



VAT: Recovery and Relief for Building Works to Voluntary Aided Schools (BSF and otherwise)

Funding for Maintained Schools

Section 22 of the School Standards and Framework Act 1998 (the 1998 Act) provides generally for the funding of “maintained” schools. The duty to defray all expenses of maintaining the school rests with the local education authority (LEA). Section 49(5) of the 1998 Act states that any amount made available by a local education authority to the governing body of a maintained school (i.e. the school’s delegated budget share) shall remain the property of the authority until spent and when spent shall be taken to have been spent by the governing body as agent of the local education authority.

An exception is made however for capital expenditure to voluntary aided (VA) schools, where the responsibility for such expenditure rests with the governing body and paragraph 5 of schedule 3 of the 1998 Act envisages direct grants being made available to the governing body by the Secretary of State. There is no provision preventing grants for capital expenditure to VA schools being paid to the local education authority (which is generally what happens under the Building Schools for the Future programme) but as the primary duty for such expenditure rests with the governing body any such grant will be deemed to have been received by the governing body.

Building Works to VA Schools

Grant for building works to VA schools can take a number of forms; Devolved Formula Capital (DFC), Specialist Schools Funding, Local Authority Co-ordinated Voluntary Aided Programme (LCVAP), the LEA’s own funds and the increasingly significant Building Schools for the Future and Primary Capital Programmes (BSF and PCP).

Whilst traditionally, works would have tended to have been procured by the governing body (with strategic and sometimes financial support being provided by the relevant diocese or trustee body), the strategic focus of BSF and PCP has led to the centralisation of procurement through a pre-procured single supplier framework, otherwise known as the “local education partnership” or LEP.

Where works are procured through the LEP, whether refurbishment or new build, the primary building contract is entered into between the LEA and the building contractor. A subsidiary contract is generally put in place between the LEA and the governing body which facilitates the works and provides for payment by the governing body, offset by the grant monies paid by the Secretary of State to the LEA. This is generally referred to as the “Development Agreement” and there is a standard form contract published on the Partnerships for



Schools website. The Development Agreement recognises the supply of works by the LEA to the governing body.

VAT supplies and Section 33 recovery

The supply of building works is normally standard rated unless a relief or an exemption applies. Recovery of any VAT paid is generally only possible if the person receiving the supply is registered for VAT purposes and is also making a taxable supply i.e. it is charging for goods or services on which it adds VAT. LEAs and governing bodies are not generally in this position.

Section 33 of the Value Added Tax Act 1994 contains a special refund scheme which allows specified bodies to recover VAT incurred on their non-business activities. This is generally confined to bodies undertaking functions ordinarily carried on by local government and that have the power to draw their funding directly from local taxation. Local authorities are of course such a body, governing bodies of maintained schools are not and the HM Revenue and Customs (HMRC) Brief 53/09 published in August has clarified when section 33 can be used in the context of expenditure from the delegated budget. It is no surprise that HMRC has confirmed that it is appropriate for local authorities to recover VAT under section 33 where it is incurred by the local authority in relation to expenditure for which it is responsible. This will therefore include all expenditure in relation to maintained schools except capital expenditure to voluntary aided schools (even where paid for from the delegated budget) which of course is the responsibility of the

governing body. Guidance on what constitutes capital expenditure is still to be drawn from the "Blue Book" issued by the Department for Children Schools & Families (DCSF). It should be noted that this will include lifecycle works carried out under a facilities management (FM) agreement (an increasingly common feature of design & build (D&B) proposals under BSF).

In an interesting development however, the same guidance has clarified that where the LEA is spending its own funds, i.e. not delegated budget or grant from DCSF on capital works to VA schools, then provided it contracts directly with the supplier (i.e. the building contractor) then it may recover any VAT on such expenditure. This could well be useful where monies obtained from, for example, section 106 agreements and related disposal programmes, are being used to top up or fund works to VA schools.

Confirmation is also contained in Brief 53/09 that Private Finance Initiative (PFI) funding, whether through BSF or otherwise, is classified as revenue expenditure and therefore not the responsibility of the governing body and so is capable of coming within section 33.

New build works and zero rating relief

It is clear from Brief 53/09 that HMRC is still expecting there to be VAT charged on the supply of building works to the governing body of a VA school, whether those works are carried out under a building contract (or FM agreement) entered into between the governing body and the contractor or via a step down following a contract entered into



between the LEA and the contractor. The obvious point is made and continues to be recognised by DCSF that where there is irrecoverable VAT, then any grant must be grossed up to enable the governing body to meet its full liability. This will include irrecoverable VAT on building works to be carried out following damage or destruction as a result of an insured risk and there is a reminder in the new guidance that governing bodies and LEAs should ensure that insurance for the usual risks includes cover for such loss.

In some cases, the construction of a building for a charity can be zero-rated under Schedule 8 Group 5 of the VAT Act, so that no VAT is chargeable by the contractor. Section 23 of the 1998 Act confirms that the governing body of a VA school is an exempt charity, i.e. a charity which is exempt from the obligation to register with the Charity Commission.

For zero-rating to apply, the legislation requires that the building must be intended 'solely' for a 'relevant charitable purpose'. This means use by a charity in non-business activities, or as a village hall or similarly. Projects that incorporate part of a previous building, or that amount to an extension or enlargement of an existing building, will not qualify. In some cases, new buildings constructed behind a retained façade can nevertheless do so, as can a self-contained annexe, but there are further conditions in each case, and in practice it is hard to qualify.

But even for new buildings, there can be significant obstacles to zero-rating. Schools that charge fees are in business for VAT purposes.

Those that do not may still find that some activities will count as business, and will fall foul of the 'solely' requirement – this is likely to include any trading activity (whether carried on in the school itself or by a subsidiary) and any out-of-hours use by the wider community. As discussed below, the 'solely' test does not mean quite 100%, but any intended use of this kind represents a potential problem. Neither will school buildings normally be seen as sufficiently similar to a 'village hall'.

If the charity does qualify for zero-rating, it needs to issue a certificate to the contractor (or the LEA where the LEA is in fact procuring the building works) stating its intended use of the building and if the actual use changes within 10 years there could be a claw back of the VAT originally saved.

Similar restrictions apply to the zero-rating for certain alterations to listed buildings.

Using the building

Recently there had been a debate about whether governing bodies of VA schools can satisfy the test that they are using the school premises "solely" for the requisite purpose. An argument had been put forward by HMRC that governing bodies were not solely using the school premises because the duty to provide education in a VA school was that of the local authority and not the governing body. There was a view that the local authority must somehow be using the school premises to provide such education even if that were jointly with the governing body. This view did not take into account the principle introduced by the White Paper preceding the Education Act 2006



which acknowledges the commissioning rather than provisioning role of the LEA with regard to education.

With much relief, the debate now seems to have been settled and HMRC has formally recognised that central government, LEAs, governing bodies and head teachers all have a role in the teaching of education in state schools. For VA schools, in particular, HMRC has confirmed that central government and LEAs do not use the school premises and that their role is far more overarching. A governing body of a VA school can therefore issue a zero rating certificate provided the usual conditions are satisfied. Whilst this has been welcome, it has come with the news that changes have been made to the extra statutory concession relating to the minor business use of premises.

Removal of the Extra Statutory Concession 3.29

The Revenue & Customs Brief 39/09 issued on 1st July 2009 announced the withdrawal of the Extra Statutory Concession (ESC) 3.29 and two related concessions from 1st July 2010. ESC 3.29 enables charities to meet the “solely” test provided that the building is intended to be used 90% or more for non-business purpose as measured by one of three specific measures (time, floor space or headcount). This was extended in 2007 so that, provided the intention was there when the certificate was issued, there would be no claw back or charge to VAT if the use changed during the 10 year claw back period. This was valuable as changes do of course occur and it would be

unlikely that funding for a claw back would have been put aside for such an eventuality. The loss of this concession is a blow to VA schools although it is in line with the review generally by HMRC of all concessions following the House of Lords judgment in *Wilkinson v Inland Revenue Commissioners* (2005).

ESC 3.29 has not been replaced with an alternative concession as such, but it has been acknowledged that a governing body wishing to issue a zero rating certificate on the new basis of “solely” using the building for a relevant charitable purpose will have to show that the relevant use of the building is 95% or more. How that is to be calculated is to be left with the person issuing the certificate and any method can be used provided that it is “fair and reasonable”. HMRC’s view of what might constitute a fair and reasonable method is whether it:

- accurately reflects the extent that the building is used for charity business and charity non-business purposes; and
- its application should not be unduly burdensome for the charity and its accuracy is relatively easy for HMRC to check.

HMRC are consulting charity representative bodies with a view to issuing further guidance at some point and until 1st July 2010, charities will have the choice as to whether they wish to use the new method or continue under the ESC.



Community and third party use under the BSF proposals

Recent government policy has of course encouraged schools to think actively and creatively about bringing the community into the school and the school into the community. New facilities are being designed and built with the intention that significant use is made of them when not in school use. The extended schools agenda encourages schools to look at after school clubs, adult education, crèches, children's centres and early year's education.

The standard form BSF documents (both PFI and FM (where the D&B route is adopted) provide for school premises to be used for community use and third party use, the latter envisaging uses which attract a commercial fee rather than a subsidised or nominal payment. Responsibility for finding and managing both community and third party uses is passed to the LEP but proceeds are shared between the LEP, the LEA and the governing body.

Planning policy also favours extended use and we are increasingly seeing conditions to this effect in planning permissions for new school buildings.

Whilst for the most part, governing bodies will welcome extended use and are likely to have an active programme in place, care needs to be taken to monitor the type and extent of such use to ensure that the relevant charitable purpose test can still be satisfied. This is obviously relevant at the outset of any construction but also during the 10 year claw back period.

The restriction of non-business use to 5% poses some real problems for schools who might have begun to appreciate a little more freedom in the way they manage their activities, potentially putting them on a collision course with HMRC, LEAs, local planning authorities and DCSF. HMRC are likely to show little flexibility in considering what constitutes non-business whilst precedents in other contexts suggest that it may not be easy to agree on what is a "fair and reasonable" calculation.

The role of schools and colleges within their communities may be changing but there is a real concern that significant progress to date in this area will come to a stop. In practice, this is not an area where we can expect much in the way of "joined-up" government. Experience suggests that HMRC will take little account of broader government objectives and whatever reassuring noises HMRC are making now, many VAT officers will look for any excuse to deny zero-rating. It is to be hoped that those seeking the transformation of our school estate will be prepared to fund the necessary cost.

Implications for other schools and colleges

To an extent the new guidance follows principles already established for FE colleges and academies, where governing bodies for both take primary responsibility for capital expenditure and where the LEA has an overarching commissioning role. There may also be questions over the continued use of section 33 for capital work to academies, although to date government has shown more sensitivity to VAT problems here than



for schools in general. And, the implications of community use and third party use may also be significant if the trend towards LEA procurement of capital works for all schools and colleges continues.

For more information about VAT recovery and relief and the BSF and PCP programmes please contact:

Andrea Squires

Partner
DT: 020 7593 5039
asquires@wslaw.co.uk

Martin Scammell

VAT Consultant
DT: 07979 752667
mscammell@wslaw.co.uk