a peppercorn basis, is a non-business activity. This is the case for Local Authorities and Academies alike.

5 *VAT liability of sporting services*

Typically, a supply of services closely linked and essential to, sport or physical recreation will be subject to VAT. However, UK VAT legislation provides exemption for certain types of services when supplied in specific circumstances. Specifically excluded from this exemption are any services relating to residential accommodation, catering or transport.

Exemptions available to all entities:

The hire of sports facilities by clubs, associations, schools or organisations representing affiliated clubs or constituent associations is exempt from VAT where –

- a) the supply is for a period of continuous use exceeding 24 hours; or
- b) the supply is for a series of 10 or more periods where the following are satisfied –
 - i. each period is for the same activity carried on at the same place;
 - ii. the interval between each period is not less than 1 day but no more than 14 days;
 - iii. the consideration is payable by reference to the whole series and is evidenced by a written agreement; and
 - iv. the customer has the exclusive use of the facilities.

VAT Act 1994 Schedule 9, Group 1, Item 1 (m)

The fee for entering into a competition in sport or physical recreation is exempt where the fee is to be allocated wholly towards the provision of a prize or prizes awarded in the competition: VAT Act 1994 Schedule 9, Group 10, Item 1.

Further exemptions available to ‘eligible bodies’

Until 31 December 1999, an ‘eligible body’ for the purposes of sporting services was simply a body which was precluded from and did not distribute any profit that it made i.e. Non Profit Distributing Organisations (“NPDO”).

However, from 1 January 2000, HMRC introduced additional conditions in an attempt to prevent commercial organisations setting up in such a way as to benefit from the exemption by artificially qualifying as non profit distributing while still being able to extract profits through charges from associated businesses.

Generally speaking, most genuine NPDOs will still qualify as an ‘eligible body’ for the purposes of the sporting exemptions. However, the additional conditions introduced from 1 January 2000 are quite complex and it is always recommended that appropriate advice is sought in order to be certain.

Where an entity qualifies as an ‘eligible body’ for the purposes of the sporting exemption the following supplies are exempt from VAT –

- Where the body is set up for the purposes of sport and physical recreation, the grant of a right to enter in to a competition in such activity.

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- The supply to an individual of services closely linked with and essential to the sport or physical education in which the individual is taking part. Where the body operates a membership scheme, the exemption only applies to its members i.e. supplies to non members remain subject to VAT.

VAT Act 1994 Schedule 9, Group 10 Items 2 and 3.

6 Academies

Academies are defined by section 579 of the Education Act 1996 (as amended), (Appendix H).

Academies are developed outside of the Local Authority by a separate legal entity, typically in the form of a company limited by guarantee (“the company”) which in most cases will also be a registered charity.

Historically the favourable VAT treatment which is afforded to Local Authorities was not available to the company and as such the normal VAT rules applied. However, in recognition of the VAT issues facing Academies, HMRC proposed changes to the existing VAT legislation that would in effect mean that, from a VAT perspective, Academies would be no worse off than they would have been had they remained a part of the Local Authority.

The new legislation was contained within Clause 75 of the Finance Bill 2011 which received Royal Assent on 20 July 2011. As a result, a new Section 33B of the VAT Act 1994 is effective from 1 April 2011. The impact of section 33B is set out at Appendix E.

HMRC have published VAT information Sheet 09/11 which details the proposed VAT refund scheme for Academies. This is reproduced at Appendix F.

In simple terms, from 1 April 2011 Academies will be entitled to recover any VAT that they incur in relation to their non business and taxable activities.

In respect of initial City Academies, the DCSF funded the respective company directly. Where this was the case, the company faced precisely the same fundamental VAT issues as a VA school. As such, any VAT incurred by the company was potentially irrecoverable and thus fell as an additional cost to the project. For project costs incurred pre 1 April 2011, this essentially remains the case.

With regard to Academies, from 1 April 2011 there will arguably be two distinct scenarios. The first is where the Academy undertakes its own capital development and the second is where the Academy inherits a completed development. In both scenarios, the irrecoverable VAT on any capital or revenue costs will be determined by the exempt use (see section 4 for liability of typical activities).

Academy undertakes its own capital development

Under the proposed new refund scheme, the Academy will be entitled to recover any VAT that it incurs in relation to both its non business and taxable activities. As a result the only irrecoverable VAT will be in relation to its exempt use.

The scope for mitigating the VAT cost in such scenarios is considered in Section 8 of this report.

Academy inherits a completed development from the Local Authority

If the Academy acquired the development without incurring VAT (via a peppercorn lease or freehold transfer from the Local Authority for nil consideration), there are no associated VAT recovery implications (in relation to the capital costs) in connection with opening the development for community use for either the Academy or the Local Authority. The charging of a peppercorn lease or a freehold transfer for nil consideration will be seen as non business activities by the Local Authority.

Where there is a charge to the Academy, whether in the form of a capital contribution or a passing on of a unitary charge (in a PFI scenario) then there are a number of issues to be carefully considered.

The single largest risk lies with the Local Authority, as supplying premises in return for consideration is likely to result in the lease being considered a business activity. As a result, the supply will be exempt unless subject to the option to tax (Appendix D). In these circumstances it is likely that the Local Authority will have to opt to tax in order to avoid becoming partially exempt. It is understood that HMRC may accept that the Unitary charge is distinct from any peppercorn lease and thus is subject to VAT in its own right. However, this is still under review and if there a possibility that an exempt supply would cause the Local Authority a partial exemption problem then it would be prudent to opt to tax in any event.

Any VAT incurred by the Academy will be recoverable to the extent that it relates to the Academy's non business activities and if it is VAT registered also in relation to its taxable activities.

It should be noted that if the Academy uses the premises for 95%+ non business use, then it will be entitled to issue a 'relevant charitable use' certificate. This would disapply the option to tax thus making the lease essentially exempt once more. While this would be beneficial to the Academy (minimises irrecoverable VAT and/or removes cash flow issues) it would likely be catastrophic for the Local Authority's partial exemption position. This is an issue that the Local Authority should look to identify, as soon as possible, and seek to negotiate with the Academy to ensure that a certificate is not issued.

The scope for mitigating the VAT cost for Academies is considered in Section 8 of this report.

7 *Basic principles for VAT recovery*

Basic principles

The general rules regarding the recoverability of VAT incurred on costs are:-

- VAT incurred on costs that are wholly attributable to taxable activities, such as the provision of sports facilities to individuals by Local Authorities (see section 5), should be recoverable in full (subject to the normal rules).
- VAT incurred on costs that are wholly attributable to non business activities, such as the provision of free education, will be irrecoverable, however, see the special rules for Local Authorities and Academies.
- VAT incurred on costs that are wholly attributable to exempt activities are irrecoverable subject to partial exemption. An example of an exempt supply is the provision of sports facilities to an individual by an eligible body, see section 5.
- VAT incurred on costs that are partly attributable to taxable activities and partly attributable to non business activities should be recoverable to the extent that the costs relate to taxable activities. These costs will be the general overheads incurred in relation to the school and sports facilities, such as the light and heat. Where the school supplies free education (non business) and is a non eligible body for sports and it provides sports facilities to individuals (taxable) the VAT incurred on the overheads would need to be apportioned between the different types of supplies.
- VAT incurred on costs that are partly attributable to taxable activities and partly attributable to exempt activities should be partly recoverable (but may be fully recoverable subject to partial exemption). These costs will be general overheads incurred in running the school and sports facilities. The VAT incurred on the overheads will need to be apportioned where the school makes a number of different types of supply for VAT purposes, for example, if the school is not an eligible body for the purposes of the sports exemption the provision of sports coaching will be a taxable supply and if it also provides sports facilities to a club this will be an exempt supply.
- VAT incurred on costs that are partly attributable to taxable activities, partly attributable to exempt activities and partly attributable to non business activities should be recoverable to the extent that the costs relate to taxable activities but may also be recoverable to the extent that the costs relate to exempt activities (subject to partial exemption). Where a school provides sports coaching as a non eligible body this will be a taxable supply, the provision of free education is a non business supply and the provision of sports facilities to clubs can be an exempt supply. In these circumstances the costs in relation to the overheads incurred in providing the facilities will need to be apportioned between the different types of supplies.

A brief summary of how partial exemption works can be found at Appendix A.

Special Rules for Local Authorities

Local Authorities fall within the scope of the VAT Act 1994 Section 33 (3) and as such are entitled to recover VAT on costs that would typically not be recoverable for any other VAT registered entity.

Bodies that fall within the VAT Act 1994 Section 33 are entitled to recover any VAT that they incur in the furtherance of their non business activities.

Schools, by their very nature are engaged in non business activities which, in the main, generate little income. Furthermore, the limited income generating activities that a school does have may be subsidised e.g. trips and school meals.

Given that the income a school generates across its range of business and non business activities is vastly disproportionate to the cost of providing the said activities, the standard method of determining the level of VAT recovery under partial exemption (income based) is considered inappropriate, as a result the, the standard de minimis limit does not apply (see Appendix A).

The VAT Act 1994 Section 33 (2)(b) permits a Section 33 body to recover any VAT that it incurs on costs wholly or partly attributable to exempt activities as long as the VAT relating to exempt activities remains below 5% of the total VAT that it incurs.

For Section 33 bodies a simplified partial exemption method has been agreed with HMRC which is considered to produce a more fair and reasonable result than the standard partial exemption calculation. Using this simplified method the VAT that is considered to relate to the exempt activities of a school (and thus needs to be incorporated into the partial exemption method) is determined as follows –

$$\frac{\text{Total value of exempt supplies}}{\text{Total school expenditure (exc VAT and capital)}} \times \text{VAT incurred by the school (inc capital)}$$

Throughout 2008 and 2009, HMRC reviewed the way in which partial exemption applied to Local Authorities. During this process HMRC introduced a moratorium and for financial years ending 31 March 2008 and 31 March 2009, Local Authorities were not required to perform a partial exemption calculation.

Although HMRC had hoped to relieve the burden of partial exemption on Local Authorities, none of the alternative methods considered were found to be viable. As a result, the requirement for Local Authorities to carry out a partial exemption calculation was reintroduced with effect from 1 April 2009. However, in reintroducing partial exemption, HMRC provided more scope for Local Authorities to avoid falling partially exempt. In terms of the actual calculation itself, HMRC agreed that the resources necessary to calculate recharges were disproportionate to any effect these may have on the final percentage figure. Consequently HMRC do not require Local Authorities to include recharges in the calculation. HMRC do, however, reserve the right to reconsider this position should it become the case that the inclusion of recharges does have a meaningful effect on the final percentage figure.

Where the partial exemption of an individual Local Authority exceeds the 5% limit in one year and this is out of line with previous years HMRC may, exceptionally, be prepared to accept that the Local Authority is not partially exempt. This is on the basis of an informal agreement with between HMRC and CIPFA where HMRC will consider circumstances leading up to the breach. This should not be relied upon unless the Local Authority has been able to obtain written agreement in advance.

While the method afforded to Local Authorities may appear very generous, it makes managing the 5% limit absolutely critical. Because of the nature of the de minimis test for Local Authorities, there is typically a significant liability for the Local Authority if it fails to remain below 5%. By definition, the minimum amount the liability can be is 5% of the total VAT incurred in the year. For most Local Authorities undertaking a BSF programme, this could amount to a cost of between £1million and £3million in irrecoverable VAT depending on the size of the authority.

It is therefore essential that for Local Authorities, partial exemption is considered in respect of any projects that have the potential to result in additional exempt activities.

8 *Scope for mitigating the VAT cost*

Subject to the specifics of the individual project, there are potentially a number of ways in which it may be possible to mitigate some, if not all, of the irrecoverable VAT costs.

Traditional LEA operated school

Where the school is operated by the LEA, the VAT issues will revolve around the Local Authority's partial exemption position. In most cases, the cost to the Local Authority of being partially exempt will be significant.

In many cases it will be possible to manage the partial exemption position by opting to tax the facilities. This will ensure that, with potentially minor exceptions, all lettings of rooms and sports facilities (irrespective of the block booking criteria) will be subject to VAT at the standard rate, the net effect being the ability to reduce the amount of VAT that is considered to be attributable to exempt activities within the partial exemption calculation. However, the down side is that VAT must then be accounted for in connection with the supplies and unless the proposed charges are increased accordingly, the anticipated net income will be reduced. It is likely that any VAT charged will not be recoverable by the users and thus represents an additional cost for them.

Alternatively, making what would be exempt services available free of charge (non business) may make a significant difference to the partial exemption calculation while still permitting the facilities to be made available to the community. This would be a commercial decision, balancing the loss of income against the impact on the partial exemption calculation.

In extreme circumstances it may be worth considering the use of a separate legal entity to deliver the leisure facilities within the Local Authority's region. Where leisure services have been transferred to separate charitable Trusts, the Trusts are permitted to operate from the facilities under a management agreement which generally includes a peppercorn lease. In such cases there is unrestricted community use, the VAT sporting exemption applies to the Trust (see section 5) and the peppercorn lease is generally considered to be a non business activity for the Local Authority. As a result the Local Authority will limit the exempt supplies that it makes and thus reduces the amount of VAT it incurs that is considered to be attributable to exempt activities within the partial exemption calculation.

Where the exempt use of the BSF facilities equates to less than 5% (see Appendix A and section 7) then the programme should not, in its own right, result in a partial exemption issue.

Academy Schools

For Academy schools that do not incur the VAT on the capital expenditure (either directly or via a unitary charge being passed on), any risk of irrecoverable VAT is confined to revenue expenditure. Although on a much smaller scale, the following options could still serve to minimise any irrecoverable VAT that exists.

For Academy schools, the position is very similar to that faced by the Local Authority. Any irrecoverable VAT in relation to either capital or revenue costs is determined by the level of exempt use.

For Academy schools, managing the level of exempt income can be done in different ways. For example, where fee paying education is provided, the supply will be exempt if the Academy is an eligible body for the purposes of education (Appendix I). Where appropriate, the Academy could intentionally fail to meet the necessary criteria to be considered an eligible body. As a result supplies of fee paying education would be subject to VAT and thus would no longer, themselves, result in any irrecoverable VAT.

The Academy can also opt to tax in the same way as the Local Authority thus making lettings subject to VAT.

With regard to sports services, it can be more difficult to escape the exemption (section 5) as the conditions for eligible body status are less strict than for education. However, it is possible to make the sports services VATable through appropriate structuring.

For Academies there is typically no partial exemption ‘bigger picture’ to consider i.e. being partially exempt will result in a proportion of the VAT incurred by the Academy in relation to its exempt activities being irrecoverable. Unless the Academy has other unconnected exempt activities then it will be unlike the Local Authority where being partially exempt crystallises significant irrecoverable VAT elsewhere in the organisation.

The key for Academy schools is to identify the optimum position at an early stage and negotiate an appropriate partial exemption method with HMRC possibly along the lines of the simplified method available to Local Authorities (section 7).

VA schools

Where the Governors of a VA school (“Governors”) are funded directly by the DCSF (LEA only acting as agent) there are fundamentally only two ways to mitigate the cost of the VAT incurred on such projects.

Do not incur VAT on the costs in the first instance

UK VAT legislation currently zero rates services (excluding architectural, surveying, consultancy or supervisory services) when supplied to a charity in the course of construction of a building intended for use solely for a relevant charitable purpose. This only applies to new buildings and not to the conversion, adaptation or extension of existing buildings.

Relevant charitable purpose is defined as use by a charity in either or both of the following ways: -

- a) Otherwise than in the course or furtherance of a business; or
- b) As a village hall or similar in providing social or recreational facilities for a local community.

It is unlikely that HMRC will accept that a BSF project will fall within the definition of a village hall or similar therefore, under UK VAT law, in order for the zero rating to apply, the VA school must be used solely for non business purposes i.e. no charges made – e.g. education of non fee paying pupils.

HMRC will allow zero rating where there is minimal business use, of up to 5%.

“Use” may be measured by any means provided it accurately reflects the use of the building. Prior approval of a method is not required from HMRC. Methods suggested by HMRC to measure use are considered in more detail in Appendix C.

Due to the way in which some of the methods operate, the actual design of the school and its sports facilities can be an important factor. For example, the results of the floor space method would be significantly different if the sports facilities (which will invariably fail to qualify for non business use) formed part of the main school building as opposed to being a separate construction.

In order to allow the contractors to zero rate their supplies, the Governors will be required to issue an appropriate certificate confirming that they are a charity and intend to use the building(s) for at least 95% non business use.

The Governors are required to maintain the conditions necessary for zero rating (including the 95%+ non business use) for a period of 10 years. If at any stage within this 10 year period, the conditions cease to be met, a VAT liability crystallises for the Governors (NOT the contractor).

This makes it even more critical that zero rating certificates are only issued after due care and consideration has been given to the intended use of the buildings in question. In reality, there will still be buildings or parts of buildings where it is simply not possible to achieve zero rating.

The 95% non business test essentially limits the amount of commercial use. This is particularly the case in respect of the sports facilities where there is greater scope for generating income from community use outside of school hours.

In theory, where the Governing body is a registered charity, it should be possible to issue some form of zero rating certificate. Professional fees, such as architect's fees, are always subject to VAT at the standard rate, it has in the past been possible to use design and build contracts to maximise the scope of the zero rating certificate to cover such fees. There is, however, speculation that HMRC no longer accepts that such elements of design and build contracts qualify for zero rating.

However, in practice, issuing a zero rating certificate can prove very difficult to support. Business use of the facilities is not always apparent at first sight. For example, admissions to school events, performances and sales of meals to staff and visitors all constitute business use.

It may be possible to tailor the physical design of the facilities and their intended use so as to maximise the availability of zero rating whilst still permitting some level of commercial use. In the majority of cases this would need to be considered very early in the process and may still result in a compromise.

The scope for zero rating can be further improved by limiting the charges that are made, for example, not charging a particular user group several hundred pounds for what would be an exempt supply may result in the construction costs being zero rated and saving several thousand pounds in VAT.

Maximise the scope for recovering the VAT incurred

For most school buildings it should be possible to identify at least a part of the building that meets the 95% time test (see Appendix C). However, in the majority of cases it is unlikely that an appropriate zero rating certificate can be issued for the whole of the school building and perhaps even less likely that one can be issued for the sports facilities (assuming there is some level of commercial use).

Where VAT is incurred, the only possible mechanism for recovery is through the VAT registration of the Governing body. As VAT registration applies to the entity as opposed to its activities, the Governing body will need to consider the implications of VAT registration on their whole range of activities (including any existing ones).

As set out in Section 7, under the basic principles only the proportion of the VAT on the development costs that relates to taxable use of the buildings can typically be recovered. The VAT that relates to exempt use is not normally recoverable. The VAT that relates to the non business use is not recoverable.

It therefore follows that the more the school buildings and sports facilities are used for taxable purposes, the greater the degree of VAT that can be recovered on the development costs (and the ongoing running costs).

Although the core school use will be almost exclusively non business, the Governors should consider the scope for introducing or increasing the taxable use by opting to tax and/or structuring the delivery of sporting services in alternative ways.

Opting to tax will ensure that, with potentially minor exceptions, all lettings of rooms and hire of sports facilities to clubs, associations etc (irrespective of the block booking criteria) will be subject to VAT at the standard rate. The net effect of this will be to increase the level of VAT recovery in connection with the construction costs. However, the down side is that VAT must then be accounted for in connection with the supplies and unless the proposed charges are increased accordingly, the net income will be reduced. It is likely that any VAT charged will not be recoverable by the users and thus represents an additional cost for them. A commercial decision based upon the long term loss of income and need to increase charges balanced against the one off increase in VAT recovery in connection with the development costs and long term increase in VAT recovery in connection with operating costs will need to be made.

Furthermore, supplies such as sporting services and coaching when supplied to individuals can also be made taxable if they are delivered by a trading company which does not itself qualify as an eligible body for the purposes of the sporting exemption (Section 5). Again, this will be a commercial decision based upon the long term loss of income and the need to increase charges balanced against the one off increase in VAT recovery in connection with the development costs and long term increase in VAT recovery in connection with operating costs. Further advice should be sought if this option is to be considered.

Unlike the traditional LEA schools, the issues for VA Schools are more of a compromise.

For VA Schools, the fact that the LEA is still responsible for the delivery of education (and is entitled to recover the VAT incurred on associated costs) provides an additional opportunity to maximise VAT recovery. If an appropriate agreement can be reached with the LEA, it may be possible to achieve full VAT recovery in connection with the sports facilities.

9 BSF – the legal entities involved

In any BSF programme, there will be a number of legal entities involved. Typically these will include a Local Authority (or more than one), Partnership for Schools Ltd (“PFS”), a Private sector Partner/s (“PSP”) and the creation of a new company in the form of the Local Education Partnership Ltd (“LEP”). However, additional legal entities may also be involved such as a special purpose company or vehicle (“SPV”), the governing body of a VA school or a charitable company in the case of a City Academy.

It is understood that the use of a LEP is not compulsory. However, for the purposes of this guidance it has been assumed that a LEP will be created.

The concept of the LEP

In essence, the purpose of the LEP is to assist Local Authorities in delivering the BSF programme. It is intended that the LEP will be a legal entity in its own right, established as a public private partnership with three members, comprising:

- The Local Education Authority (“LEA”) - 10% shareholding
- Private sector partners - 80% shareholding
- Partnership for Schools (“PFS”) - 10% shareholding

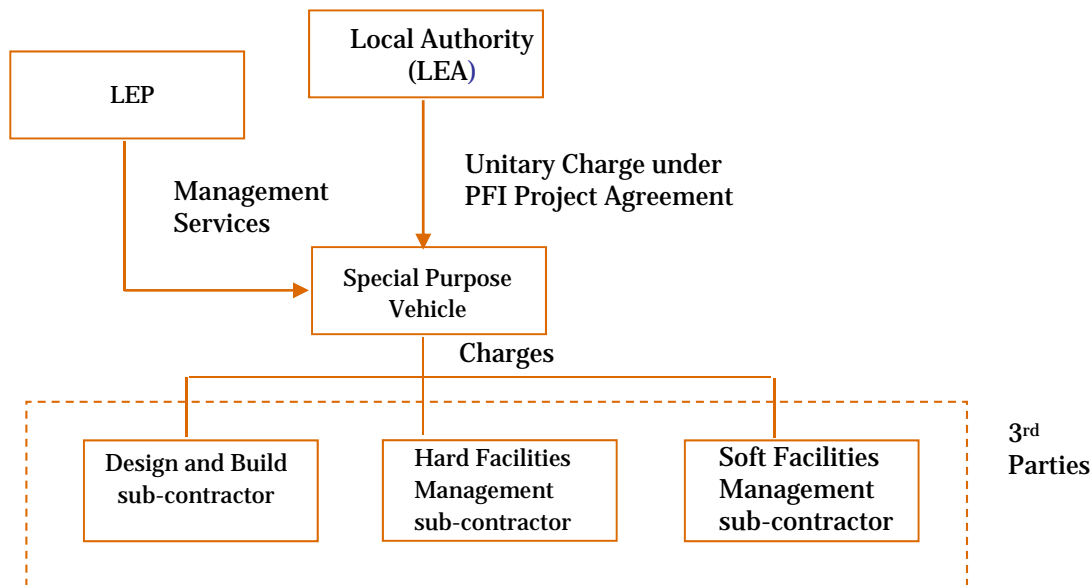
It is hoped that the LEP, combining the skills of both private and public sector, will assist in managing the complexities that BSF creates.

The LEP will act as a single point of contact for procurement and delivery and will have an exclusive right to develop proposals for and deliver BSF schools. It is anticipated that the LEP will enter into design and build contracts, maintenance contracts and ICT contracts. In terms of PFI projects however, it is understood that the LEA will enter into the PFI agreement with the PFI special purpose vehicle directly (probably a subsidiary of the LEP).

10 PFI projects

The BSF standard documentation indicates the following contractual relationships.

The contractual structure for PFI contracts will in general reflect:



The LEP

In a PFI project it is envisaged that the LEP will provide management services to the SPV.

Supplies by the LEP

The supply of management services by the LEP are likely to be subject to VAT at the standard rate.

Supplies to the LEP

The LEP will incur a variety of costs that relate to the provision of the management services. Some of these costs will carry VAT and some will not.

VAT recovery for the LEP

In accordance with the basic principles for VAT recovery the LEP should be entitled to recover any VAT that it incurs on costs that are wholly and exclusively attributable to the taxable management services.

The recoverability of any other VAT incurred by the LEP will be subject to the LEP's other activities and whether they are taxable, exempt or non-business.

The SPV

It is envisaged that the SPV will act in the same way as it would in any other PFI arrangement.

Supplies by the SPV

Any charges to the Local Authority are likely to be liable to VAT. This would include any one-off payments by the Local Authority to the SPV and the ongoing monthly unitary charge. There may be a challenge by Customs that the SPV is actually making two supplies - an exempt supply of an interest in land to the Local Authority and a taxable supply of facilities management. As discussed in Section 7, making exempt supplies would probably result in irrecoverable VAT in the hands of the SPV and depending on the contractual terms, could increase the on-going costs to the Local Authority.

To manage this issue, it is often recommended that Local Authorities seek to include an appropriate clause in their PFI agreement which obliges the SPV to opt to tax the development. An option to tax changes the VAT liability of the supply from exempt to taxable. However, it should be noted that an option to tax is not effective in all cases. Specific anti-avoidance legislation may disapply the option to tax in certain circumstances e.g. where the Local Authority has provided funding to the SPV and intends to use the facilities for exempt purposes.

Assuming the option to tax is not disapplied, this should ensure that all charges to the Local Authority are liable to VAT at the standard rate. The SPV's VAT recovery position should therefore be protected thus minimising the risk that irrecoverable VAT will become an additional cost that is ultimately recharged to the Local Authority.

It is understood that in some PFI agreements, the right to use the facilities outside of the agreed Local Authority school use will remain with the SPV. In these circumstances it will be the SPV that charges and retains the income for the use of the facilities and thus is responsible for accounting for VAT.

The letting of rooms and in certain circumstances, the letting of sports facilities to clubs and associations, is exempt from VAT (see section 5 – liability of Sporting services). Therefore, if the SPV generates exempt income from the use of the facilities, it is likely to face a restriction in the amount of VAT that it can recover. This would apply equally to VAT incurred on operating costs as well as capital costs.

However, if the SPV has exercised the option to tax in respect of the facilities then, other than in a limited number of specific circumstances, all of the letting income should be subject to VAT at the standard rate.

Given that the SPV will be capable of distributing profits, it is unlikely to qualify for VAT exemption in respect of any supplies of either education or sporting services to individuals. Therefore, where supplied by the SPV, such supplies should be subject to VAT at the standard rate.

Supplies to the SPV

The SPV is likely to incur VAT on the cost of the Management Services provided by the LEP.

The supplies made under the Design and Build contract and the Hard and Soft Facilities Management Services will more than likely be subject to VAT at the standard rate.

It is also envisaged that the SPV will incur additional overhead costs which will be a mix of VATable and non VATable items. These supplies may also include the licence granted by the Local Authority permitting the SPV to access the sites.

VAT recovery for the SPV

In accordance with the basic principles for VAT recovery the SPV should be entitled to recover any VAT that it incurs on costs that are wholly and exclusively attributable to its taxable activities.

If the SPV engages in non business or exempt activities then some of the VAT that it incurs will be irrecoverable.

Exactly how the SPV will operate the facilities will clearly differ on a case by case basis. However, as long as the SPV only uses the facilities for taxable business purposes, then the SPV should be entitled to recover any VAT that it incurs subject to the normal rules. Therefore, in a typical arrangement where the SPV simply makes a taxable

unitary charge (and does not engage in supplies of lettings, education or sports facilities), then it should be entitled to recover all of the VAT that it incurs.

The Local Authority

The Local Authority will operate the facilities in the course and furtherance of the education of under 19 year old non-fee paying students. In most cases, the Local Authority will also have the opportunity to operate the facilities outside of normal school hours although there are a number of ways this may be achieved.

Supplies by the Local Authority

In order to give the SPV the ability to go onto the school sites, the Local Authority will often grant a licence over the sites. It is usual that the Local Authority does not specifically charge the SPV for this licence (any charges would have to be passed back onto the Local Authority through an increased unitary charge). Providing there is genuinely no consideration payable by the SPV (monetary or otherwise including barter arrangements) then it is likely that the granting of the licence would be seen to be a non business activity for VAT purposes. However, where consideration is payable, the grant of the licence would be exempt from VAT or, where an option to tax has been exercised by the Local Authority, subject to VAT at the standard rate.

The primary purpose of the redeveloped site is the provision of education by the Local Authority to under 19 year old non-fee paying students. This is a non business activity for the Local Authority.

However, there are a number of potential ways in which the Local Authority can use the facilities outside of normal school use. A summary of the typical envisaged use can be found at Section 4.

The Local Authority will need to consider the VAT liability of the supplies that it makes and any resulting impact on VAT recovery.

Where the Local Authority makes exempt supplies by virtue of hiring or letting space or rooms or by supplying sports facilities to clubs associations etc... (see Section 4) it may wish to consider exercising the option to tax in respect of the facilities thus making such supplies subject to VAT at the standard rate. It should be noted that the Local Authority would then be required to account for VAT on all such supplies including supplies to organisations that may not be in a position to recover the VAT charged.

Subject to the approach of the individual Local Authority, the operation of the facilities outside of normal school use may be the responsibility of the school fund and/or a Leisure Trust.

Where the Local Authority uses a specifically set up Leisure Trust to operate its facilities then consideration will need to be given as to how the interest in the facilities will be granted to the Leisure Trust. Typically this would be by way of a peppercorn lease which is generally accepted by HMRC as a non-business activity. However, where a commercial lease is used, the supply would be exempt unless an option to tax had been exercised. Again, the Local Authority may wish to consider exercising the option to tax in respect of the facilities thus making such supplies subject to VAT at the standard rate.

Supplies to the Local Authority

If the SPV has made an effective option to tax (not disapplied by virtue of the anti-avoidance rules) then the Local Authority will incur VAT on the full value of the unitary charge.

It is also envisaged that the Local Authority will incur a number of other costs which will be a mix of VATable and non-VATable items.

Additional supplies may take place if the SPV is responsible for providing catering in the schools. In respect of catering supplies, if the SPV operates as a principal for VAT purposes it will be supplying the meals direct to the pupils and staff in its own right. This will be a taxable supply and VAT will need to be added to the prices charged. This will mean that the prices to the pupils will increase by 20%.

If the SPV acts as an agent of the Local Authority, then the supply of the meals to the pupils will be a non business activity since they will be seen as being provided by the authority in conjunction with non business education. (Non business treatment only applies to supplies of catering at or below cost when provided by the same person that supplies the education.)

Therefore, it is more VAT efficient if the SPV acts as the Local Authority's agent in providing the meals. However it should be noted that not all of the income collected from the catering service will be non-business. The supply of meals to staff and visitors will generally be standard rated since they cannot be incidental to education. Therefore, where the SPV act as agent for the Local Authority it will need to provide information relating to taxable sales to enable the Local Authority to account for the correct amount of VAT on catering to non-pupils.

Any separate agency charge by the SPV will typically be subject to VAT at the standard rate. However, a specific concession exists for institutions which use third party caterers to provide their catering facilities under agency arrangements. Under such arrangements, a caterer will typically incur costs for consumables which are subsequently recharged to the institution concerned. The caterer will also charge the institution for its staff costs, along with a management fee. Normally, a supply of staff would attract VAT, as would a management fee. However, in these circumstances, the recharge of staff costs can, by concession, be ignored for VAT purposes. This is on the basis that, if the institution provided the catering services from its in-house resources, it would not incur a VAT charge on the employment costs. As the caterer acts as agent for the institution, the staff costs are treated as though they are disbursements for the caterer.

VAT recovery for the Local Authority

As per the special rules discussed in Section 7, a Local Authority can recover any VAT that it incurs on costs attributable to its taxable and non-business activities.

The key is identifying the VAT to be incurred on costs that will be attributable to a Local Authority's exempt activities within the facilities. This can then be factored in to the Local Authority's partial exemption calculation to establish whether the Local Authority will be able to remain below the critical 5% de minimis limit and thus be entitled to full VAT recovery.

Where the 5% limit is exceeded or is too close for comfort, the Local Authority can exercise the option to tax as necessary to reduce the exempt activities and thus reduce the overall amount of VAT incurred on costs associated with exempt activities.

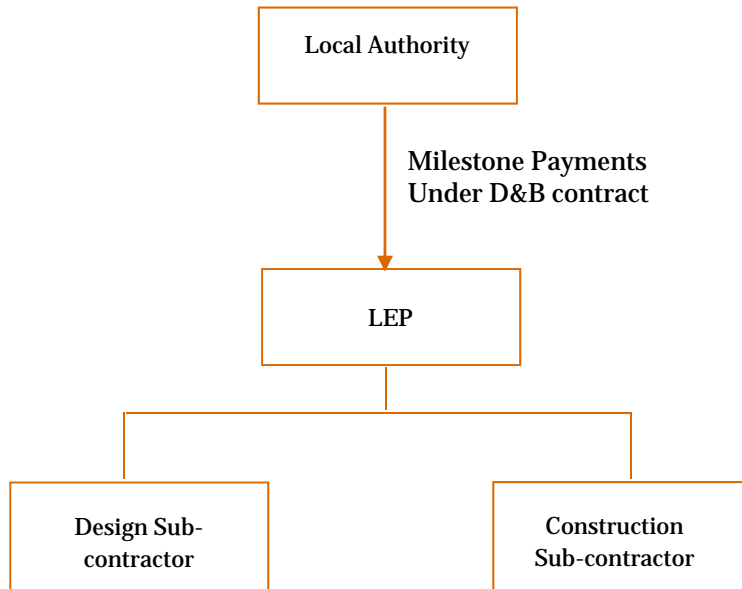
Because of the unusual nature of a school's financial make up, it is not always straight forward to arrive at a method for determining what proportion of the VAT incurred relates to exempt activities. A simplified method has been agreed with HMRC in relation to schools and it is understood that this has also been accepted by HMRC (subject to minor changes) as applicable in BSF.

The method is reproduced at Section 7 and subject to how the individual Local Authority makes the facilities available for use outside of normal school use, may need slight amendment.

In principle, a school's PFI scheme should not lead to a change in the VAT status of a Local Authority. It is expected that, providing the scheme is effectively managed, there should not normally be any significant additional VAT exposure for the Local Authority. However, Local Authorities should be aware that PFI arrangements can give rise to increased exempt activity through the granting of interests in land and/or sports facilities (e.g. sales, leases and licences) and this exempt activity needs to be monitored so that if necessary, the authority can opt to tax in order to protect its partial exemption position.

11 Conventional projects

The BSF standard documentation indicates the following contractual relationships.



The LEP

On conventional projects it is envisaged that the LEP will provide the Design and Build (D&B) services to the Local Authority.

Supplies by the LEP

The LEP will effectively assume the role of the main contractor in a standard design and build arrangement. The LEP will charge the Local Authority for the services supplied based upon pre agreed milestones.

The LEP's services are likely to be subject to VAT at the standard rate i.e. as the Local Authority is not itself a charity it is unlikely that any zero rating will be applicable.

Supplies to the LEP

The LEP will incur the costs of the design and construction. These services will more than likely be subject to VAT.

VAT recovery for the LEP

In accordance with the basic principles for VAT recovery the LEP should be entitled to recover any VAT that it incurs on costs that are wholly and exclusively attributable to the taxable services under the design and build contract.

The recoverability of any other VAT incurred by the LEP will be subject to the LEP's other activities and whether they are taxable, exempt or non-business.

The Local Authority

The Local Authority will operate the facilities in the course and furtherance of the education of under 19 year old non-fee paying students in the normal way. In most cases, the Local Authority will also have the opportunity to operate the facilities outside of normal school hours although there are a number of ways this may be achieved.

Supplies by the Local Authority

The primary purpose of the redeveloped site is the provision of education by the Local Authority to under 19 year old non-fee paying students. This is a non-business activity for the Local Authority.

However, there are a number of potential ways in which the Local Authority can use the facilities outside of normal school use. A summary of the typical envisaged use can be found at Section 4.

The Local Authority will need to consider the VAT liability of the supplies that it makes and any resulting impact on VAT recovery.

Where the Local Authority makes exempt supplies by virtue of hiring or letting space or rooms or by supplying sports facilities to clubs associations etc... (see Section 4) it may wish to consider exercising the option to tax in respect of the facilities thus making such supplies subject to VAT at the standard rate. It should be noted that the Local Authority would then be required to account for VAT on all such supplies including supplies to organisations that may not be in a position to recover the VAT charged.

Subject to the approach of the individual Local Authority, the operation of the facilities outside of normal school use may be the responsibility of the school fund and/or a Leisure Trust.

Where the Local Authority uses a specifically set up Leisure Trust to operate its facilities then consideration will need to be given as to how the interest in the facilities will be granted to the Leisure Trust. Typically this would be by way of a peppercorn lease which is generally accepted by HMRC as a non-business activity. However, where a commercial lease is used, the supply would be exempt unless an option to tax had been exercised. Again, the Local Authority may wish to consider exercising the option to tax in respect of the facilities thus making such supplies subject to VAT at the standard rate.

Supplies to the Local Authority

The Local Authority will more than likely incur VAT on the full value of the design and build services provided by the LEP.

It is also envisaged that the Local Authority will incur a number of other costs which will be a mix of VATable and non VATable items.

VAT recovery for the Local Authority

As per the special rules discussed in Section 7, a Local Authority can recover any VAT that it incurs on costs attributable to its taxable and non-business activities.

The key is in identifying the VAT to be incurred on costs that will be attributable to a Local Authority's exempt activities within the facilities. This can then be factored in to the Local Authority's partial exemption calculation to establish whether the Local Authority will be able to remain below the critical 5% de minimis limit and thus be entitled to full VAT recovery.

Where the 5% limit is likely to be exceeded or is too close for comfort, the Local Authority can exercise the option to tax as necessary to reduce the exempt activities and thus reduce the overall amount of VAT incurred on costs associated with exempt activities.

Because of the unusual nature of a school's financial make up, it is not always straightforward to arrive at a method for determining what proportion of the VAT incurred relates to exempt activities. A simplified method has been agreed with HMRC in relation to schools and it is understood that this has also been accepted by HMRC (subject to minor changes) as applicable in BSF.

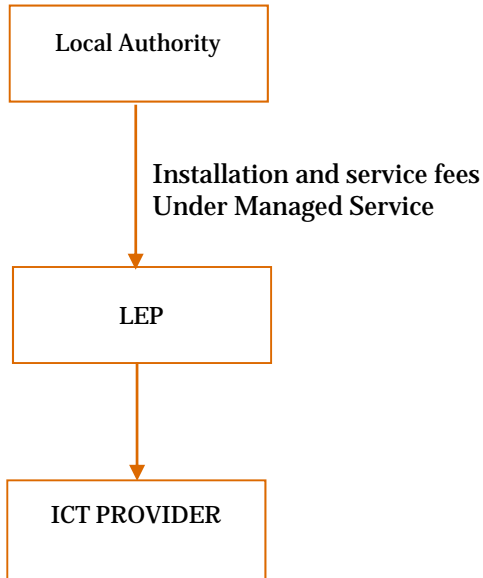
The method is reproduced at Section 7 and subject to how the individual Local Authority makes the facilities available for use outside of normal school use, may need slight amendment.

From a VAT perspective there is no material difference between a BSF conventional project and historic school construction or renovation projects.

It is expected that, providing the project is effectively managed (options to tax exercised where appropriate), there should not be any significant additional VAT exposure for the Local Authority.

12 ICT services

The BSF standard documentation indicates the following contractual relationships.



The LEP

It is envisaged that the LEP will act as the main contractor for the provision of ICT services and buy in the said services from a service provider.

Supplies by the LEP

The LEP will effectively assume the role of the main contractor for the provision of ICT services to the Local Authority. The LEP will charge the Local Authority installation and managed services fees.

The LEP's services will be subject to VAT at the standard rate.

Supplies to the LEP

The LEP will incur the costs of ICT service provider. These services will more than likely be subject to VAT.

VAT recovery for the LEP

In accordance with the basic principles for VAT recovery the LEP should be entitled to recover any VAT that it incurs on costs that are wholly and exclusively attributable to the taxable services under the contract for ICT services.

The recoverability of any other VAT incurred by the LEP will be subject to the LEP's other activities and whether they are taxable, exempt or non-business.

The Local Authority

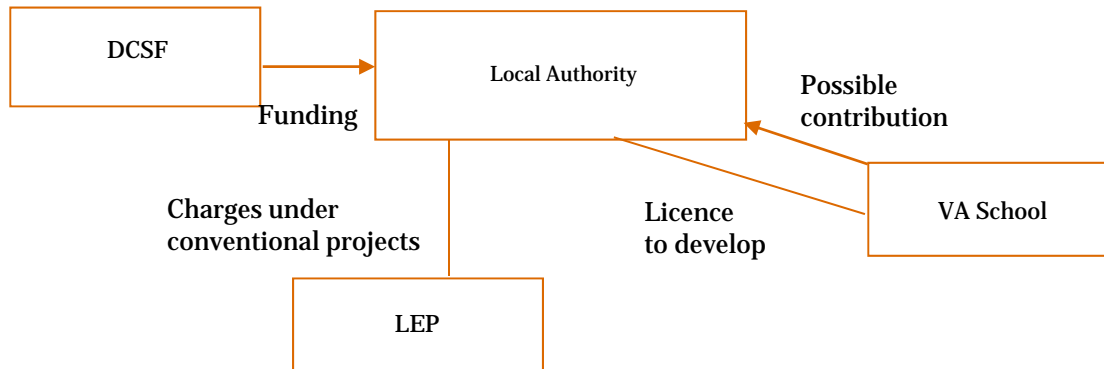
For the Local Authority, the cost of the ICT services will form part of the overall cost of operating the school facilities.

The VAT incurred will therefore be recoverable to the extent that it is attributable to taxable or non business activities.

Assuming that the ICT services are not used exclusively for taxable or non-business activities, the VAT incurred will need to be included within the Local Authority's partial exemption calculation.

13 Voluntary Aided Schools

The BSF standard documentation indicates the following contractual relationships.



In many BSF projects, one or more of the schools being constructed may be voluntary aided schools (“VA schools”). In the case of VA schools, the governing body has an obligation to maintain the external fabric of their building and provide certain items of furniture and equipment. Normally, such expenses are funded by a direct grant from the DCSF and where the Governors contract for works for which they are responsible, the VAT that they incur will generally be irrecoverable.

On the other hand, where the Local Authority (via the LEA) funds a project, wholly or in part, the Local Authority can currently recover the VAT incurred on this element, irrespective of who is actually responsible for carrying out the works. The Local Authority would need to contract for the works, receive an invoice in its own name and pay for the supply from its own resources.

In 2009, HMRC issued Revenue and Customs Brief 53/09 which clarified their position concerning VA school capital works. This is reproduced at Appendix G.

Following in depth discussions between HMRC and the DCSF it has been concluded that the LEA receives the funding only as agent on behalf of the Governors of a VA school. As such there will be no scope for VAT recovery via the LEA. If the Governors were to pass the funding to the Local Authority who in turn engage the contractors and carry out the project, HMRC would view the payment to the Local Authority as consideration upon which VAT would be due. Therefore, while the Local Authority could recover VAT on the costs associated with the project, it would need to charge and account for VAT on the onward supply to the Governors i.e. nil net benefit.

VA schools will need to consider the scope for mitigating irrecoverable VAT.

As a VA school is not part of the Local Authority, the favourable rules for VAT recovery do not apply and in principle a VA school cannot recover any VAT that it incurs on costs associated with its non-business or exempt activities. Therefore, in most cases, the majority, if not all, of the VAT incurred by a VA school will fall to be irrecoverable and thus will be a cost to the project.

It is possible that the buildings being constructed will fall within the scope of the Capital Goods Scheme to the extent that they are used for business purposes and thus any VAT recovery will need to be monitored for a period of approximately 10 years (see Appendix B) and adjusted accordingly, if the levels of taxable or exempt use change.

There are fundamentally only two ways to mitigate the cost of the VAT incurred on a VA school BSF project. These are considered in Section 8 of this report.

14 Summary of key points

- The LEP will be a separate legal entity and as a result, consideration should be given to VAT registration of the LEP.
- The LEP should also consider the VAT liability of the supplies it makes to other partners and third parties and its ability to recover VAT on its costs.
- The partners will need to consider if they are “connected” to the LEP; this could give rise to open market value issues for VAT purposes.
- The Local Authority should consider if the BSF programme gives rise to any additional exempt activity in order to assess the partial exemption implications.
- Both the SPV and the Local Authority should consider whether an option to tax over land and buildings is appropriate to protect their ability to recover VAT on costs attributable to supplies of those land and buildings.
- The catering arrangements of any PFI structure should be carefully considered to ensure that the arrangements do not create an additional VAT cost in the supply of meals and refreshments to pupils.
- The Local Authority may pass on a proportion of the costs incurred in relation to a PFI structure to the Governors of a VA school. Where the recharge represents the costs of ongoing external repairs and maintenance, the supply to the governing body will be standard rated and such VAT may fall as a cost to the Governors.
- A PFI structure should normally not have a detrimental impact on a Local Authority’s VAT position, provided the arrangements are carefully considered and the partial exemption position is managed appropriately.
- VAT may fall as a cost to the governing body of a VA school. Consideration should therefore be given to the possibility of zero rating supplies of construction services to minimise such additional costs.
- In the context of BSF, zero rating is only available where services are supplied to the Governors of a Voluntary Aided school in the course of construction of a new building (not extension or renovation) to be used for a relevant charitable purpose.

15 Further advice

This guidance has been produced to assist BSF project teams in identifying the generic VAT issues inherent within the BSF programme and the various methods of delivery. It should not be taken as a substitute for obtaining VAT advice in respect of a specific BSF project.

It is always recommended that specific advice should be sought, which should be based on the particular arrangements of that BSF project. If further advice or clarification is required please feel free to contact the author of this document, Mark Eastwood on 0113 2894556 (email mark.eastwood@uk.pwc.com), or your usual PwC Government and Public Sector team contact.

Appendix A – Partial Exemption

It should be noted that this Appendix is only a high level analysis of partial exemption and is intended simply to illustrate the mechanisms for identifying irrecoverable VAT.

Any VAT registered entity that makes both taxable and exempt supplies is described as being partially exempt. As discussed, VAT incurred on costs associated with exempt activities is not normally recoverable.

The process of determining to what extent the VAT incurred (on costs directly or indirectly associated with exempt activities) is recoverable is called partial exemption.

UK VAT legislation sets out what is referred to as the standard method for partial exemption which is as follows-

The Standard Method

The first stage is what is referred to as direct attribution and each cost (invoice) needs to be considered individually:

- VAT incurred on costs that are wholly and exclusively attributable to taxable activities is recoverable in full.
- VAT incurred on costs that are wholly and exclusively attributable to exempt activities will not be recoverable subject to the de minimis limit (see below).

Any VAT incurred on costs that relate partly to taxable and partly to exempt activities will be recoverable in part but may be recoverable in full subject to the de minimis limit.

VAT on costs which cannot be directly attributed is normally referred to as 'non-attributable' or 'residual' input tax. A partial exemption method must then be used to apportion this residual input VAT to determine how much of it is reclaimable. As the standard method for calculating recoverable VAT is an income based method, the percentage of residual input VAT which can be reclaimed is calculated as follows:

$$\frac{\text{Total value of taxable supplies}}{\text{Total value of supplies}} \times 100$$

If the resulting percentage is not a whole number (and the total residual input VAT is less than £400,000 per month on average), it should be rounded up to the next whole number.

In principle VAT that is recoverable is the amount that is directly attributable to taxable supplies plus the percentage of residual VAT arrived at by performing the calculation outlined above.

De Minimis limit

Where the total non recoverable VAT (i.e. that which is directly attributable to exempt supplies or is not recoverable under the above calculation) in any VAT period is not more than:

1. £625 per month on average over the period, and
2. one half of the total input VAT for the period concerned,

then all such VAT in that period is treated as being attributable to taxable supplies i.e. it is recoverable in full.

Annual adjustment

The VAT recovery determined above is only a provisional recovery as there is also a requirement to carry out an annual adjustment. This is essentially the same calculation applied to the year as a whole. It is intended to balance out any seasonal trends.

The level of VAT recovery resulting from the annual calculation is compared to the actual VAT recovery throughout the year. Any difference is required to be adjusted accordingly.

Special Methods

If it can be demonstrated that the standard method does not produce a fair and reasonable result, then HMRC will consider proposals for use of a special method. An example of a special method would be a method based upon a combination of space and time that the facilities are used for taxable and exempt activities.

Local Authorities

As with any other VAT registered entity, if a Local Authority makes exempt supplies then it is considered to be partially exempt. However, the de minimis limit that applies to Local Authorities is much more favourable as it is based upon a percentage (5%) of the total VAT that the Local Authority incurs in the year.

Therefore, a Local Authority is entitled to recover all of the VAT that it incurs on costs that are attributable to exempt activities as long as such VAT remains below 5% of the total VAT that the Local Authority incurs in the year.

As discussed, Local Authorities are entitled to recover VAT on costs that are attributable to non business activities. Therefore, for many Local Authorities the VAT incurred on costs attributable to exempt activities will be less than 5% of the total VAT incurred and thus is recoverable in full.

However, the mechanics of this more favourable de minimis limit mean that exceeding it more than likely results in a significant cost. Based upon the amount of VAT that a typical Local Authority incurs in a year, exceeding the de minimis limit will generally result in a significant irrecoverable VAT cost. For example, engaging in a £500,000 project that results in exempt activity may push a Local Authority over its de minimis limit and cost significantly more in irrecoverable VAT across the authority as a whole. For many Local Authorities, managing their partial exemption position is a high priority.

Every Local Authority has adopted a partial exemption method which it uses to determine the recoverability of VAT that it incurs on costs associated with exempt activities. Such methods are often complicated, taking into account specific projects and recharges between different departments or committees within the authority. Although a Local Authority specific 'special method' has been agreed with HMRC, each Local Authority will operate its own version taking into account its own unique circumstances.

Appendix B – Capital Goods Scheme

The Capital Goods Scheme (CGS) applies to items of capital expenditure in excess of £250,000 on land and buildings, civil engineering works and refurbishments and fitting-out works which are not used wholly for making taxable supplies.

The scheme recognises that such items of capital expenditure can be used by a business over a number of years and that there may be variation over those years in the extent to which the items are used to make taxable supplies. The scheme provides a mechanism whereby the initial input tax claimed can be adjusted over a period of up to ten years.

When a capital item within the scheme is acquired, the normal rules for claiming input tax apply i.e.

- If it is used wholly in making taxable supplies, input tax is recoverable in full;
- If it is used wholly in making exempt supplies, none of the input tax is recoverable; and
- If it is used for making taxable and exempt supplies, a proportion of the input tax may be claimed under the partial exemption rules.

Where, subsequently, in the ten year adjustment period for that item there is a change in the extent of taxable use, an input tax adjustment has to be made to take account of this. If taxable use increases, a further amount of input tax can be claimed from HMRC and, if it decreases, some of the input tax already claimed must be repaid to HMRC.

The Capital Goods Scheme also takes into account fluctuations in the extent to which a capital item within the scheme is used for business and non business purposes.

Appendix C – Zero Rating Certificate – Non Business Use Tests

The possible methods for determining the minimum 95% non business use required in order for a charity to issue a zero rating certificate are set out below.

“Use” may be measured by any fair and reasonable means, provided that it accurately reflects the extent to which a building is used for a qualifying purpose. The chosen measure must be capable of being carried out and checked without undue difficulty and cost. “Use” in this context means either or both of the following:

- The physical occupation of a building and the carrying on of an activity or activities there.
- The leasing or letting of the building.

HMRC Information Sheet 13/10 (June 2010) describes the methods that can be used to determine whether the 95% test is satisfied. The suggested methods are set out below:

1. Time Based Method -The non business use of a building can be ignored if the building is used solely for a qualifying purpose for more than 95% of the total time the building is available for use.
2. Headcount Based Method - The non qualifying use of a building can be ignored if the building is used solely for a qualifying purpose by 95% or more of the people using the building (on a head count basis).
3. Floor Space - The non qualifying use of a building can be ignored if 95% or more of the floor space of the building will be used solely for a qualifying purpose.
4. Alternate Methods:
 - i. Comparison of the full time equivalents of staff engaged on qualifying activities with the total number of staff.
 - ii. Comparison of the commercial funding of the use of the building to the total funding of the use of the building. Funding includes all income including grants, donations etc. This method is only likely to give a fair answer where the costs of using the building for non business activities are similar to those for business activities.
 - iii. A hybrid method combining floor space and time.
 - iv. A hybrid method combining area and time.

Conditions

- From 1 July 2010, where part of a building is concerned, there is no restriction as to the method to be used, provided it accurately reflects the extent to which that part is used for a qualifying purpose.
- Prior approval from HMRC for the use of any method is not required.
- It is a condition of the relief for charitable buildings that they continue to be used at least 95% for a qualifying purpose for the ten years following completion. Should the use of the building (or a part) change from a qualifying purpose to a non qualifying purpose within that ten year period, VAT must be accounted for at the standard rate on the deemed self supply that arises by virtue of Part 2, Schedule 10, VATA 1994.

Appendix D – Option to Tax/Anti-avoidance rules

A grant of a right over or interest in land is generally exempt from VAT. However, in certain circumstances the grantor can elect to waive the exemption or opt to tax the supply thus making it subject to VAT at the standard rate.

Anti-avoidance rules

Although introduced to combat what HMRC perceive as VAT avoidance, the anti-avoidance rules also inadvertently apply to many scenarios where HMRC accept that no VAT avoidance is taking place.

The anti-avoidance rules are complex but in principle they disapply the option to tax in relation to a grant of an interest in land or buildings in circumstances where –

- The grantor is the developer of the land or buildings and the grant involves a building or part of a building which is a capital item for the purposes of the VAT Capital Goods Scheme i.e. cost in excess of £250,000 (exc VAT) to develop.
- The grant is made within the 10 year period of adjustment required by the VAT Capital Goods Scheme.
- At the time of the grant, it is intended that the grantor or a person responsible for funding (or part funding) the grantors development or a person connected with either, will during the 10 year period of adjustment, occupy the building otherwise than mainly for eligible purposes (at least 80% VATable business activity).

Appendix E – VAT Refund Scheme for Academies

With effect from 1 April 2011 Academies will be able to recover VAT on costs which are incurred to support their non business activities (primarily the provision of free education). This is to ensure that *they* are treated, for VAT purposes, in the same way as schools which are controlled by Local Authorities.

HMRC will refund VAT (other than any which is specifically blocked) charged on the supply of goods or services to the proprietor of an Academy acting when he is acting in that capacity, where:

1. The supply is not for the purpose of any business carried on by the proprietor of the Academy;
2. The supply takes place on or after 1 April 2011;
3. A claim is made in the format required by HMRC; and
4. The claim is made before the end of a four-year period beginning with the day on which the supply is made.

Where it is not possible to easily distinguish between goods or services attributable to business and non business activities, the VAT shall be apportioned between the two on a fair and reasonable basis.

For this purpose the term “Academy” means a school to which Academy arrangements relate and “proprietor” means the person or body of people responsible for the management of the school.

Appendix F – VAT Refund Scheme for academies – HMRC Information Sheet 09/11 June 2011

Introduction

What is this Information Sheet about?

This Information Sheet provides guidance for academies, free schools, 16 to 19 academies, alternative provision academies and university technology colleges for 14 to 19 year olds following the introduction of section 33B VAT Act 1994.

Clause 75 of the Finance Bill 2011 inserted a new section 33B (section 33B) into the VAT Act 1994, which will (from the date of Royal Assent to the Bill) refund the VAT incurred by proprietors of academies in certain circumstances.

This Information Sheet explains how the scheme will operate and which bodies will benefit from it.

Academies and VAT

What is the VAT treatment of education taught in academies?

Education is taught to pupils of academies for no consideration. Consequently no supply takes place for VAT purposes and the activity is outside the scope of VAT. For further information on the VAT treatment of the activities of academies, including the goods and services they supply to their pupils, please see [Notice 701/30 Education and vocational training](#).

Can academies recover the VAT paid on the goods and services they purchase in relation to their provision of free education?

Ordinarily VAT cannot be recovered on purchases, acquisitions or imports made in relation to non-business activities, such as the provision of free education. However, from the date of Royal Assent to the Finance Bill (probably in July) a VAT Refund Scheme was enacted which allows academies to recover the VAT incurred on those goods and services that they purchase, and on those goods that they acquire from another Member State or import, which are used in connection with the education they teach for no consideration. They can also recover the VAT incurred on purchases, acquisitions and imports which are used for any other non-business activities. The legal basis is in section 33B of the VAT Act 1994.

When does this refund mechanism apply from?

From the date of Royal Assent to the Finance Bill academies can recover the VAT referred to in paragraph 3 above retrospectively from 1 April 2011. Adjustments for VAT not claimed from 1 April 2011 are, of course, subject to the normal time limits for claiming (as of the date of this Information Sheet, four years). The refund scheme does not extend to VAT incurred by academies on goods and services purchased before 1 April 2011.

Academies that received a VAT grant previously will continue to do so as an interim measure until the new scheme is in place.

HM Revenue & Customs (HMRC) are unable to accept claims from academies until after Royal Assent. New academies that incur expenditure before Royal Assent, and cannot manage this within their wider budgets, should contact the Young People's Learning Agency (YPLA).

What is not covered by the VAT refund mechanism?

The refund scheme does not cover (and therefore does not refund):

Any VAT that cannot be recovered because of the block in section 25(7) of the VAT Act 1994. This is presently the case for cars and certain business entertainment (please see Notice 700 The VAT Guide).

Any VAT incurred on purchases, acquisitions or imports relating to an Academy's business activities. This VAT is only recoverable subject to the normal rules relating to recovering VAT.

Any VAT incurred on purchases made outside the UK (for example, French TVA). In certain circumstances this can be reclaimed from the authorities in the EU Member State in which the VAT was incurred (please see [Notice 723A: Refunds of VAT in the EC](#)).

What are the normal rules relating to VAT recovery?

If you are VAT registered you can recover VAT incurred on your purchases made to support the supplies you make which are either subject to VAT (currently 20 per cent or 5 per cent) or are zero-rated. This is referred to as 'input tax'. So, for example, a business selling stationery (subject to VAT at 20 per cent) can recover the VAT (input tax) paid on the purchase of these goods for sale.

In principle VAT cannot be claimed on purchases made to support the making of VAT exempt supplies unless the amount is small, referred to in VAT guidance as 'de minimis'.

This is a complex area of VAT which requires careful consideration and you may wish to seek professional help.

Further guidance can be found in [Notice 706 Partial exemption](#).

What happens where a purchase, acquisition or importation relates to both the business and non-business activities of an academy?

Where goods or services are purchased (or goods are acquired or imported) for both the business and non-business use of an academy, a fair and reasonable apportionment should be made so as to only recover:

the proportion that can be recovered under the VAT refund mechanism

the proportion that can be recovered under the normal VAT rules for recovering input tax

If an academy does not do this, the law gives HMRC the power to make a suitable apportionment.

What is meant by an academy for the purposes of the VAT refund mechanism?

The scheme is confined to England because its rationale is to ensure the same VAT treatment for academies as applies to Local Authority maintained schools which can recover VAT under section 33 of the VAT Act 1994. The same need does not apply elsewhere in the UK.

An academy is one which is defined in section 579 of the Education Act 1996 (as amended). These are academies which teach pupils up to the age of 19, 16 to 19 academies and alternative provision academies. It could be a new academy, an existing academy or a school which becomes an academy (but only from the time where this formally happens).

The 'free schools' which parents, teachers and others are encouraged to establish are academies.

Who can make the VAT claim?

The claim must be made by the proprietor of an academy acting in that capacity. If the academy is registered for VAT, the VAT claimed under the VAT refund mechanism should be included with the input tax to be reclaimed.

If the academy is not registered for VAT, it should write to the following address in order to make claims under a simplified arrangement using a form that will be issued individually:

HM Revenue & Customs Banking/GABS 7th Floor SW Alexander House 21 Victoria Avenue Southend-on-Sea SS99 1AU

An academy that is not registered for VAT can only claim VAT incurred on purchases acquisitions and imports made in relation to their non-business activities. Other VAT is irrecoverable.

If you have any questions about this change, please contact the VAT Helpline on Tel 0845 010 9000.

In complex circumstances, including where large sums are at issue, an academy may wish to seek independent advice from an appropriately qualified specialist.

How can I claim refunds I am entitled to?

Apply in writing, please see paragraph 2.8 above.

Make sure your claim relates to a period of at least one month.

Make sure the period you choose ends on the last day of the calendar month.

Keep invoices and other records to support your claims for six years, unless HMRC agrees in writing to a shorter period.

If you obtain refunds by Bankers' Automated Clearing Services (Bacs), inform us of any changes to the details of your bank account.

Please note these are the current rules and may be subject to change.

What is the time limit for making a claim?

VAT should be claimed by VAT-registered academies in the VAT accounting period in which it has been incurred. However, this is subject to a four year time period for claiming, after which the VAT cannot be claimed at all. Neither can VAT be claimed on VAT incurred on purchases, acquisitions or imports before 1 April 2011.

Academies which are not registered for VAT will normally claim annually, or more frequently as agreed by HMRC. Again, the four year time period for making a claim applies.

Frequently Asked Questions

How do schools currently reclaim VAT costs?

The majority of public sector education is provided by schools which are under Local Authority control. Schools incur VAT costs on the goods and services they buy but Local Authorities (LAs) are able to recover the schools' input VAT under the public bodies VAT refund regime found in section 33 of the VAT Act 1994.

The fact that schools are not generally engaged in business activity for VAT purposes means that they cannot recover this input VAT by setting it off against output VAT charged on the supplies which they make. This input VAT is therefore borne by the schools.

How do academies currently reclaim VAT costs?

Academies are outside Local Authority control and are therefore unable to access the section 33 refund regime. To date the Treasury has provided funding to the Department for Education (DfE) to enable DfE to provide grants to academies to cover the irrecoverable VAT which they incur. However as the number of academies is increasing rapidly, it is preferable for the academies to obtain direct refunds of irrecoverable VAT, rather than indirectly via DfE.

What will academies be able to reclaim under the VAT Refund Scheme?

Academies that are not VAT registered will be able to reclaim their non-business VAT costs, subject to certain exceptions directly from HMRC - see paragraph 2.5 above.

What is defined as 'non-business' income?

There are a number of guiding principles that an academy can use to help in deciding whether something is a business activity or a non-business activity. Examples of non-business activities that are generally outside the scope of VAT include:

receiving income from purely voluntary donations where nothing is given in return

receiving grant funding where nothing is supplied to the funding body in return

activities where an organisation doesn't make a charge

Therefore, grant income from DfE provided to academies for the provision of free (non-fee paying) education and closely related supplies will still qualify to be treated as non-business income.

Academies will be providing free educational activities and services without a charge. This is defined as a non-business activity and under the VAT Refund Scheme the VAT incurred on goods and services, and on those goods acquired from another member state or imported, which are used in connection with that activity will be refunded.

What is 'business activity'?

Business has a very wide meaning for VAT purposes. The underlying reason for an activity, and the question of whether or not it is undertaken in order to make profit, do not of themselves determine whether it is undertaken by way of business. The courts have given guidelines which apply the following six criteria:	Question
1.	Is the activity a serious undertaking earnestly pursued?
2.	Is the activity an occupation or function, which is actively pursued with reasonable or recognisable continuity?
3.	Does the activity have a certain measure of substance in terms of the quarterly or annual value of taxable supplies made? (Bearing in mind that exempt supplies can also be business)
4.	Is the activity conducted in a regular manner and on sound and recognised business principles?
5.	Is the activity predominately concerned with the making of taxable supplies for a consideration?

6.	Are the taxable supplies that are being made of a kind which, subject to differences of detail, are commonly made by those who seek to profit from them?
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From this it follows that the community use of an academy's premises, for example, an academy may be charging an external organisation to use a sports facility during out-of-school hours, is very likely to be regarded as a business activity.

Academies will want to check HMRC guidance carefully in determining what their business and non-business activity is. For example, 'Business activity' is defined in paragraph 4.1 of the [VAT Notice 701/1 Charities](#).

What happens where a purchase, acquisition or importation relates to both business and non-business activities of an academy?

Where an academy is VAT registered a fair and reasonable apportionment should be made to ensure only the proportion that can be recovered under the refund scheme is claimed and the proportion that can be recovered under the normal VAT rules is identified and claimed.

Where an academy is **not** VAT registered a fair and reasonable apportionment should be made to ensure only the proportion that can be recovered under the refund scheme is claimed.

Which types of school will be included in the measure?

Any existing school in England that becomes an academy, or a new academy. The measure will also apply to any free schools in England, which are legally new academies. It will also apply to all existing English academies. Such academies do not exist elsewhere in the UK, so the scheme only applies in England. Non-state funded independent schools are not covered by the scheme.

An academy school is one which has entered into an agreement with the Secretary of State under Section 482 of the Education Act 1996 or into academy arrangements with the Secretary of State under Section 1 of the Academies Act 2010.

Academies are defined in section 579 of the Education Act 1996 (as amended) and are:

academy schools which teach pupils up to the age of 16 years

16 to 19 years academies

alternative provision academies

free schools which parents, teachers and others are encouraged to establish fall within the description of an academy school

Who can make the claim?

The **Proprietor** of an academy, acting in that capacity, can make a claim.

A 'proprietor' is defined in section 33B Para 8 a) and b) and has the same meaning as in the Education Act 1996 section 579.

In relation to a school, 'Proprietor' means the person or body of persons responsible for the management of the school so that, in relation to academies and free schools it may be the Head Teacher or Governing Body.

Why won't independent sixth form or further education colleges be included?

This measure is to ensure continuity of funding for schools leaving Local Authority control to become academies, to ensure academies are not put at a disadvantage and to fund existing academies' VAT costs in a more efficient way. This measure will mean that schools leaving Local Authority control can continue to recover VAT on their non-business activities, which was previously recovered by the Local Authority. The refund scheme will not provide any additional funding through the VAT system.

But what if an academy school has its own sixth form?

If an academy school catering to GCSE level also has its own sixth form (which is an integral part of the school) then the non-business VAT incurred in providing free education to the sixth form will be recoverable through the new refund scheme.

Why are voluntary aided schools not included?

The refund scheme is being introduced to address an issue that is specific to academies. Voluntary Aided (VA) schools have always had the VAT element of their revenue costs refunded via the Local Authority. But VA schools remain responsible in law for their own buildings and land and have not previously had the VAT element of their capital costs refunded. This is taken into account by adding an allowance for VAT in capital funding to VA schools. These institutions will be no better or worse off than before.

In broad terms, what will this mean for an academy?

From the date of Royal Assent, an academy will be able to claim back input VAT (in this instance VAT on revenue and capital expenditure) incurred to support their non-business activity from HMRC. This non-business activity includes the supplies that an academy receives to deliver free education services. Once the law has effect, the ability to reclaim this VAT will be backdated to include VAT incurred on goods and services supplied to an academy on or after 1 April 2011.

What will happen to the VAT grant that an academy currently receives from the YPLA?

The VAT grant to academies ceased as of 31 March 2011. However academies that were established before this date, and so received the VAT grant, will continue to receive a VAT grant loan from YPLA to cover the period April - September 2011, after which academies will be able to reclaim their VAT costs directly from HMRC. The VAT grant loan will be recovered in full by YPLA by March 2012.

What if an academy's cash flow depends on being able to recover any VAT paid monthly? Will this still be possible?

A VAT-registered academy may request to submit their VAT Returns monthly (so they would send to HMRC 12 returns in a year). Normally returns are completed on a quarterly basis and in the absence of anything else this is the default position. The return shows the VAT accounting period and the date by which that return is due to be with HMRC; this is normally one month after the end of the accounting period. Returns can be submitted online and that will become the only way to submit a Return.

Academies that are not required to register for VAT can submit their section 33B claim in accordance with paragraphs 2.8 and 2.9 above.

There are some special points to note concerning submission of returns:

The first return may be for an irregular period and thereafter returns will either be required on a quarterly, or if allowed monthly, basis. You should check the accounting period shown on the return and the date by which the return is due.

HMRC reserves the right to check a return before paying the amount claimed, and this is likely to be the position with the first returns.

If an academy is already registered for VAT, will this scheme mean that any changes are required to these arrangements?

No changes are required if the legal entity remains the same. VAT claimed under the scheme will be included in box 4 on the return. It is possible that HMRC may check to see why there has been an increase in VAT being claimed.

Will an academy need to be VAT registered to be eligible for the new refund scheme?

No, an academy does not need to be VAT registered unless its taxable turnover exceeds the registration threshold (£73,000 per annum from 1 April 2011). However, the easiest way to recover non-business VAT is on the return so an academy may wish to register voluntarily. To do so, an academy must make some taxable supplies of goods or services by way of business, such as the sale of school uniform. If an academy does not make any business supplies it cannot be registered for VAT. Each academy will want to consider its own position and individual circumstances.

How much time will an academy need in order to register for VAT? What is the process that they will have to follow?

To register for VAT, an academy will need to complete HMRC's registration process. The registration form (VAT 1) and guidance notes are available from HMRC's website.

You may also wish to register for online VAT services. Further information on how to register and available services can be found on the [Register for HMRC Online Services webpage](#).

It can often take some time for an application for registration to be considered, so academies should do this as soon as possible.

What if an academy is not required to be VAT registered or is ineligible to do so?

If an academy is not required to register for VAT, separate arrangements will be made by HMRC for an academy to provide the required information and receive a VAT refund. This will likely include an academy submitting a list of their expenditure on goods and services relating to non-business activities to HMRC using a simplified claim form. Such claims should be made no more than once a month.

This procedure does not, however, facilitate the recovery of any other VAT that an academy may pay. This measure will be to facilitate the recovery of VAT incurred against non-business activities only. Any VAT incurred against business activities will not be recoverable by an academy that is not VAT registered.

Also, non-registered academies will still need to maintain records as they may be required to submit evidence to HMRC at any stage.

An academy that does not submit returns and makes a claim to recover VAT relating to non-business activities may have to wait longer because the procedure is different and the claim may need to be checked by HMRC.

What extra work will this create for an academy?

Returns, including simplified claims, are furnished to HMRC without any supporting documentation. However HMRC may from time to time need to check them.

This means that an academy will need to maintain relevant accounting records to isolate VAT costs to support any VAT reclaims and make them available to HMRC on request. However, these records will not necessarily be additional to the records already kept in the day-to-day running of an academy other than the inclusion of a VAT account, which summarises the build-up of the figures on the return form.

But what about the exact record keeping requirements?

Any academy must keep proper accounting records for its own benefit. These can be used to calculate the return, meaning there should be few additional accounting burdens. The record keeping requirements should be no more extensive than currently required by the YPLA and the return process itself is largely automated. Any school that is VAT registered will have to follow the rules for VAT, such as producing VAT invoices and keeping a VAT account.

What about breakfast clubs or after-school activities for children?

Generally, any activities run by a school for the benefit of its pupils between 8.00 am and 6.00 pm are regarded as being part of the provision of free education. Therefore, any VAT incurred in providing these activities will be recoverable under the refund scheme.

Can academies still access the Assisted Instruments Purchase Scheme (AIPS)?

This is a scheme run by Local Authorities using approved musical instrument suppliers.

What is defined as 'taxable business supplies' and 'taxable turnover'?

Taxable supplies of goods and services are those which are subject to the standard rate (currently 20 per cent), a reduced rate (currently 5 per cent) or a zero rate. Supplies which are exempt from VAT are not classed as 'taxable supplies'. Some very general examples, which are not necessarily authoritative since different situations may produce a different outcome:

Sales of printed books are zero-rated

Sales of school uniforms are zero-rated irrespective of size for certain garments which are items of official uniform for schools whose pupils are all under 14 years old. However, beyond this there is no general relief for school uniforms, and the usual size criteria apply.

Sales of sports equipment are standard rated (20 per cent).

Sales of CDs are standard rated (20 per cent).

Sports tuition by an academy in return for payment (for example to the wider community) is exempt from VAT.

Letting out classrooms after school hours to an adult education provider is likely to be exempt from VAT.

The structure of VAT is that generally goods and services supplied for consideration by a VAT-registered person are taxed at the standard rate unless they are specifically relieved through a reduced rate, a zero rate or an exemption.

Taxable turnover is the turnover in an expected (or actual) 12 month period from supplies of goods and services which would be taxable supplies. When these reach the VAT registration threshold (£73,000 from 1 April 2011) in a 12 month period or less, a person must register for VAT.

Will an academy be able to recover VAT incurred on the construction or refurbishment of buildings?

Yes, to the extent that the building relates to non-business activity - but only in relation to supplies of goods and services received on or after 1 April 2011.

Recovery of VAT depends on the use to which the building is put. This measure only allows recovery relating to expenditure on non-business activities, which will include the building work and normal maintenance of an academy being used for the provision of free education.

Will a refund of VAT costs be possible where a capital project is funded by other sources (eg sponsor contributions or private contributions raised in other ways) or where public funds from other sources are applied to a project?

Unfortunately there is no single answer to this question as different models may produce different outcomes. The general expectation is that VAT incurred on purchases made from grant funding and donated funds freely given will be recoverable to the extent that the asset is used for a non-business purpose. However it is necessary to exercise caution because the VAT implications of arrangements may not always be obvious.

Will newly converted academies be able to claim for VAT on ongoing capital work?

This depends on who holds the contract from the date of conversion. If the contract for the building works remains with the Local Authority, then the authority can claim VAT back in the usual way. Where the contract has been formally transferred to the academy or academy trust, then a refund will only be possible after the new scheme is in place, and only for expenditure incurred after 1 April 2011 subject to qualifying use, each case must be considered based on the specific contractual arrangements in place and how the building will be used. Where a qualifying building is transferred to an academy and a zero rating certificate has been issued by the transferor the transferee must also issue a certificate provided the conditions for issuing such a certificate are met. You may wish to take advice to ensure the certificate is correctly issued because there are penalties for incorrectly issued certificates.

Will an academy that is undergoing capital works and is buying services from the Local Authority to complete this be able to reclaim VAT, or obtain zero rating for the project?

This will depend on the nature of the project. Zero rating only applies where the project is a new build, and will involve less than five per cent community use once it is completed and the appropriate certificate is correctly issued. If an academy is charged VAT it can be claimed from HMRC provided it relates to non-business activities.

Can an academy obtain zero rating on a project where the build will have significant community use?

If the amount of use for a non-business purpose is less than 95 per cent, the construction of the building would not qualify for the zero rate. However, if the use for a business purpose is restricted to a particular part of the building and the rest of the building is intended to be used solely for a non-business purpose, the construction of the latter part would qualify for the zero rate.

Will schools that have ongoing capital works under the Building Schools for the Future Scheme have to pay VAT if they convert to become academies?

HMRC is looking at this issue in conjunction with the Department for Education, and will update this document once an answer is confirmed.

What about academies with boarding provision? Are the related goods and services treated as non-business activity?

Provided boarders receive non business education, at the academy where they board and any charge for boarding is at or below cost the provision of boarding is also non-business.

Can academies reclaim the VAT charged on buying in catering services?

The provision of catering charged at or below cost to the pupils of an academy is related to the non-business education provided to them; therefore, VAT will be recoverable.

Is there a minimum level beneath which business and non-business VAT refund claims need not be split?

HMRC is unable to agree to a minimum level, as legislation only allows for recovery of non-business VAT, regardless of the amount. If there is some VAT on business activities then there are separate rules for this, and academies may or may not be able to reclaim it - but academies are required to keep records to show the division between the two, and to show which claims relate to which activities. What HMRC will be looking for is an apportionment calculation that produces a fair and reasonable result, accurately reflects business/non-business use and that can be carried out and checked without undue difficulty or cost.

Can an academy submit a monthly return before September 2011?

Once these proposals become law, claims can be backdated to take into account supplies received on or after 1 April 2011 and this should form a part of the total VAT claimed on the next available return or simplified claim.

So, assuming the law takes effect in July and the next return an academy has to complete is for a period ending on 31 August - the academy would calculate all of the non-business VAT costs to be claimed from 1 April 2011 to 31 August 2011 and include the whole amount on the August return. There is no need to split the figure into months or quarters on the return itself, even though this will probably have been completed as part of an academy's internal records.

Who can I contact for further information?

If you have a query for which you have been unable to find the answer within this VAT Information Sheet please contact the VAT Helpline on Tel 0845 010 9000

The Helpline is available from 8.00 am to 6.00 pm, Monday to Friday.

If you have hearing difficulties, please ring the Textphone service on 0845 000 0200

Appendix G – Revenue & Customs Brief 53/09

VAT Recovery by Local Authorities under section 33 VAT Act 1994 in respect of voluntary aided schools

This Revenue and Customs Brief explains our revised policy on VAT recovery by Local Authorities on expenditure relating to capital works at voluntary aided schools.

Background

Under Section 33 of VAT Act 1994 ('Section 33') specified bodies, including Local Authorities, are entitled to recover VAT incurred on supplies made to them which relate to their non-business activities. Their provision of free education in state maintained schools is one such non-business activity.

However, governing bodies of maintained schools are separate legal entities and are not bodies specified in Section 33. Therefore any VAT they incur in relation to their non-business activities is not recoverable.

Where the Local Authority has a statutory duty to 'defray' all expenses of maintaining a school, for example, community schools, then any VAT incurred on purchases made by it in connection with these schools is recoverable under Section 33.

However, in the case of voluntary aided schools the governing body retains statutory responsibility for certain capital expenditure, including when made from the school's delegated budget. Therefore, in respect of any supplies which fall within the prescribed definition of such expenditure, the supply will be made to the governing body, even where the expenditure is met from the school's delegated budget, and VAT incurred may not be recovered by the Local Authority. Governing bodies in England receive funding from the Department for Children, Schools and Families (DCSF) of up to 90 per cent of the cost of meeting these responsibilities (and there are similar arrangements in place in the devolved administrations).

Capital expenditure for which the governing body of a voluntary aided school is responsible is defined by DCSF as expenditure relating to:

- the existing buildings (internal and external)
- those buildings previously known as 'excepted' (kitchens, dining areas, medical/dental rooms, swimming pools, caretakers' dwelling houses)
- perimeter walls and fences, even if around the playing fields
- playgrounds
- furniture, fixtures and fittings – including ICT infrastructure and equipment
- other capital items (which can include capital work to boilers or other services)

Revised policy

A Local Authority is allowed to contribute funding to a governing body to help it meet the cost of its responsibilities. We have to date accepted that Local Authorities can recover the VAT incurred on expenditure which is the responsibility of the governing bodies but which the authority funds. This is explained in Public Notice 701/30 paragraph 15.5 and 'V1-14: Government and public bodies' and 'V1-07 chapter 21; Education'.

We have reviewed this policy, and we now realise that it goes beyond what Section 33 actually permits. Section 33 is confined to VAT incurred by Local Authorities etc on the goods and services that they purchase, not on the goods and services that another legal entity purchases. Therefore, with effect from 1 September 2009, with respect to projects initiated after this date, VAT may no longer be recovered by Local Authorities in these circumstances, as the supplies are not made to them (whether or not paid for from the delegated budget). We will consider, on their individual facts, cases where a project initiated after 1 September 2009 was funded on the basis of the previous policy.

A Local Authority may, however, continue to recover VAT on expenditure at a voluntary aided school for which the Local Authority is statutorily responsible, or where the Local Authority, rather than the governing body, procures a supply of works and pays for that supply from its own funds (for further details please refer to Public Notice 749 Local Authorities and similar bodies paragraph 7.1). In such cases HMRC accept that the Local Authority receives the supply in connection with its non business activities.

What next?

Guidance currently contained in Public Notice 701/30 paragraph 15.5 and 'V1-14: Government and public bodies' and 'V1-07 chapter 21; Education' will be amended to take account of this revised policy.

If you have any queries in relation to this, or any other tax matter, please contact the National Advice Service on Tel 0845 010 9000.

Issued 17 August 2009

Appendix H – Definition of Academies – Section 579 Education Act 1996 (as amended)

In section 579(1) (general interpretation of Act):

“Academy” means a school to which Academy arrangements relate;

“Academy arrangements” has the meaning given by section 1 of the Academies Act 2010;

“Academy order” means an order under section 4 of that Act;”.

Section 1 of the Academies Act 2010 defines “Academy arrangements” as an agreement between the Secretary of State and the other party under which:

The other party gives the undertakings in subsection (5); and

The secretary of State agrees to make payments to the other party in consideration of those undertakings.

The undertakings required under subsection (5) are broadly to establish and maintain an independent school in England which has a curriculum satisfying the requirements of section 78 of EA 2002, to provide education for pupils of different abilities, to provide education for pupils who are wholly or mainly drawn from the area in which the school is situated.

Appendix I – Eligible Bodies for the Purposes of Providing Exempt Education

An 'eligible body' for the purposes of providing exempt education comprises any of the following:

Schools

A school within the meaning of Education Act 1996, Education (Scotland) Act 1980, Education and Libraries (Northern Ireland) Order 1986 (SI 1986/594) or Education Reform (Northern Ireland) Order 1989 (SI 1989/2406) which is:

- i. Provisionally or finally registered (or deemed to be registered) as a school within the meaning of that legislation in a register of independent schools;
- ii. A school in respect of which grants are made by the Secretary of State to the proprietor or managers;
- iii. A community, foundation or voluntary school within the meaning of the School Standards and Framework Act 1998, a special school within the meaning of Education Act 1996, s 337 or a maintained school within the meaning of Education and Libraries (Northern Ireland) Order 1986;
- iv. A public school within the meaning of Education (Scotland) Act 1980, s 135(1);
- v. A grant-maintained integrated school within the meaning of Education Reform (Northern Ireland) Order 1989, Art 65.

Universities

A UK university, and any college, institution, school or hall of such a university, but excluding any subsidiary companies that universities and colleges set up to pursue commercial business.

Further and Higher Education

An institution:

- i. Falling within Further and Higher Education Act 1992, s 91(3)(a) or (b) or s 91(5)(b) or (c);
- ii. Which is a designated institution as defined in Further and Higher Education (Scotland) Act 1992, s 44(2);
- iii. Managed by a board of management as defined in Further and Higher Education (Scotland) Act 1992, s 36(1); or
- iv. To which grants are paid by the Department of Education for Northern Ireland under Education and Libraries (Northern Ireland) Order 1986, Art 66(2).

Public Bodies

A Government department or Local Authority (or a body which acts for public purposes and not for its own profit and performs functions similar to those of a government department or Local Authority), this includes executive agencies and Health Authorities.

Non-Profit Making Organisations

A body which:

- Is precluded from distributing and does not distribute any profit it makes; and

-
- Applies any profits made from exempt supplies of education, research or vocational training to the continuance or improvement of such supplies.

Teaching English as a Foreign Language

A body, not falling within the above categories which provides the teaching of English as a foreign language.

Appendix J – Example case studies

These high level case studies are intended to illustrate the issues and potential solutions in a typical BSF programme. They are not intended to provide definitive advice.

Case study 1

Somewhereborough Council (“the Council”) is a Unitary authority delivering the usual range of services.

The Council typically incurs £24million of VAT per year of which approximately £1.1m (4.5%) relates to exempt activities. The Council is therefore below its 5% partial exemption de minimis limit and thus recovers the £24million in full

The Council has 15 LEA schools and 1 VA school. The Council is receiving £50million under BSF which it has allocated as follows –

<i>School</i>	<i>Cost</i>		<i>Works</i>
A1 secondary school	£10m	£2m VAT	New school
Conventional contract	£5m	£1m VAT	New sports facility
Other schools	£15m	£3m VAT	Refurbishment of schools
Conventional contracts	£5m	£1m VAT	Refurbishment of sports facilities
St John’s VA school	£10m	£2m VAT	New school
Conventional contract	£5m	£1m VAT	New sports facility
A2 secondary school	£4m	£800k VAT	Refurbishment
PFI contract	£4m	£800k VAT	New sports facility
£1m per annum unitary charge			

Once completed the Council intends to utilise the new facilities for community use outside of normal school hours. This will include adult education, lettings to third parties and hire of sports facilities. With the exception of the A1 and A2 secondary schools the Council estimates that the use of the school buildings will include fee paying adult education (1%) and room/facilities hire (1%).

The A1 and A2 secondary schools are much more community facing and the Council estimates the usage as follows.

A1/A2 secondary school building	
Core school use	90%
Adult education (fee paying) evenings, weekends and holidays	5%
Lettings of class rooms/hall to community groups etc...	5%
A1/A2 secondary sports facilities	
Core school use	50%
Club block bookings	35%
Private hire/individuals	5%
Coaching sessions/lessons (fee paying)	10%

For the purposes of this study it has been assumed that all of the costs are incurred in the same financial year.

VAT implications

All of the conventional contracts will be managed by the LEP under design and build contracts. The value of the contracts means that the LEP will be obliged to register for VAT. The design and construction sub contractors will charge VAT to the LEP on their respective services. The LEP will be entitled to recover the VAT that it incurs on the basis that it makes an onward taxable supply of services to the Council. The LEP will charge and account for VAT on its services to the Council. Therefore, VAT should not fall to be a cost for the LEP.

With regard to the PFI contract, the SPV incurs all of the construction costs along with the hard and soft facilities management charges and the LEP management charges (all subject to VAT). In order to recover the VAT that it incurs, the SPV must make only taxable supplies to the Council. Therefore, to avoid any potential challenge by HMRC that an element of the unitary charge relates to an interest in land and thus should be exempt, the SPV opts to tax its interest in the school/sports facilities. As with the LEP, VAT should not fall to be a cost for the SPV.

If managed correctly, all of the VAT and associated complications ultimately flow through the LEP and the SPV to the Council

In this scenario there are 2 key areas on which the Council must focus. The first is the capacity in which the Council receives the funding for the VA school. The second and always most significant, is the impact on the Council's partial exemption calculation.

Based upon current agreements with HMRC, the Council will be entitled to recover the VAT that it incurs on the costs of the VA school works providing it meets the conditions set out in Section 12 of this report.

However, if the Council is simply receiving the funding as agent of the VA school then the VAT will not be recoverable. Alternatively, the Council may be entitled to recover the VAT if it makes an onward charge (plus VAT as appropriate) to the VA school. Either way, the VAT then becomes an issue for the VA school. For the purposes of this particular study it is assumed that the Council is entitled to recover the VAT.

Turning to the second key issue, the Council must ascertain whether, having incurred all of the VAT on the costs of the BSF programme, it will remain below its partial exemption de-minimis limit.

Based upon the level of VAT typically incurred in a year, plus the additional VAT resulting from the BSF programme, the Council can project what it believes will be its 5% de-minimis limit for the year.

Typical VAT incurred	£24m
A1 secondary school	£3m
Other schools	£4m
St John's VA school	£3m
A2 secondary school	£0.200m – annual unitary charge only
New Total Liability	£34.2m
New de-minimis limit (5%)	£1.71m

Of the £24m VAT typically incurred, £1.1m is already identified as attributable to exempt activities. Therefore, providing that no more than an additional £610k of VAT is considered to relate to exempt activities then the Council will remain below its partial exemption de-minimis limit and all of the VAT will be recoverable.

The required level of analysis of the exempt use of the schools and their sports facilities will vary significantly from one Local Authority to another depending upon how easily it can be demonstrated that the partial exemption de-minimis limit will not be exceeded.

For the purposes of this study each BSF funded development will be considered in turn.

A1 secondary school - new build school and sports facility

VAT incurred - £2m school, £1m sports facility

The exempt use of the school amounts to 10% overall i.e. the fee paying adult education and the room and hall lettings. Therefore in principle, the worst case scenario is that 10% of the VAT incurred on the cost of the school is attributable to exempt activities and needs to be included in the partial exemption calculation – 10% of £2m equals £200k.

The exempt use of the sports facility amounts to 45% overall i.e. the club block bookings and the coaching. Therefore in principle, the worst case scenario is that 45% of the VAT incurred on the cost of the sports facility is attributable to exempt activities and needs to be included in the partial exemption calculation – 45% of £1m equals £450k.

A2 secondary school – PFI refurbished school and sports facility

VAT incurred on unitary charge (say split 50:50) - £100,000 school, £100,000 sports facility

As above, the exempt use of the school amounts to 10% overall. Therefore in principle, the worst case scenario is that 10% of the VAT incurred on the cost of the school is attributable to exempt activities and needs to be included in the partial exemption calculation – 10% of £100k equals £10k.

The exempt use of the sports facility amounts to 45% overall. Therefore in principle, the worst case scenario is that 45% of the VAT incurred on the cost of the sports facility is attributable to exempt activities and needs to be included in the partial exemption calculation – 45% of £100k equals £45k.

The St John's VA school - new build school and sports facility

VAT incurred - £2m school, £1m sports facility

As the VAT is attributable to the non-business transfer of the completed facilities to the Governors of the VA school, there is no exempt supply and thus no impact upon the partial exemption calculation.

Remaining schools

VAT incurred - £4m

The exempt use of the facilities amounts to 2% overall. Therefore in principle, the worst case scenario is that 2% of the VAT incurred on the costs is attributable to exempt activities and needs to be included in the partial exemption calculation – 2% of £4m equals £80k.

Summary

VAT on BSF costs associated with exempt activities (£200k+£450k+£10k+£45k+80k)	£785k
VAT on costs relating to wider exempt activities	£1.1m
Total VAT attributable to exempt activities	£1.885m
De- minimis limit (5%)	£1.71m

The Council will therefore be partially exempt if it does not take steps to minimise exempt activity and will face an irrecoverable VAT cost of £1.885m.

Possible solutions

The Council must reduce the VAT attributable to exempt activities by at least £175k in order to avoid being partially exempt. There are potentially a number of steps that the Council can take.

1 Opt to tax the A1 Secondary school

Opting to tax the A1 Secondary school buildings will result in the following supplies becoming subject to VAT i.e. no longer exempt –

- School building – lettings of class rooms/hall (5%)
- Sports facilities – club block bookings (35%)

As a result, the partial exemption position for the A1 Secondary School would change as follows -

- The exempt use of the school amounts to 5% overall i.e. the fee paying adult education. Therefore in principle, the worst case scenario is that 5% of the VAT incurred on the cost of the school is attributable to exempt activities and needs to be included in the partial exemption calculation – 5% of £2m equals £100k, a reduction of £100k.
- The exempt use of the sports facility amounts to 10% overall i.e. coaching. Therefore in principle, the worst case scenario is that 10% of the VAT incurred on the cost of the sports facility is attributable to exempt activities and needs to be included in the partial exemption calculation – 10% of £1m equals £100k, a reduction of £350k.

The total reduction in VAT that is attributable to exempt activities is £450k. Therefore, under this option the Council would avoid being partially exempt. Furthermore, it is evident that the Council could also avoid being partially exempt by opting to tax only the Sports facilities. This would only be possible if the Sports facilities were not connected to the School buildings.

The impact of opting to tax means that the Council must charge VAT on services which otherwise would be exempt from VAT. Therefore, having opted to tax, the Council must either increase its charges to reflect the VAT charged or absorb the VAT itself. This is a commercial decision for the Council.

As previously stated it is unlikely that many of the users of the Sports facilities will be in a position to recover any VAT charged by the Council. Therefore the addition of VAT to the charges would represent a real cost to the users.

1a Adopt a specific booking policy at the A1 Secondary school Sports facilities

By adopting a booking policy that prevents any potential user qualifying for exemption under the block booking conditions it is possible to achieve the exact same result in respect of the Sports facilities in 1 above, without opting to tax.

This is particularly advantageous where the School buildings are connected to the Sports facilities as it does not impact upon the non sports lettings in the School building.

2 Opt to tax the A2 Secondary school

Opting to tax the A2 Secondary school buildings will result in the following supplies becoming subject to VAT i.e. no longer exempt –

School building – lettings of class rooms/hall (5%)
Sports facilities – club block bookings (35%)

As a result, the partial exemption position for the A2 Secondary school would change as follows -

- The exempt use of the school amounts to 5% overall i.e. the fee paying adult education. Therefore in principle, the worst case scenario is that 5% of the VAT incurred on the cost of the school is attributable to exempt activities and needs to be included in the partial exemption calculation – 5% of £100k equals £5k, a reduction of £5k.
- The exempt use of the sports facility amounts to 10% overall i.e. coaching. Therefore in principle, the worst case scenario is that 10% of the VAT incurred on the cost of the sports facility is attributable to exempt activities and needs to be included in the partial exemption calculation – 10% of £100k equals £10k, a reduction of £35k.

The total reduction in VAT that is attributable to exempt activities is £40k. Therefore, in isolation, this option would not avoid the Council being partially exempt.

As a PFI contract, the level of VAT incurred is considerably less as it relates to an annual unitary charge as opposed to a one off capital cost. The impact of the PFI project on the Council's partial exemption calculation is less significant. Therefore any option to tax will also have less impact on the partial exemption calculation but

will still result in exactly the same issues regarding the commerciality of charging VAT to the users of the facilities.

2a Adopt a specific booking policy at the A2 Secondary school Sports facilities

As per 1a above an alternative is to adopt an appropriate booking policy to avoid the block bookings being exempt.

3 Opt to tax the remaining schools

Opting to tax the remaining school buildings will result in the following supplies becoming subject to VAT i.e. no longer exempt –

School building – lettings of class rooms/hall (1%)

As a result, the partial exemption position for the remaining schools would change as follows -

The exempt use of the school amounts to 1% overall i.e. the fee paying adult education. Therefore in principle, the worst case scenario is that 1% of the VAT incurred on the cost of the school is attributable to exempt activities and needs to be included in the partial exemption calculation – 1% of £4m equals £40k, a reduction of £40k.

Again, in isolation, this option would not avoid the Council being partially exempt.

4 If possible, cease charging for certain activities e.g. adult education and or coaching

By ceasing to charge, the supply of adult education and coaching become non-business activities. Although from a commercial perspective, not charging may seem like a bad idea, the impact of not charging what may be a relatively small amount could have a significant impact upon the partial exemption calculation. By not charging the VAT attributable to exempt activities would be reduced as follows -

- A1 Secondary school

School building (£2m VAT), 5% adult education becomes non-business therefore the VAT attributable to exempt activities is reduced by £100k.

Sports facilities (£1m VAT), 10% coaching becomes non-business therefore the VAT attributable to exempt activities is reduced by £100k.

- A2 Secondary school

School building (£100k VAT), 5% adult education becomes non-business therefore the VAT attributable to exempt activities is reduced by £5k.

Sports facilities (£100k VAT) - 10% coaching becomes non-business therefore the VAT attributable to exempt activities is reduced by £10k.

- *Remaining schools*

School building (£4m VAT) - 1% adult education becomes non-business therefore the VAT attributable to exempt activities is reduced by £40k.

Conclusion

The partial exemption issues can be addressed by opting to tax the Sports facilities at A1 Secondary School or alternatively adopting a booking policy that prevents a block booking being made that qualifies as exempt.

Alternatively, a permutation of the other options will also ensure that the Council does not fall to be partially exempt.

Example Case studies

Case study 2

This case study examines the issues that are faced by VA Schools (where the Local Authority only receives the funding as agent of the school). Unlike the first case study, the issues faced are wider ranging and result in compromises rather than definitive solutions.

As part of its BSF programme Somewhereborough Council (“the Council”) received £15m funding as agent on behalf of the governing body of St John’s VA school (“the Governors”). The funding is to be used to replace the existing school buildings and sports facilities, which are to be demolished. The funding has been allocated as follows -

£10m	£2m VAT	New school
£5m	£1m VAT	New sports facility

Once completed the Governors intend to utilise the new facilities for community use outside of normal school hours. This will include adult education, lettings to third parties and hire of sports facilities. An analysis of use is set out below –

School building

Under 19/non fee paying students (non-business)	1,500
School building total floor space	15,000m ²

It is expected that fee paying courses (exempt business activity) will attract approximately 200 individuals over the year who will use classrooms that amount to no more than 400m² for 3 hours on weekday evenings.

Approximately 1,000m² relates to areas where there could be occasional business use. For example, admission charges to school productions and special events.

A further 600 m² will be available for casual hire by third parties (business use). The level of expected hires has proved impossible to gauge.

Sports facilities

Total envisaged opening	255 weekdays for 14 hours per day 102 weekend days for 9 hours per day
Core school use (non-business)	190 days for 9 hours per day

All parts of the Sports facilities will be used at some time by all 1,500 pupils and commercial customers.

In principle, when the Sports facilities are not used for Core school purposes they will be available for commercial use.

Other than the hire of rooms in the school and the hire of sports facilities it is assumed that all other supplies are made by the LEA e.g. catering, concerts etc and the VAT accounted for accordingly. It is acknowledged that this may differ from school to school.

VAT implications

Under the standard BSF contractual arrangements the Governors grant a licence to develop to the Council (typically for no consideration). The Council would then engage the LEP as with any other conventional contract.

The value of the contract means that the LEP will be obliged to register for VAT. The design and construction sub contractors will charge VAT to the LEP on their respective services. The LEP will be entitled to recover the VAT that it incurs on the basis that it makes an onward taxable supply of services to the Council. The LEP will

charge and account for VAT on its services to the Council. Therefore, VAT should not fall to be a cost for the LEP.

The VAT incurred by the Council will be fully recoverable as it relates to an onward taxable supply to the Governors. However, unless any action is taken by the Governors, the Council will need to charge VAT to them in respect of the services supplied i.e. the construction services associated with building the new school and sports facilities. In theory, the VAT simply flows through the Council and thus is not an issue for them. However, in reality the available funding is finite and if the VAT is not managed efficiently it will have an adverse impact on the development and hence the LEA's ability to deliver education.

Generally speaking, the Governors will not be registered for VAT and unless the level of taxable activity exceeds the VAT registration threshold there will be no requirement to register. However, where VAT is incurred, the only mechanism through which recovery can be sought is VAT registration. That said the Governors will only be entitled to recover the VAT charged by the Council to the extent that it relates to their taxable business activities. In most cases this will not amount to a significant proportion.

Summary

The VAT on the costs associated with the construction of the new school building amounts to £2m VAT. The school building will be used predominantly for non-business activities although there will also be exempt use (room hire). It is assumed that the Governors will not make any other supplies such as adult education or catering and that these will be supplied by the LEA. In this scenario none of the £2m will be recoverable.

The VAT on the costs associated with the construction of the new sports facilities amounts to £1m VAT. The sports facilities will be used for non-business activities for a good proportion of the time although there will be a greater degree of business use. In contrast to the school building it is assumed that the business supplies will be made by the Governors. These will be a mix of exempt and taxable supplies. In this scenario the proportion of the £1m VAT that relates to the provision of taxable supplies will be recoverable if the Governors register for VAT.

Mitigating the VAT cost

The Governors have a number of potential areas to consider. Some will be more appropriate than others but each is considered below.

- *Avoid VAT being charged by the Council*

The most effective way to mitigate the cost of irrecoverable VAT is to avoid being charged VAT in the first instance. The Governors can consider the scope for issuing a zero rating certificate so as to make the supplies by the Council (all or in part) zero rated. As this does not result in exempt supplies being made by the Council it does not have an adverse effect on them.

The Governors can consider the various methods available to them to determine whether they can issue a certificate and also, just as importantly, if they can maintain the conditions attached to the certificate for the necessary 10 year period. In considering the tests for the purposes of issuing a zero rating certificate all business activities that take place in the buildings must be taken into account, even if they are carried out by the LEA. Assuming that the school building and the sports facilities are separate unconnected constructions the business use tests apply as follows -

School building

Time based (whole of the building)	As various parts of the building will be used for business purposes, the building as a whole will not be used wholly for non-business purposes for at least 95% of the time. Also the level of business use is difficult to predict.
Time based (parts of the building)	Could be applied in respect of the areas used wholly (or at least 95% of the time) for non-business purposes i.e.

14,500m² out of 15,000m² and a zero rate certificate issued in respect of 14.5/15th's of the cost.

Floor space	As 2,000m ² (13%) of space is used at least for part of the time for business purposes this method is not applicable in this case. If the space used for business purposes could be reduced to below 5% (e.g. by ceasing to charge for room hire or adult education), the method would permit a zero rate certificate to be issued for the full cost.
Head count	The total non-business headcount amounts to the 1,500 pupils. The 200 fee paying students therefore equate to 12%. However, as the business use includes hiring rooms, the headcount of these bookings must also be taken into account – not an easy task. Therefore irrespective of the student analysis HMRC are unlikely to accept this method as fair and reasonable.

Sports facilities

Time based (whole of the building)	As above, the mix of use makes this method inappropriate.
Time based (parts of the building)	As there are no identifiable areas that would meet the criteria this is inappropriate.
Floor space	As there are no identifiable areas that would meet the criteria this is inappropriate.
Head count	The total non-business headcount amounts to 1,500 pupils. In order for this method to be effective the actual total fee paying users of the facility would need to be kept below 166 – not practical.

Based upon the circumstances in this case study there is scope to issue a zero rate certificate in respect of 14.5/15th's of the school building under the time based (part building) method.

There is also potential to issue a zero rate certificate for the whole of the school building under the floor space method if the space used for business activities can be contained within the 5%. In considering this option, the conditions attached to the certificates must be born in mind.

Recovery of the VAT that is charged

Any VAT that is charged by the Council will be recoverable to the extent that it relates to taxable business activities. Therefore, in simple terms, the more taxable business use to which the development is put, the greater the recovery of VAT on the development costs.

In considering the position for the school building, the only business activity undertaken by the Governors is the letting of rooms. The letting of rooms is an exempt activity. Any VAT incurred on costs attributable to exempt activities is unlikely to be recoverable. However, if the Governors register for VAT and opt to tax the school buildings then the letting of rooms will become subject to VAT. While this results in VAT being due in respect of the letting income, it permits recovery of a proportion of the VAT incurred. Therefore the Governors would need to take a commercial decision based upon the scale of the lettings and the level of VAT recovery that they would permit.

Conclusion

It should be possible to issue a zero rating certificate in connection with 14.5/15th's of the VAT on the costs of constructing the school building. It may even be possible to extend this to cover the whole of the building if the business use can be contained within 5% of the total floor area.

It is possible to increase the level of taxable use of the buildings by opting to tax and/or using a trading company to deliver some of the services thus making them taxable (as opposed to exempt). This in turn can significantly increase the level of VAT that falls to be recoverable.

In the case of a VA School, where an appropriate agreement can be reached with the LEA, there may be scope to structure the delivery of the facilities in such a way as to achieve full VAT recovery (including the proportion that relates to the LEA use for core school use) in connection with the sports facilities. Further advice should be sought.

Case Study 3

This case study examines the issues that are faced by Academy schools. With Academy schools there are two potential scenarios, those schools which undertake their own capital development or receive a VATable unitary charge and those schools who did not incur VAT on the capital costs themselves and occupy the premises on a peppercorn lease.

In this case study £15million received under BSF is allocated as follows –

Cost	Works
£10m £2m VAT	New School
£5m £1m VAT	New sports facility

The new facilities will be community facing and it is estimated that the usage will be as follows:

School

Core school use	90%
Adult education (fee paying) evenings, weekends and holidays	5%
Lettings of class rooms/hall to community groups etc...	5%

Sports Facilities

Core school use	50%
Club block bookings	35%
Private hire/individuals	5%
Coaching sessions/lessons (fee paying)	10%

Academy undertakes its own capital development – VAT Implications

For the Local Authority there are no VAT implications when the Academy receives the funding directly and is responsible for the capital development.

Under the new refund scheme for Academies (Appendix E) the Academy will be able to recover the VAT incurred on the capital expenditure in relation to its non business use of both the school and sports facilities. VAT incurred in relation to its business activities is not reclaimable under the refund scheme.

In order to recover the VAT incurred on the capital expenditure which relates to its business activities the Academy can register for VAT. If the Academy's VATable business income is in excess of the VAT registration threshold, it has no choice but to register for VAT, for Academies with VATable business income less than the threshold they can choose to register voluntarily.

If an Academy's VATable business income is below the compulsory registration threshold and it chooses not to register for VAT it will be unable to recover the VAT incurred in relation to its business activities.

If an Academy is either required to compulsorily register for VAT or chooses to register it will be required to account for VAT in respect of VATable business income. If the Academy chooses to pass this on to its customers it would make its facilities more expensive for them to use, alternatively the Academy could keep its charges at the same level but treat them as VAT inclusive this would have the effect of reducing the Academy's net income.

It would, however, enable the Academy to recover the VAT incurred on the capital expenditure which relates to its VATable business income. The VAT on the capital expenditure which relates to any exempt business income would remain irrecoverable.

In deciding to voluntarily register for VAT the Academy would have to make a commercial decision based upon the increased VAT recovery in relation to capital expenditure compared to the potential loss of income by treating its income as VAT inclusive, if it chose not to pass the VAT on to its customers.

The exempt use of the school amounts to 10% i.e. the fee paying adult education and the room and hall lettings. Therefore in principle, the worst case scenario is that 10% of the VAT (i.e. £200k) incurred on the cost of the school is attributable to exempt activities.

The exempt use of the sports facilities amounts to 45% overall, i.e. the club block bookings and the coaching. Therefore in principle, the worst case scenario is that 45% of the VAT (i.e. £450k) incurred on the cost of the sports facilities is attributable to exempt activity.

Of a total VAT charge of £3 million £650k, or 21%, is irrecoverable as it relates to exempt business supplies.

One possible solution is to opt to tax the school. By opting to tax the school buildings and sports facilities the letting of the class rooms and hall and the club block bookings will become VATable supplies.

As a result the exempt use of the school would change as follows:

- The exempt use of the school amounts to 5% overall, i.e. the fee paying adult education. Therefore in principle, the worst case scenario is that 5% (£100k) of the VAT incurred on the cost of the school is attributable to exempt activities.
- The exempt use of the sports facilities amounts to 10% overall i.e. the coaching. Therefore in principle, the worst case scenario is that 10% (£100k) of the VAT incurred on the cost of the sports facilities is attributable to exempt activities.

The total reduction in VAT that is attributable to exempt activities is £450k. Therefore by opting to tax the school site only £200k, or 6%, of the VAT incurred on the capital costs would be irrecoverable. Again consideration should be given to whether the VAT is going to be passed onto the users of the Academy or if the charges are retained at the same level but are treated as VAT inclusive thereby reducing its net income. This would be a commercial decision balancing the potential loss of income against the increased VAT recovery.

Academy does not incur VAT on capital costs

In this scenario the Academy will occupy the development by way of peppercorn lease from the Local Authority. The Local Authority will incur the expenditure, and therefore the VAT, in relation to the capital costs. There are no associated VAT recovery implications in relation to the capital costs in connection with opening the development for community use for either the Academy or Local Authority.

Where there is a charge to the Academy, whether in the form of a capital contribution or the passing on of a unitary charge, the risk for the Local Authority is that it will be supplying premises in return for consideration, which is an exempt business activity.

In this situation it is probable that the Local Authority will opt to tax the school and sports centre to avoid it (the Local Authority) becoming partially exempt. This would enable the Local Authority to recover the VAT incurred on the capital costs in full.

It would however, have to add VAT to the charges made to the Academy. This would be recoverable by the Academy to the extent that it relates to its non business and to its taxable activities, if the Academy were VAT registered itself.

For Academies who do not incur the capital costs themselves, the risk of irrecoverable VAT is limited to that on revenue expenditure, and any charges made by the Local Authority which are subject to VAT.

Although on a much smaller scale than the first scenario the irrecoverable VAT will continue to be determined by the level of exempt use of the school and sports facilities.

The Academy will be able to recover, under the special refund scheme, the VAT incurred on revenue expenditure which relates to its non business activities. If the Academy is VAT registered it will be able to recover the VAT on revenue expenditure which relates to its taxable activities.

Depending on the Academy's level of exempt income to taxable income it may be able to recover the VAT incurred on revenue expenditure which relates to its exempt business activities under the partial exemption rules (Appendix A).

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