

## Responses to questions from Grant Thornton's tax webinar on 6<sup>th</sup> February 2024

- 1. We are considered as a "foreign" owned company as our major shareholder is a Jersey based Trust. Would this mean any risk if setting up a New Co for VAT purposes. Currently not VAT registered.**

For VAT welfare restructuring purposes, there should be no additional risk because your major shareholder is Jersey based, you should still be able to set up a New Co in the UK and implement the welfare restructuring as you would if you were owned by a UK major shareholder.

- 2. We are not VAT Registered. We are converting our previous offices to 9 flats for support of people with Learning Difficulties. The construction companies we use are charging 5% Vat under VAT notice 708. We are not reclaiming this VAT from HMRC. Are there VAT considerations if we sell this property to a Housing Association? Property Value will be circa £1.8m.**

The 5% charge by the construction companies sounds correct as this is a conversion project from commercial to residential properties. We would expect the sale of the flats to be zero rated as the first grant in a major interest (ie freehold or leasehold over 21 years) of a dwelling, and therefore, the VAT incurred on the construction and other associated costs may be recoverable, either in full or in part subject to the activities carried out in between completion and sale. To recover the VAT, you would need to register for VAT and also review whether there were any exempt activities of the flats, such as exempt rental income before the sale, which could restrict the amount of VAT recoverable on costs.

In addition, businesses are required to register for VAT once their taxable turnover (which includes zero rated income) exceeds £85,000 in a 12-month period. Therefore, assuming the sale of the flats was zero rated and over £85,000 you could have a requirement to register for VAT, unless you apply to HMRC for an exemption from VAT registration (assuming you did not want to or could not recover VAT on costs).

- 3. In terms of getting local authorities to agree to novation's, appreciate it depends on the individual authorities - but are you finding authorities are open to novating? And are there any steps you can take if you find an authority refuses to novate or relies on "under review" (particularly where they have historically novated for competitors in years gone by)?**

We are noticing a trend where local authorities are more aware of the restructure and open to discuss the potential to novate, even those that have historically been a firm 'no'. We have also seen disparities between local authorities agreeing to novate contracts with some care providers, but not with others. We find the issues are usually due to not speaking to the right person and have found even where we have had an initial 'no', if we speak to someone in another team, or perhaps someone higher up in the local authority, this can be very successful. It also really helps from the start if the care provider has a good working relationship with the local authority.

- 4. We are finding that ICBs are now wanting to novate back to provider co, how can we challenge this?**

As discussed on the call, we will follow up on this separately once we have a better understanding of the ICBs' reasoning. We have not come across any ICBs wanting to novate back to the original care provider and there have been no changes in the VAT world that could have prompted this. We also understand that previously the NHS has written to ICBs to explain and legitimise the welfare restructure.

- 5. Can you explain who associated persons might be in respect to the HMRCs view/Criminal Finances Act.**

The definition of "associated persons" includes employees/agents and those providing services on behalf of the business, so employees, directors, suppliers, contractors, debt providers, investors and the like can all be considered associated persons. The detail will vary from business to business. The Act doesn't specifically

reference clients or customers but often in the risk review a business may consider whether there is any inherent risk with these as well and include in their risk matrix.

## **6. How would increasing taxable income from local authorities increase the VAT recovery on costs and how does the calculation work?**

VAT incurred on costs relating to business supplies can only be recovered where it is attributable to the making of onward taxable supplies. For partially exempt businesses, there are two stages to determine VAT recovery:

1. Direct attribution – any VAT incurred that directly relates to making a taxable supply can be recovered in full. Similarly, any VAT incurred that directly relates to making an exempt supply would need to be blocked in full.
2. Overhead/residual VAT recovery – where the VAT incurred does not solely relate to a taxable or exempt supply, only a proportion of this VAT can be recovered subject to the partial exemption calculation.

There are various ways of calculating the recoverable proportion of VAT under 2. However, the default method, known as the standard method, is the most commonly used and is based on taxable turnover as a proportion of total turnover. Therefore, the higher the taxable income, the higher the resulting percentage will be which will be applied to the total overhead/residual VAT figure and determine how much of this VAT can be recovered.

## **7. What impact will the implementation have on my finance team which is already stretched?**

There will be some additional administration in getting the restructure implemented correctly to start with, however over time we expect the additional requirements to be minimal. Additional requirements the finance team may have to carry out include, but are not limited to:

- Setting up a new company
- Creating a VAT group
- ‘Switching on’ VAT in your accounting system and allocating VAT rates to cost centres and income streams, if you have not been previously registered for VAT
- Recording and submitting VAT returns (if not done already)
- Completing partial exemption calculations (if not done already) – this should get simpler over time as a business can use the previous year’s percentage as an estimate the following year and then just carry out an annual adjustment at the end of the year, ie just one partial exemption calculation as opposed to four

## **8. You mentioned not advising doing retrospective applications of VAT on operating costs - what about the initial 12 months from registering for VAT, can you use an estimated partial exemption recovery percentage (based on estimated novated contracts success) for the first 12 months? Do these first 12 months recovery get challenged by HMRC?**

We would not expect novated contracts with local authorities to be dated before the VAT group registration date. During the first year of novation, the VAT recovery may vary from the first VAT return quarter to the fourth given that not all contracts with local authorities will be novated from the first day of VAT registration and this may happen later in the year. Therefore, we would generally expect to see an increase in the amount of VAT recovered on costs throughout the year.

At the end of the year, a partial exemption annual adjustment calculation would be carried out which would look at taxable income for the year as a whole and adjust the correct amount of VAT recoverable on costs based on annual, rather than quarterly values.

After your first year of annual adjustment calculations, you can use the previous year's recovery percentage each quarter and then complete an annual adjustment calculation at the end of the year as opposed to carrying out a partial exemption calculation each quarter.

If the standard method does not produce a fair and reasonable result at the start, including during the first tax year, businesses may be able to use an alternative use-based calculation. Once this period has expired, the business must revert to using the default standard method or alternatively apply to HMRC for a special method, which is where VAT on costs can be based on a calculation other than based on turnover, for example based on floor space.

Depending on the values in questions and in particular, if the business goes from being in a VAT payment position with HMRC to a VAT repayment position, this may trigger further questions from HMRC on the VAT return in question, however equally, it may not trigger any further investigation from HMRC.

#### **9. Can you tell me more about the TOGC conditions I need to meet when selling a business or part of a business?**

HMRC list the TOGC conditions as follows:

- The assets must be sold as part of the TOGC
- The buyer must intend to use the assets in carrying on the same kind of business as the seller — this does not need to be identical to that of the seller
- Where the seller is a taxable person, the buyer must be a taxable person already or become one as the result of the transfer
- In respect of land or buildings which would be standard rated if it were supplied not as a TOGC, the buyer must notify HMRC that they have opted to tax the land by the relevant date, and must notify the seller that their option has not been disapplied by the same date
- Where only part of the business is sold it must be capable of operating separately
- There must not be a series of immediately consecutive transfers of the business

All the conditions must be met for the TOGC treatment to apply and if all conditions apply, it is compulsory.

#### **10. How much VAT can be recovered on associated deals fees with sale of a business?**

This can be a complex answer and has been subject to lots of case law, including the on-going VAT case of Hotel La Tour. Generally, whether VAT is recoverable on deal fees costs will depend on the VAT treatment of the sale and the business activity of the seller. If the sale is a TOGC, then associated costs incurred by the seller will be treated as overheads to the seller's business and recoverable subject to its business activities, ie if it is fully taxable - VAT will be recoverable in full, if it is wholly exempt - VAT will be wholly irrecoverable and if it is partially exempt - VAT will be recoverable subject to its partial exemption calculations.

#### **11. An employee ownership trust was referenced on the business succession slide. What is an employee ownership trust?**

An EOT provides a mechanism for company owners to transfer, by way of sale, all or a majority stake in their business to a trust established for the benefit of all of the business's employees.

#### **12. Is external funding required to implement the opco/propco structure?**

You can undertake demerger planning without needing to obtain external funding.

#### **13. You have explained the CFA imposes a 'criminal' offence on a company. What does this mean?**

The Act imposes an unlimited criminal fine on guilty organisations. There may also be knock on adverse implications for example in terms of negative PR and liabilities arising from directors not meeting their fiduciary duties.

**14. I'm only a relatively small business with a handful of care homes. Does the CCO apply to me?**

Yes, it applies to all businesses regardless of size.