David Ogilvie

Policy Manager

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HMRC

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Dear David,

**Re: EXEMPTION FOR LOCAL AUTHORITIES FROM THE PROPOSED CONSTRUCTION REVERSE CHARGE**

As discussed at the CIPFA VAT Committee on 6 March 2019, local authorities believe there are good pragmatic reasons to exempt local authorities from the proposed construction reverse charge due to come into effect on 1 October 2019; this would mean that all supplies of construction services procured by a local authority could then be treated as subject to ‘normal’ VAT rules without enquiry or declaration.

***Justification***

There are only three scenarios in which a local authority procures construction services:

1. to an asset that it owns and/or runs pursuant to its public service responsibilities, eg a school, a social services establishment, a leisure centre, a library, a museum  -  the local authority is clearly an end user in this context;
2. to properties that it lets or leases to third parties, notably council housing and commercial properties leased to businesses  -  the local authority is procuring works as an intermediary supplier in this context;
3. in pursuit of its statutory public service responsibilities, eg to provide dropped kerb access to a property, to carry out works-in-default where the owner or landlord fails to carry out required remedial works to their property, to undertake disabled adaptations to a person’s home, to facilitate a group repair scheme where publically funded improvements to a group of properties requires consistent treatment, eg matching frontages  -  although in some cases the cost of the works may be recharged to the beneficiary, the local authority is nonetheless acting in pursuance of its statutory functions and not making an onward supply of construction services hence must be seen as the end user.

For completeness, I understand it is accepted by HMRC in the context of the proposed reverse charge that, in scenario (3) the local authority is not making a supply of construction services and so its procurement thereof cannot fall within the reverse charge.

In fact, while local authorities are in some situations permitted to recharge the cost of carrying out construction works to the ultimate beneficiary, as in scenario (3), local authorities cannot make any onward supply of construction services by way of a commercial venture as Section 95 of the Local Government Act 2003 prohibits a local authority from engaging in trading with a view to profit (other than by establishing a separate company, a so-called local authority trading company or ‘LATC’ to carry on the trading activity).

***Further discussions***

In fact, since the meeting on 6 March 2019, further discussions with colleagues from other disciplines, including finance, procurement, regeneration, property services and housing, have ellicited a number of observations that reiterate and/or support the above justification for exempting local authorities from the proposed reverse charge.

First, local authorities generally only procure construction services for the purpose of creating, maintaining and enhancing their own assets, assets such as public buildings, council housing, schools, libraries, museums, leisure centres, community centres, etc, as well as highways and other public realm works, eg flood alleviation. In each case it is clear the local authority is the ‘end user’ or, at worst, is an intermediary supplier, in terms of the proposed reverse charge.

Second, most importantly, local authorities do not, indeed cannot, supply construction services to any other VAT-registered persons with a view to profit. Whilst there might be an appetite to do so as an income generating activity, local authorities are prohibited by Section 95 of the Local Government Act 2003 from engaging in trading other than by establishing a separate company, a so-called local authority trading company or ‘LATC’, to carry on the trading activity (and local authorities have no objection to LATCs being required to comply with the proposed reverse charge).

Third, local authorities never engage suppliers of construction services without first ‘getting to know them’. Local authorities have a structured procurement process which they are required to follow whereby they check any prospective supplier’s credentials before engaging with them. Typically, potential suppliers are required to complete a ‘Selection Questionnaire’, a typical example of which is annexed. Referring to the annexed example, it is clear that the information potential suppliers are required to provide about themselves is in some depth and clearly sufficient for the local authority to satisfy itself that the supplier is a bona fide business that meets its public responsibilities, ie is not engaged in VAT fraud.

***The administrative burden***

Without the exemption sought, local authorities will have to devise a process that stretches across procurement, the service department, accounts payable and accounts receivable in order to identify those examples of construction procurement that fall outside the scope of the proposed reverse charge - in practice virtually all such - and those that do not - in practice almost none.

Furthermore, even though almost all examples of construction works procured by local authorities will fall outside the scope of the proposed reverse charge, absent the exemption sought, local authorities will still have to actively determine this and then advise the supplier accordingly, ie ‘do nothing’ will not be an option under the proposed new rules without the exemption sought.

The key component in this will be the service department, as they will need to act as co-ordinator, giving instructions to all the others. But the service department will have little or no knowledge of VAT hence there will be a significant educational requirement absent the exemption sought.

And such a process to comply with the new rules under the proposed reverse charge would have to be documented and evidenced as being followed in order to satisfy both internal and external audit.

In practice though, as noted above, it is very unlikely a local authority would ever be procuring construction services as part of a supply chain involving onward supplies to VAT-registered persons and so subject to the reverse charge. The consequence then is more administrative work for colleagues in following the required process, because this requires they check each and every construction contract and invoice to see if it might be subject to the reverse charge and, in practice, confirm that it does not and advise the supplier accordingly. The serious risk this raises is that such near pointless processes soon fall into disrepute and can then not be relied upon to be accurate.

Furthermore, this is against the background of local authorities’ funding being cut year on year in real terms, and available resources to meet increasing demands from such services as children in care and older adults meaning that the back office has got less and less resource. Local authorities have already had to accommodate revised rules on engaging workers off-payroll, the so-called ‘IR35 rules’, further changes to which are anticipated from April 2020, as well as Making Tax Digital for VAT from October 2019, with further enhancements thereto also required from next year.

There is no bottomless pit and if local authorities are further required to accommodate the proposed construction reverse charge, it is inevitable that something else will have to be sacrificed, general VAT compliance work perhaps?

***Conclusion***

It is apparent from the above that there is, in practice, very little risk to HMRC in exempting local authorities from the proposed reverse charge for construction services.

To reiterate, local authorities do not ordinarily sit within a supply chain of the type envisaged by the proposed legislation; specifically local authorities are statutorily prohibited from trading and, therefore, cannot onward supply construction services procured with a view to generating a profit.

In any case, local authorities have extensive robust procedures to verify the credibility of their suppliers, suggesting the latter’s involvement in supply chain fraud of the sort the proposed reverse charge is aimed to prevent, is extremely unlikely.

Conversely, without the exemption sought, there will be a substantial additional workload placed on local authorities in the need to administer what in all likelihood will be a fruitless process.

Local authorities, therefore, seek a pragmatic solution akin to that which was agreed some years ago in respect of schools and the Construction Industry Scheme (CIS). There, following discussion with HMRC and Governmemnt more widely, it was agreed that schools could be exempted from the CIS where construction work is funded from devolved school budgets. This was on the grounds that the risk of the abuse at which the CIS is targeted is negligible in the context of schools and the amounts involved relatively small and dispropotionate to the effort required to apply the CIS to schools’ procurement. Local authorities believe that the proposed construction reverse charge can legitimately be seen in the same context

I look forward to hearing from you with, hopefully, a positive response.

Yours sincerely

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on behalf of the CIPFA VAT Committee

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