

Paper 1 - VAT provision and revised budget

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Agenda Item:						
Item Subject:	Revised budget and VAT provision					
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For:	Discussion	X	Decision	X	Information	

Recommendation 1:

The Committee is asked to review the options for VAT provision within the operational core budget this financial year (FY) and recommend a preferred option to the GLLEP Board.

Recommendation 2:

The Committee is asked to recommend to the GLLEP Board that a payment is made from Reserves to cover the VAT Input retrospective liability of £306,003.

Recommendation 3:

The Committee is asked to review the options for VAT provision within the operational core budget for future FYs and recommend a preferred option to the GLLEP Board.

Recommendation 4:

The Committee is asked to recommend to the GLLEP Board that the existing Company Provision Reserve is increased by 20% to make an allowance for any VAT liability in the case of the provision having to be utilised.

1. Background

HMRC are undertaking a VAT audit with respect to LCC and LEP company finances, reviewing both output and input tax liability, where output tax is the VAT incurred as a result of the LEP receiving services and/or benefits from LCC. This includes VAT applied to salaries for staff employed by LCC for LEP use, and to charges for LCC services such as Accountable Body and Legal provision. Input tax is the VAT incurred on external expenditure.

The working assumption at the time of writing this paper is that the historic VAT liability could be up to £600,000 in total, and the in-year liability c. £200,000 per annum based on current budget projections.

There is an argument that both the LEP and LCC should contribute to the VAT liability for the company. The LEP and LCC therefore need to review options to pay both the historic liability and projected in year VAT going forward, and potentially review the operating model.

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1.1. Input VAT

Further to the paper presented to the Committee on 16th June 2022 regarding the increased risk of HMRC ruling that LCC can no longer reclaim Input VAT on the GLLEP's expenditure, we have now had confirmation from HMRC that this is indeed the case. A retrospective payment of £306,003 is now due, and provision for Input VAT in-year and in future years will also have to be made, see sections 3 and 5 for details.

1.2. Output VAT

HMRC are now reviewing the GLLEP's liability for Output VAT. This hinges on a decision around whether payments recharged back to LCC are for benefits and/or services received by the GLLEP. We have reviewed this in detail and expect that the ruling will confirm that output VAT is also due, including a retrospective payment. We anticipate that the output tax liability will apply to all staff salaries, (excluding the first £310,000, which is covered by LCC in-kind match funding), as well as all payments to LCC for services such as Accountable Body and Legal fees.

We anticipate that a retrospective payment of c. £280,000 could be due. Provision for Output VAT in-year and in future years will also have to be made, please see section 3 for details.

1.3. Effectively, this means that the full core operational budget, minus £345,000 LCC total in-kind match funding, is liable for some form of VAT from this year forwards, as shown in section 3.

2. Reserves position as at 1st April 22

Reserve	Balance at 01 April 2022	
Core Operational	£	2,078,724
Core Other	£	463,606
Invest	£	1,383,182
Programmes	£	3,500,000
Company Provision	£	423,000
Grand Total	£	7,848,512

We consider the Core Operational Reserve of £2,078,724 to be the most appropriate source of any additional funding required to cover VAT liability. It is this value that has been considered in assessing the various options and scenarios in the rest of this paper.

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3. VAT provision in-year and future years

3.1. Current FY 22/23

We offer two options for making a VAT provision within the current FY. The Committee is asked to consider these options and recommend a preferred approach to the GLLEP Board.

Option 1

Utilise additional reserves to cover the full VAT liability

Option 2

Cover VAT liability as far as possible within existing approved budget

The following measures could be utilised to reduce the budget:

- Converting net budget amount to gross
- Removing activity
- Renegotiation of contracts
- Reviewing commitment against budget lines
- Reallocation of funding pots
e.g. utilising external grants to contribute to staff costs

	Previously agreed Budget FY22/23	Revised Budget FY 22/23 Option 1	Revised Budget FY 22/23 Option 2
NET budget	£ 1,465,160.55	£ 1,404,040.70	£ 1,327,148.35
VAT liability	Not included	£ 201,940.01	£ 184,327.72
GROSS budget	N/A	£ 1,605,980.71	£ 1,511,476.07
Reserves Drawdown required for in year spend	£ 471,342.00	£ 655,227.96	£ 544,845.13

3.2. Future years - FY23/24 and FY24/25

We currently do not know the level of core funding that LEPs will be assigned from government beyond this FY. We therefore suggest two scenarios for

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FY23/24 and FY24/25, to demonstrate the possible range of reserve drawdown that may be required:

Scenario 1

Core funding is maintained at the level of the current FY, at £375,000 each FY.

Scenario 2

Core funding is reduced each year by £125,000.

3.3. In both these scenarios, we have attempted to demonstrate where savings could be made to ensure reserves are sufficient to maintain LEP activity as follows:

- No further contribution to Team Lincolnshire beyond FY22/23
- No addition of a UKFV Programme Manager post
- No designated SAB budgets, with the exception of £14,000 in FY23/24 for Defence Board, which is the remaining balance of a pre-approved allowance of £40,000

Conversely, budgets have been maintained as far as possible for research, UKFV comms and UKFV consultancy support, albeit at a slightly reduced level compared to this FY.

This results in the following:

	FY23/24 Scenario 1 £375,000 Core Funding	FY23/24 Scenario 2 £250,000 Core Funding	FY24/25 Scenario 1 £375,000 Core Funding	FY24/25 Scenario 2 £125,000 Core Funding
NET budget	£ 998,966.97	£ 998,966.97	£ 995,493.62	£ 995,493.62
VAT liability	£ 128,282.36	£ 128,282.36	£ 128,195.31	£ 128,195.31
GROSS budget	£ 1,127,249.33	£ 1,127,249.33	£ 1,123,688.93	£ 1,123,688.93
Reserves Drawdown required for in year spend	£ 342,329.00	£ 467,329.00	£ 339,068.00	£ 589,068.00

This compares with our original projections previously reported to Board of c. £1m per FY net operational budget.

As can be seen from the table above, the main impact is the difference in reserve drawdown related to potential changes in core funding.

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4. Company Provision Reserve

In addition to the Output VAT liability on the operational budget, we believe it is likely that, if the Company Provision had to be utilised to close the Company, Output VAT would be liable, as the redundancy payments would be made by LCC and then recharged back from the GLLEP. LCC have sought advice on this from PwC and this view has been confirmed.

The Company Provision Reserve currently stands at £423,000. We request that the Committee recommends to the GLLEP Board that this Reserve be increased by 20% (£84,600) to £507,600. It is recommended that this is sought from uncommitted core reserve, see section 5 for details.

5. Utilisation of Core Reserve

As shown in section 2, the Core Operational Reserves position currently stands at £2,078,724. We recommend that this be utilised as follows:

Available in Operational Core Reserve	£	2,078,724
Input VAT repayment	£	306,003
Company provision top up	£	84,600
Balance of reserves available for 22/23 - 24/25	£	1,688,121
Reserves balance after reserves use Option 1 FY22/23	£	1,032,893
Reserves balance after reserves use Option 2 FY22/23	£	1,143,275
Worst case reserves drawdown 23/24 - 24/25	£	1,056,397
Best case reserves drawdown 23/24 - 24/25	£	681,397

Where:

Worst case reserves drawdown reflects scenario 2 where core funding is reduced each year.

Best case reserves drawdown reflects scenario 1 where core funding is maintained at £375,000.

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This demonstrates that even if Option 1 for greater reserves drawdown is selected this FY (22/23), there will remain enough in the core operational reserve to make an allowance for FY23/24 and FY24/25, where the worst-case scenario only exceeds the available reserve by £23,504. However, it needs to be considered that there is a great deal of uncertainty in estimating costs going forward for future years.

6. Output VAT retrospective payment

Assuming HMRC rule as expected that LCC must charge Output VAT on recharges for services and/or benefits received by the GLLEP, we estimate the retrospective payment (backdated to September 2018) to be in the region of £280,000. The responsibility for this repayment has not yet been determined, therefore the risk needs to be acknowledged that the LEP may also have to fund this amount.