

# VAT Cost Sharing Exemption

## Budget 2012

It was confirmed yesterday that only technical changes will be made to the draft provisions to be included in the Finance Act 2012 to implement the VAT cost sharing exemption in the UK.

## The Exemption

It has taken a long time for this exemption to be introduced into domestic law. Broadly, the exemption applies to services supplied by a "cost sharing group" (a "**CSG**") formed by businesses and other organisations which are unable to recover all the VAT they incur. Examples of such businesses/organisations include banks, insurance companies, universities, care homes, housing associations and charities. Where the exemption applies, no VAT is payable on the services supplied by the CSG to its members.

## Criteria

The exemption applies where:

- each of the CSG's members makes exempt or non-business supplies
- the CSG's services are "directly necessary" for the members' own supplies
- the members "exactly reimburse" the CSG for their share of the CSG's expenses
- application of the exemption is not likely to cause a distortion of competition.

## Practical Considerations

Implementation of the exemption follows months of consultation, during which a number of issues were identified. HMRC have said they would publish guidance later this year on how the exemption would operate in practice (hopefully addressing all such issues).

In the meantime, we set out below a short list summarising the key practical considerations when looking to avail of the exemption.

- **"Independence"**: the exemption as set out in the Directive refers to the CSG being an "independent group of persons" and this term is replicated in the UK legislation. HMRC have said it is permissible for one member of the CSG to have a majority interest in the CSG and/or to control it. This raises the question as to whether all the members of a CSG can come from the same corporate group or if at least one member must be an unrelated person.
- **Vehicle**: a CSG cannot make a profit. This means that certain entities (such as an English partnership the existence of which depends on a view to profit) would be unsuitable vehicles for a CSG.
- **Members**: HMRC have confirmed that a person is eligible to form a CSG even if only 5% of his total supplies are exempt and/or non-business. They have also confirmed that a VAT group may be a member of a CSG.
- **Ongoing monitoring**: the CSG will need to be able to confirm the status of its members. Members will also want to ensure that if one member loses its exempt or non-business status, that does not in turn result in the loss of the exemption for all the members. These (and other similar issues) will need to be properly addressed in the CSG's constitutive documents.

- **Contribution:** the exemption looks to services from the CSG to its members. It does not apply to any assets, staff or other resources supplied to the CSG itself. This raises the question as to how best to structure such supplies so as to minimise unnecessary costs.
- **Cross borders:** HMRC have confirmed that the exemption applies not only to UK to UK supplies but also to supplies to and from the UK (provided that the relevant criteria are all satisfied). This raises interesting questions because although the UK has taken a fairly broad approach with its domestic provisions, certain other EU member states have been more restrictive. The Commission is expected to release a paper setting out its own interpretation of the exemption, and the possibility of further harmonisation inevitably brings with it a certain degree of uncertainty.
- **"Directly necessary":** HMRC have said that where at least 85% of a member's total supplies are exempt or non-business, they would in normal circumstances regard all the supplies it receives from the CSG as being "directly necessary" for its own supplies. This raises the question as to the extent to which HMRC will scrutinise the link between the CSG's supplies and the member's own supplies (in particular, the member's taxable supplies, if any) where less than 85% of the member's total supplies are exempt or non-business. The position is further muddled by the infringement proceedings which the EU Commission initiated against Luxembourg (IP/12/63) earlier this year.
- **Transfer pricing:** where one member controls the CSG, (direct tax) transfer pricing issues may arise, resulting in a conflict with the restriction against the CSG making a profit/margin. HMRC have said they will in practice allow some flexibility on the interpretation of "exact reimbursement" so as to enable the CSG to budget sensibly and appropriately.

## Authors

**Etienne Wong**  
Partner

T: +44 20 7006 8825  
E: [etienne.wong@cliffordchance.com](mailto:etienne.wong@cliffordchance.com)

**Simon Corzberg**  
Director – VAT

T: +44 20 7006 8945  
E: [simon.corzberg@cliffordchance.com](mailto:simon.corzberg@cliffordchance.com)

**Alex Tostevin**  
Senior Associate

T: +44 20 7006 2761  
E: [alex.tostevin@cliffordchance.com](mailto:alex.tostevin@cliffordchance.com)

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

[www.cliffordchance.com](http://www.cliffordchance.com)

Clifford Chance, 10 Upper Bank Street, London, E14 5JJ

© Clifford Chance LLP 2012

Clifford Chance LLP is a limited liability partnership registered in England and Wales under number OC323571

Registered office: 10 Upper Bank Street, London, E14 5JJ

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications

If you do not wish to receive further information from Clifford Chance about events or legal developments which we believe may be of interest to you, please either send an email to [nomorecontact@cliffordchance.com](mailto:nomorecontact@cliffordchance.com) or by post at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London E14 5JJ

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Kyiv ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh\* ■ Rome ■ São Paulo ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

\*Clifford Chance has a co-operation agreement with Al-Jadaan & Partners Law Firm in Riyadh.