



VAT: Withdrawal of the exemption for business supplies of research between eligible bodies

Consultation document

Publication date: 20 December 2012

Closing date for comments: 14 March 2013

Subject of this consultation:	The UK has received notification from the European Commission that its exemption for business supplies of research between eligible bodies does not comply with European legislation. The UK has accepted that this is the case and plans to withdraw the exemption from 1 August 2013.
Scope of this consultation:	The purpose of this consultation is to allow Her Majesty's Revenue & Customs (HMRC) to assess the impact that the withdrawal of the exemption will have and to see whether there are any possible options to mitigate the impact of the withdrawal.
Who should read this:	All suppliers of business or non-business research and those that commission research.
Duration:	The consultation will start on 20 December 2012 and end on 14 March 2013
Lead official:	For enquiries about the content of the consultation or requests for hard copies please contact: Keith Parnell HMRC, VAT Liability Policy Team Room 3/34 100 Parliament Street London SW1A 2BQ Email: keith.parnell@hmrc.gsi.gov.uk Telephone enquiries 020 7147 0529 (from a text phone prefix this number 18001)
How to respond or enquire about this consultation:	Postal address and email address to which written responses can be submitted are as above. When responding please indicate your status e.g. do you commission research projects; do you make business and/or non-business supplies of research. If you are a representative body please provide information on the number and nature of your membership.
Additional ways to be involved:	HMRC is also happy to meet with and speak to interested parties during the consultation period. Contact details are shown above.
After the consultation:	The responses will help HMRC in deciding whether or not there is a need to mitigate the impact and if so whether transitional arrangements could meet that need.
Getting to this stage:	HMRC have had confidential discussions with some representative bodies with a view to obtaining the information sought in this consultation. As the outcome of these discussions was inconclusive as to the impact, we have decided to undertake a full consultation.
Previous engagement:	There have been confidential discussions with certain trade representatives as mentioned above.

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1. Introduction

Background

In the UK, the supply of research services can be outside the scope of VAT, standard-rated or exempt depending on how the research is funded, who is providing them and who they are provided to.

- i). **Outside the scope research** (non-business research) - research that is block-funded or grant-funded; this is often carried out by universities. This type of research is generally for the public good and the body funding it (e.g. one of the research councils) does not receive any supply of goods or services in return for the funding. Typically, the research does not give rise to intellectual property that will be exploited.
- ii). **Standard-rated research** (business research) - contracted research (carried out for business purposes) supplied between two commercial organisations or between a commercial organisation and an eligible body, such as a university or a charity. Typically this type of research will give rise to intellectual property which will likely be of value to the commissioning body.
- iii). **Exempt research** – any research that is supplied between two eligible bodies (eligible bodies include Government departments, schools, universities, charities and other public bodies).

HMRC understand that the majority of research carried out in the UK is grant-funded and therefore outside the scope of VAT. Most of the remainder is taxable business research and so the amount of exempt research is understood to be very small. If this is right, the loss of this exemption should not have a significant impact on UK research but we hope responses to this consultation will clarify this one way or another.

Action being taken by the European Commission

The European Commission has challenged the exemption of business research supplied between eligible bodies and the UK accepts that the exemption is not permitted by the Principal VAT Directive. The Government has accepted the Commission's analysis and has informed the Commission that they plan to withdraw the exemption with effect from 1 August 2013. This date, which is still subject to agreement with the Commission, has been chosen because it offers a fair balance between allowing suppliers reasonable time to make adjustments and avoiding an unacceptable delay in implementation which would prompt legal action on the part of the Commission. In addition, since this date is the start of the academic year, HMRC hope that this will fit neatly into accounting systems.

What is Research?

Although there is no legal definition of research in VAT law it is generally considered that research means original investigation undertaken in order to gain knowledge and understanding.

It is the intention of the parties at the beginning of a project that will determine whether the services supplied qualify as research for VAT purposes. If the intention is to advance knowledge and understanding, the supply is one of research.

Research does **not** include supplies such as merely confirming existing knowledge or understanding, consultancy, business efficiency advice, market research or opinion polling.

The fact that a particular project may have a specific commercial application does not prevent it from being research. Indeed much research funded by the Department of Business, Innovation and Skills and by Research Councils is aimed at developing improved equipment or techniques for use in industry.

2. Effects of withdrawing the exemption

Impact of the withdrawal

The withdrawal of the exemption for research supplied between eligible bodies will not affect the VAT treatment of research that is currently outside the scope of VAT (non-business research) or research that is standard-rated (business research).

The UK has an obligation to bring its VAT legislation into line with European law. The purpose of this consultation is therefore to enable HMRC to gain a better understanding of the impact that the withdrawal will have on the sector so that consideration can be given to whether any transitional relief is necessary or possible within the confines of that obligation.

Once the exemption is withdrawn supplies of research between eligible bodies, which are currently exempt from VAT, will become taxable at the standard rate. This will mean that there will be a corresponding increase (20 per cent) in the cost of the supply although this will, in part, be offset by the ability to deduct input tax against making such supplies.

Examples of how VAT will now apply

1). A charity grant funds University A to carry out some research. The supply University A makes to the charity is outside the scope of VAT. However, University A needs to subcontract part of the research to University B. At present, the supply University B makes to University A is exempt from VAT but after the exemption is withdrawn it will be taxable (20% VAT). This will not affect the supply University A makes to the charity which will remain outside the scope of VAT.

In this scenario, University A's costs increase by the VAT charged by University B. However, since University B can now deduct input tax on making this supply, this may allow, in some cases, for a lower net price to be charged to University A.

2). A commercial company provides funding to University Z to conduct research with the expectation that there will be intellectual property produced. The supply made by University Z to the commercial company is a standard-rated business supply. However, University Z needs to subcontract part of the research to University X. At present, the supply made by University X to University Z is exempt from VAT but after the exemption is withdrawn it will be taxable (20% VAT). This will not affect the supply made by University Z to the commercial company which will remain taxable at the standard rate.

In this scenario, University Z's costs will be the same since they will be able to deduct the VAT charged by University X as directly attributable to their onward supply to the commercial company.

3. Tax Impact Assessment

The purpose of this consultation is to inform HMRC of the impact that the withdrawal of the exemption will have; no prior Tax Impact Assessment has been made.

However, HMRC consider that the impact is likely to affect only those businesses that commission, receive or supply research, in particular those that are classified as eligible bodies for the purposes of Group 6 of Schedule 9 to the VAT Act 1994. It is not expected that there will be an impact on households or individuals.

Summary of Impacts

Exchequer impact (£m)	2012-13	2013-14	2014-15	2015-16	2016-17
	This measure is estimated to increase receipts by approximately £5 million per annum. The final costing will be subject to scrutiny by the Office for Budget Responsibility, and will be set out at Budget 2013.				
Economic impact	This measure is not expected to have any significant economic impacts.				
Impact on individuals and households	The withdrawal of the exemption is not expected to have any impact on individuals and households				
Equalities impacts	The withdrawal of the exemption is not expected to have any equalities impact.				
Impact on businesses and Civil Society Organisations	The withdrawal of the exemption is expected to have a negligible impact on businesses and civil society organisations, although it will have an effect on those charities and universities that currently provide exempt supplies of research. Further assessment of any impact on eligible bodies will be informed by this consultation.				
Impact on HMRC or other public sector delivery organisations	There may be a minimal impact on HMRC as the withdrawal of the exemption will mean that some universities and other providers of business research will need to amend their partial exemption methods and agree them with HMRC.				
Other impacts	No other impacts have been identified.				

4. Consultation Questions

As this consultation is designed to assist HMRC in evaluating the impact that the withdrawal will have, we need to know details of the research that is currently underway or planned. The following questions will improve our knowledge and allow us to consider the impact and whether any transitional arrangements are necessary or possible.

1. What is the annual value of research that you supplied or expect to supply in each of the following categories for both the current financial year and the next financial year?
 - a. Exempt;
 - b. Standard-rated
 - c. Outside the scope
2. What is the annual value of research that you commissioned/received, or expect to commission/receive, including research you sub-contracted in each of the following categories for both the current financial year and the next financial year?
 - a. Exempt;
 - b. Standard-rated
 - c. Outside the scope
3. What field of exempt research (if any) do you specialise in?
4. If you commission exempt research, approximately what proportion or value of your exempt research only is funded by:
 - a. Charitable grants
 - b. Government grants
 - c. Own funds
 - d. Financial or other commercial institutions
 - e. Other (*please specify*)?
5. If you are an eligible body and you sub-contract out research to a third party is it to an eligible body and therefore exempt or is it to a non-eligible body and therefore standard-rated?
6. As of 1st January 2013 what is the total number and value of your exempt research contracts currently in progress (please give separate figures for each if you both supply and commission research)?
7. What is the average length of your contracts to supply/receive exempt research?
8. What scope is there to vary the terms of exempt research contracts currently in progress that are likely to become standard-rated from 1 August 2013?
9. What would the overall cost and effect on your organisation be when the liability changes and there are no transitional arrangements put in place (i.e. all exempt research in progress becomes standard-rated from 1 August 2013)?

10. Do you have any comments on the expected impact of the withdrawal including any administration burdens that may affect you as a result of the withdrawal?

5. The Consultation Process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

- Stage 1 Setting out objectives and identifying options.
- Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.
- Stage 3 Drafting legislation to effect the proposed change.
- Stage 4 Implementing and monitoring the change.
- Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stages 2 and 3 of the process.

The purpose of the consultation is to seek views on i) the detailed policy design and a framework for implementation of a specific proposal, rather than to seek views on alternative proposals; and ii) draft legislation in order to confirm, as far as possible, that it will achieve the intended policy effect with no unintended effects.

How to respond

A summary of the questions in this consultation is included at chapter 4.

Responses should be sent by 14 March 2013, by e-mail to [keith.parnell@hmrc.gsi.gov.uk] or by post to:

Keith Parnell
HMRC
VAT Liability Policy Team
Room 3/34
100 Parliament Street
London
SW1A 2BQ

Telephone enquiries: 020 7147 0529 (from a text phone prefix this number with 18001)

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from the HMRC Internet site at <http://www.hmrc.gov.uk/consultations/index.htm>. All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Consultation Principles

This consultation is being run in accordance with the Government's Consultation Principles.

The Consultation Principles are available on the Cabinet Office website:

<http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance>

If you have any comments or complaints about the consultation process please contact:

Amy Burgess, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

Please do not send responses to the consultation to this address.

Annex A: Relevant (current) Government Legislation

VAT ACT 1994 - Group 6 of Schedule 9

Item No.

1. The provision by an eligible body of-

- (a) education
- (b) research, where supplied to an eligible body; or
- (c) vocational training.

Notes:

For the purposes of this Group an "eligible body" is-

(a) a school within the meaning of the Education Act 1996, the Education (Scotland) Act 1980, the Education and Libraries (Northern Ireland) Order 1986 or the Education Reform (Northern Ireland) Order 1989, which is-

- (i) provisionally or finally registered or deemed to be registered as a school within the meaning of the aforesaid legislation in a register of independent schools; or
- (ii) a school in respect of which grants are made by the Secretary of State to the proprietor or managers; or
- (iii) a community, foundation or voluntary school within the meaning of the Schools Standard and Framework Act 1998, a special school within the meaning of section 337 of the Education Act 1996 or a maintained school within the meaning of the Education and Libraries (Northern Ireland) Order 1986; or
- (iv) A public school within the meaning of section 135(1) of the Education (Scotland) Act 1980; or
- (v) omitted
- (vi) repealed
- (vii) omitted
- (viii) a grant-maintained integrated school within the meaning of Article 65 of the Education Reform (Northern Ireland) Order 1989;

(b) a United Kingdom university, and any college, institution, school or hall of such a university;

(c) an institution-

- (i) falling within section 91(3)(a), (b) or (c) or section 91(5)(b) or (c) of the Further and Higher Education Act 1992; or
- (ii) which is a designated institution as defined in section 44(2) of the Further and Higher Education (Scotland) Act 1992; or
- (iii) managed by a board of management as defined in section 36(1) of the Further and Higher Education (Scotland) Act 1992; or
- (iv) to which grants are paid by the Department of Education for Northern Ireland under Article 66(2) of the Education and Libraries (Northern Ireland) Order 1986;

- (d) a public body of a description in Note (5) to Group 7 below;
- (e) a body which-
 - (i) is precluded from distributing and does not distribute any profit it makes; and
 - (ii) applies any profits made from supplies of a description within this Group to the continuance or improvement of such supplies;
- (f) a body not falling within paragraphs (a) to (e) above which provides the teaching of English as a foreign language.

Note(5), Group 7 to Schedule 9 of the VAT Act 1994

- (5) In item 9 "**public body**" means-
- (a) a Government department within the meaning of section 41(6);
 - (b) a local authority;
 - (c) a body which acts under any enactment or instrument for public purposes and not for its own profit and which performs functions similar to those of a Government department or local authority.

Annex B: Draft proposed legislation.

Order made by the Treasury, laid before the House of Commons under section 97(3) of the Value Added Tax Act 1994, for approval by resolution of that House within twenty-eight days beginning with the day on which the Order was made, subject to extension for periods of dissolution, prorogation or adjournment for more than four days.

STATUTORY INSTRUMENTS

2013 No.

VALUE ADDED TAX

The Value Added Tax (Education) Order 2013

Made - - - - - ***

Laid before the House of Commons ***

Coming into force - - - *1st August 2013*

The Treasury, in exercise of the powers conferred by section 31(2) of the Value Added Tax Act 1994 (1), make the following Order:

1. This Order may be cited as the Value Added Tax (Education) Order 2013 and comes into force on 1st August 2013.
2. In Group 6(2) of Schedule 9 to the Value Added Tax Act 1994 (exemptions: education), in item 1, omit paragraph (b) (but not the 'or' after it).

Date *Name Name*
Name Name
Two of the Lords Commissioners of Her Majesty's Treasury

EXPLANATORY NOTE

(This note is not part of the Order)

This Order amends Item 1 of Group 6 ("Group 6") of Schedule 9 (education: exemptions) to the Value Added Tax Act 1994 ("the Act") to remove the supply of research by an eligible body to an eligible body from exemption from value added tax with effect from 1st August 2013.

Group 6 describes supplies of goods and services in connection with education which are, pursuant to section 31 of the Act, exempt from value added tax. Item 1 of Group 6 exempts the provision of certain services by eligible bodies (which are defined by Note 1 to Group 6). Item 1(b) exempts the supply of research to another eligible body.

Article 2 deletes the operative part of item 1(b).

(1) 1994 c. 23
(2) Group 6 was amended by SI 1994/2969, paragraph 125 of Part I of Schedule 37 to the Education Act 1996 (c.56), paragraph 51 of Schedule 30 to the School Standards and Framework Act 1998 (c. 31), Schedule 3 to the Standards in Scotland's Schools etc. Act 2000 (asp 6) and SI 2010/1080; there are other amending provisions and instruments but none is relevant to this Order.

A Tax Information and Impact Note covering this instrument will be published on the HMRC website at <http://www.hmrc.gov.uk/thelibrary/tiins.htm>.