

2011 VAT INSPECTION

Report of the Director & Company Secretary

1. SUMMARY

This report summarises the outcome of a VAT inspection which took place between March and November 2011.

2. RECOMMENDATION

To note the contents of the report and the future actions proposed in paragraphs 3.7 and 3.8.

3. MATTER FOR CONSIDERATION

- 3.1 The investigating officer visited the company on 15 and 16 March 2011 and on 14 July 2011. Considerable correspondence and discussions took place throughout the inspection and full co-operation was given to the investigating officer. Throughout this investigation Derby Homes has received advice and assistance from the Taxation Manager at the Council.
- 3.2 The turnover and associated expenditure of Derby Homes over five financial periods was reviewed. This turnover amounted to over £80,000,000 in value.
- 3.3 The Inspector's decision was that VAT had not been correctly dealt as follows:

Item	Income stream or expenditure	Net value in review period £	VAT Assessments £	VAT Charge £	Interest payable £
1	Legal, professional and other costs on New Build Development	213,000	31,700	31,700	2,400
2	Income received for Family Intervention Project and Neighbourhood Renewal Fund	1,269,000	205,000	Nil	Nil
3	Other items	34,000	6,100	Nil	Nil

- 3.3.1 Item 1 in the table above arises because during the review period Derby Homes had reclaimed standard rate VAT in relation to professional, legal and other costs incurred during the construction of the ten New Build properties whereas because these costs could be attributed to an eventual exempt supply the input VAT should have been disallowed.
- 3.3.2 The total amount of VAT involved was £31,700 and this has now been paid over to HMRC. This is effectively an additional cost of the New Build programme and will be charged to revenue in the current financial year. Additionally because this error resulted in a loss of income to HMRC interest on the late payment has been calculated at £2,400. This will also be charged to revenue in the current year.
- 3.3.3 The VAT and interest on item 1 therefore remain a charge to Derby Homes but can be covered within the current budget due to under spends and business transformation savings. Items 2 and 3 in the table above have a neutral effect for Derby Homes because equivalent VAT only invoices have been raised on the Council in compensation.
- 3.4 In view of the volume of transactions relating to a turnover of £80,000,000 and the fact that this was the first VAT inspection that has taken place since the start up of the company in 2002, this can be considered to be a reasonably satisfactory outcome. Additionally, no VAT issues arose relating to the Maintenance Operations which transferred to Derby Homes on 1 June 2010 and accounted for a turnover of £12,000,000 in 2010/11.
- 3.5 Income in relation to the Tenants Contents Insurance and the New Build rents are VAT exempt and the Inspector required partial exemption calculations to be undertaken for the period 1 June 2008 to 31 March 2011. The purpose of these calculations is to determine whether any input VAT on supplies and services which are common to both taxable and exempt supplies (non-attributable VAT) should also be disallowed. De-minimus rules apply on both a quarterly and annual basis.
- 3.5.1 The calculations prepared for the Inspector showed that no further disallowance was necessary and all non-attributable VAT had been correctly claimed as input VAT on the company's VAT returns.
- 3.6 Severe penalties can be imposed by HMRC and these can be made payable on demand.
- 3.6.1 The Inspector was of the view Derby Homes had not taken full advice on deciding whether income streams should be subject to VAT and had not followed VAT guidelines concerning the New Build exempt activity. Additionally, a clerical error resulted in VAT of £16,000 due in the quarter ended December 2010 not being paid until the following quarter ended March 2011. For these reasons the Inspector decided to calculate a penalty but has agreed to suspend payment provided the conditions listed in paragraph 3.8 are met.
- 3.6.2 The errors on which the suspended penalty was calculated carry a penalty of 30% of the VAT involved but an abatement applies which can reduce the percentage to 15%.

3.6.3 The abatement is earned according to the following percentages:

- 30% - for cooperation and giving the Inspector full details
- 40% - for helping the Inspector to understand issues
- 30% - for giving access to records.

3.6.4 In each case Derby Homes was given the maximum percentage abatement, thus reducing the penalty rate from 30% to 15%. The suspended penalty is still to be finalised but is approximately £27,000 and would therefore have been £54,000.

3.7 The penalty suspension conditions have been confirmed by the Inspector as follows

1) To meet the company's payment, notification and filing obligations to HMRC.	This has always been done by Derby Homes.
2) To determine the VAT liability of current and future income streams, establishing whether the consideration is a grant outside of the scope of VAT or is for a supply of services subject to VAT and to take technical advice when it is not clear.	A certain amount of work has been done on this in the past but this aspect will now be made a priority when considering future income streams. If necessary advice will be taken from the Council's Tax Manager and external consultants.
3) Appropriate partial exemption calculations to be completed each VAT quarter.	This is now being done.
4) Error correction procedures to be followed.	Should an error in excess of £10,000 be discovered, the correct procedures will be followed.

3.8 A two day visit to the company by the Council's Taxation Manager was arranged for early December to review the findings of the investigation and to assist in ensuring that current procedures are correct. No new recommendations arose.

3.8.1 Brief VAT guidelines will also be prepared which will be circulated to senior management and other managers so that VAT aspects will be considered whenever new income streams arise.

4. FINANCIAL AND BUSINESS PLAN IMPLICATIONS

As noted in this report.

5. LEGAL AND CONFIDENTIALITY IMPLICATIONS

There is a legal obligation to comply with the findings of Inspector and to respect the penalty suspension conditions imposed.

6. COUNCIL IMPLICATIONS

The Council's Tax Manager has been kept fully informed on all aspects of this VAT investigation.

7. RISK IMPLICATIONS

If the penalty suspension conditions are not met payment of the penalty of £27,000 to HMRC will become immediately due.

The areas listed below have no implications directly arising from this report:

Consultation
Personnel
Environmental
Equalities Impact Assessment
Health & Safety
Policy Review

If Board members or others would like to discuss this report ahead of the meeting please contact the author, or Phil Davies, Chief Executive, phil.davies@derbyhomes.org – Phone: 01332 888528

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Background Information: None

Supporting Information: None