

THE NPDO

Guidance in relation to VAT, corporation tax and stamp duty land tax implications

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The information set out below provides high level guidance in relation to the VAT, corporation tax and stamp duty land tax implications in relation to the creation of a not for profit body to take over the operation of certain Council functions.

VAT

The NPDO

Status of new body

In order for there to be a VAT advantage in transferring activities to a new body, the body will be required to be a Non Profit Distributing Organisation (NPDO). This will mean that the new body cannot be a Company Limited by Shares. The options are a Company Limited by Guarantee or an Industrial and Provident Society.

VAT liability of sporting income and VAT recovery

The bulk of sports related supplies will move from being standard rated for VAT purposes to being VAT exempt. However, it should be noted that coaching / tuition provided by the Council will already be VAT exempt. Where the VAT liability changes, this will mean that VAT will no longer be due to HMRC, which will mean that the NPDO can retain all of the income. If the level of charges remains unchanged pre and post transfer, there will be an increase in the level of income

However, the Council can generally reclaim all of the VAT which it incurs in relation to delivering the services, but the NPDO will not be in this favourable position. As a result of making VAT exempt supplies, the NPDO will be unable to reclaim all of the VAT which it incurs on its expenditure.

The net VAT benefit will be the difference between the additional income, less the increase in costs.

A major factor in determining the level of recoverable VAT will be the VAT treatment of the funding payments from the Council to the NPDO (hereafter referred to as the "Service Payment"). If there is a taxable Service Payment, this will improve the VAT recovery position of the NPDO by giving it a higher ratio of taxable (standard rated) income. With careful wording of the Funding Agreement, it is possible to create a Service Payment position, although this does have procurement consequences. The requirement for the NPDO to charge the Council standard rated VAT in relation to the Service Payment will not result in an additional cost to the Council, as the Council can reclaim this VAT.

Due to the VAT recovery position of the NPDO, it is beneficial for the Council, rather than the NPDO, to be responsible for major capital costs, although it is accepted that this can have operational consequences.

VAT impact of libraries and museums

The provision of library books etc without charge by the Council and allowing the public to enter museums free of charge is a non business activity for the Council. As a result of the Council's special VAT status, the Council can reclaim all the VAT which it incurs in relation to such non business activities. However, free access granted by an NPDO could lead to a total blocking of all VAT recovery in relation to running such facilities.

Due to the above, the VAT treatment of any Council funding is particularly important.

VAT impact of other activities

Due to the potential wide range of other activities, these are not covered here.

VAT impact analysis

It is recommended that the NPDO's Partial Exemption position is modelled before a decision to transfer is taken, in order that the VAT benefits are fully understood.

VAT Registration

The NPDO will be required to register for VAT, as its taxable income will be significantly in excess of the VAT registration limits. It will also be necessary to consider the VAT registration position where a Subco is set up, perhaps for direct tax purposes. It would be possible for the NPDO and Subco to separately register for VAT or form a VAT group. A VAT group would create administrative benefits, and may also create VAT savings.

The Council

Council property assets

In order that the Council does not suffer a clawback of previously incurred property related VAT, or suffer a restriction in relation to new facilities, the Council would lease the Council owned facilities to the NPDO for a wholly nominal sum. This would make the supply by the Council non business, thus permitting the VAT recovery due to its special VAT status.

It is critical that there are no additional charges, for example, charges for insurance or utilities.

VAT impact analysis

Although it is expected that there will be no adverse impact on the Council's overall Partial Exemption position post transfer, it would be necessary to carry out modelling to confirm the position, particularly where libraries and museums form part of the transfer to the NPDO. Such modelling should be carried out before the decision to transfer is taken.

Corporation tax

The NPDO

Charitable recognition

In light of the NNDR advantages to be gained through the NPDO being granted charitable status it is assumed that the NPDO will seek charitable status from OSCR and HMRC. In addition to the NNDR advantage, charitable recognition will exempt the NPDO from corporation tax in relation to profits arising from certain activities. In order to obtain charitable status the NPDO will have to be established for charitable purposes only and be covered by one or more of the following:

- (a) the prevention or relief of poverty;
- (b) the advancement of education;
- (c) the advancement of religion;
- (d) the advancement of health;
- (e) the saving of lives;
- (f) the advancement of citizenship or community development;
- (g) the advancement of the arts, heritage, culture or science;
- (h) the advancement of public participation in sport;
- (i) the provision of recreational facilities, or the organisation of recreational activities, with the object of improving the conditions of life for the persons for whom the facilities or activities are primarily intended;
- (j) the advancement of human rights, conflict resolution or reconciliation;
- (k) the promotion of religious or racial harmony;
- (l) the promotion of equality and diversity;
- (m) the advancement of environmental protection or improvement;
- (n) the relief of those in need by reason of age, ill-health, disability, financial hardship or other disadvantage;
- (o) the advancement of animal welfare;
- (p) any other purpose that may reasonably be regarded as analogous to any of the preceding purposes.

There is also an overriding requirement of public benefit.

Typically Cultural and Leisure activities such as the provision of sporting facilities to the public; the lending of books and other research materials; the exhibiting of works of art and antiquities etc to the public; and the services supplied to the Council by the NPDO, should come within the above charitable qualifying headings.

The exemption from corporation tax also extends to activities which are ancillary to the above “primary purpose” activities. Such ancillary activities would include:

- The hire of CDs and DVDs at public libraries;
- The provision of non sporting facilities at leisure centres, for example, saunas;
- The provision of catering at sports centres, depending on how the facilities are publicised and who can use them;
- The letting out of NPDO assets, such as the letting out of a facility, including community centres and venues (provided the letting does not form part of a package of services).

A charity is also able to carry out activities which are neither charitable in nature, nor ancillary to the primary purpose charitable activities, provided the purpose is to raise funds to be applied for charitable purposes and provided this non-primary purpose trading does not involve significant risk to the resources of the charity. The NPDO’s Memorandum and Articles of Association must permit the charity to carry out these activities for fundraising purposes. A small scale exemption is available to exempt, from corporation tax, profits from small scale non-primary purpose trading, provided that certain conditions are met.. Where the turnover limit is breached, the NPDO would be liable to corporation tax on the profits arising from non-primary purpose activities.

Examples of such non-primary purpose activities may include:

- Shops in museums which sell a range of goods some of which are related to a primary purpose (e.g. prints of exhibits) and some which are not (e.g. promotional pens, mugs etc);
- Catering outlets in museums which are available to both visitors to the museums and the general public.

Where the NPDO carries out both primary purpose (or ancillary) and non-primary purpose activities, its accounting records would need to be capable of tracking the income and expenditure relevant to each category of activity and reflected in its tax returns.

Where there are activities which are to be undertaken in the NPDO which do not fall within the statutory or concessional exemptions then this will result in the loss of funds to the NPDO since it will be liable to corporation tax on profits from these activities. This corporation tax liability can however be avoided if the taxable activities are instead undertaken by a wholly owned subsidiary company of the NPDO and Gift Aid is used.

Stamp duty land tax

The NPDO

Leases from the Council to the NPDO

As stated in the VAT section above, the Council would lease the Council owned facilities to the NPDO for a wholly nominal rent. Since the NPDO is to obtain charitable status, it should be able to benefit from the charity exemption from SDLT, where the building is used predominantly for charitable purposes. There are reporting requirements, which have to be adhered to in relation to this exemption.

It may be the case that the NPDO may grant leases to a subsidiary. Provided the subsidiary is wholly owned by the NPDO, SDLT group relief should be available to exempt the sub-lease from SDLT. Again, there are certain reporting requirements.

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12 November 2010