LOOKING AT LATCOs

Be aware of VAT leakage

In our experience, one of the most troublesome areas of tax for LATCOs is VAT.

VAT is a subject that, by and large, local authorities haven't had to spend a significant amount of time contemplating thanks to the various exemptions they benefit from. However, the same is not true of a LATCO and, in most cases, those VAT exemptions do not apply.

VAT is a transactional tax and is therefore driven by the nature and in some cases the timing of the transaction. Therefore, it is normally very difficult, if not impossible, to change the VAT status of a transaction once it has happened but, with advance planning, it is often possible to improve VAT efficiency.

Common areas where LATCOs have experienced problems recovering VAT include:

- Purchase costs where the activity of the LATCO is deemed to be non-business;
- Costs where the income to which those costs relate is a transaction that is exempt from VAT – for example residential property rental income;
- Situations where the LATCO has no staff of its own but is provided with staff or services by the parent local authority; and
- Residential property developments which were originally intended for re-sale but which ended up being retained and rented out.

With the current rate of VAT at 20%, any leakage is likely to represent a significant additional cost and some of the activities most prone to suffer losses include:

- Property development or rental activities;
- Utilisation of labour resources not related to a LATCOs own employees; and
- Any potentially charitable activities or quasi charitable activities.

Considering the VAT implications of a transaction in advance allows for the correct treatment and ensures that you don't end up paying more than you should.

Our specialist VAT team offer a blend of technical knowledge and practical commercial problem solving which we have found has been of significant benefit to LATCOs as they are created and develop.

'Advice before Action' is always recommended!

ENSORS

Making you more than just a number

Corporate Taxation

When a local authority spins activities out into a LATCO it is important to understand that corporation tax is going to apply to the LATCO just as it does to any privately owned company. This means that it will be required to file annual corporation tax returns before the first anniversary of the end of each accounting period, and to pay corporation tax on its profits (currently at 19%).

The default position is that the LATCO will be taxed on all its profits, no matter what activity they have arisen on, so including trading, rental income, capital gains, investment income and interest receivable. In very specific circumstances, the mutual trading exemption may apply to exempt certain profits from trading with the parent authority, meaning that only non-mutual profits are taxed. Mutual trading is a complex area, where specialist advice should be sought.

The good news is that LATCOs can also claim corporation tax reliefs like any other company. These include capital allowances, loss relief, land remediation relief and R&D tax relief, with the most commonly seen of these being capital allowances and loss relief.

Capital allowances can be claimed on plant, equipment and fixtures and fittings, where the Annual Investment Allowance (AIA) currently means that up to the first £1 million spent in the year can be deducted in the tax computation. The rate of AIA is expected to reduce on 1 January 2021. If the LATCO buys or builds non-residential properties, the Structures & Buildings Allowance may allow relief for the costs over the first 50 years of use.

Where the LATCO incurs losses in a year, these can be carried forward and offset against future profits. Alternatively, trading losses can be carried back to reduce taxable profits in the previous 12 months. Also, if there is a group of LATCOs under common ownership, it is possible for a loss-making group member to surrender its losses to a profitable sister LATCO.

Transactions between the LATCO and the local authority will usually be subject to the transfer pricing rules. This means in practical terms, if the LATCO is charging the authority less for its services than it would a third-party, its taxable profits could be adjusted upwards. Equally if the authority charges the LATCO more for its services or in interest than a third party would charge, the LATCO can only take a tax deduction for that lower amount.

As you can see, there is plenty for LATCOs to think about when it comes to corporation tax, so it helps to have an expert advisor like Ensors on hand.

Funding sources available to LATCOs

Over the last several years the popularity of outsourcing within the public sector has fallen, largely due to the failure of high-profile providers such as Carillion. This has combined with the squeeze on government budgets caused by the era of austerity to create an environment where local councils have been forced to look for alternative ways of providing services that are cheaper and more secure. One option that has seen a significant rise in utilisation has been the Local Authority Trading Company or LATCO.

Given that falling council budgets were a key motivator in this increase in the use of LATCOs it is important to consider what access they may have to external methods of funding.

LATCOs fall into three broad categories; wholly owned companies, joint ventures, and social enterprises.

Wholly owned companies and joint ventures are LATCOs where the local council retains direct control of the company and will share in the financial risks and rewards of ownership. Because of this they are largely unable to obtain external finance because most banks and other finance providers are restricted or highly reluctant to fund what is essentially a public body.

This leaves social enterprises as the main practical structure through which a LATCO can obtain external funding. A common model for this is a Community Interest Company or CIC.

The principal source of funding available to CICs (and indeed any social enterprise LATCO) is grant funding and donations. In this manner CICs have a lot in common with charities because their goals are not profit focused. There is therefore an incentive for funding bodies and private individuals to support them where they agree with the CIC's particular cause.

A CIC can also, in theory, access any type of funding that a normal company can access. For instance, debt financing through a high street bank, private equity firm, or social investor. Where the CIC is not limited by guarantee, it can also employ equity financing in the form of a standard share issue, or through the use of preference shares.

The practical restriction on such external finance is the 'Asset Lock' which is a mechanism inherent to CICs that is designed to ensure that its assets are used for the benefit of the community. This limits the maximum return that can be received by equity investors and will make it more difficult to attract such funds unless the investor has a social motivation. However, the Asset Lock does not limit the use of debt financing, as long as it can be demonstrated that the relevant interest rate has been set at a normal commercial level.

Generally speaking, social enterprise LATCOs have not been as popular in recent years as their wholly owned company and joint venture counterparts. This is probably because, as stated above, the latter enable public bodies to share in the rewards of more profitable ventures. Nevertheless, the former should still be considered a good option, especially where external funding is a key requirement and/or where profitability is low or not a concern.

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SPOTLIGHT ON SERVICE
VAT REVIEW

Why not speak to our **specialist VAT team** regarding a review? They will provide clarity on your VAT status, ensuring that where entitled, you are benefitting from partial exemption and not missing out on recovering VAT suffered.

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