
EXPLANATORY NOTE

(This note is not part of the Order)

This Order, which comes into force on 1st August 2004, modifies the conditions that certain bodies corporate must satisfy in order to be eligible to be members of VAT groups. Additional conditions will prevent certain suppliers from being in the same VAT group as their customers where third parties control the suppliers or receive most of the benefits of their activities.

Article 2 modifies the eligibility rules in section 43A of the Value Added Tax Act 1994 (“the Act”) by imposing additional conditions. If a body corporate is a “specified body” as defined in article 3, then it may only join a VAT group if, as well as satisfying the existing section 43A test of “control”, it meets the benefits condition (set out in article 5), and the consolidated accounts condition (set out in article 6).

Article 3 determines which bodies corporate are specified bodies. The body must be carrying on a “relevant business activity” (defined in article 4) and the group must have an annual turnover exceeding £10 million. Paragraphs (3) and (4) describe bodies corporate that are and are not capable of being specified bodies. Paragraph (5) defines expressions used in article 3.

Article 4 defines a relevant business activity as one that involves making reduced rate or standard-rated supplies (other than incidental supplies) to other VAT group members, where the group cannot fully recover VAT on such supplies as input tax. When applying this criterion to a body that is already a member of the VAT group, paragraph (2) deems it not to be a member.

Article 5 describes the benefits condition. By paragraph (1), this condition is not satisfied if more than 50% of the benefits generated by the relevant business activity accrue to third parties (defined in article 7). Paragraph (2) ensures that benefits accruing to persons in their capacity as shareholders of a body corporate that controls the whole VAT group are not regarded as accruing to third parties. Paragraph (3) defines what is meant by the benefits of a business activity. Paragraph (4) ensures that the benefits condition can be applied even if there are no benefits, by deeming profits of £100 to have been generated.

Article 6 sets out the consolidated accounts condition. The person controlling the VAT group must be required by “generally accepted accounting practice” to consolidate the body corporate as a subsidiary in its consolidated accounts. In addition, the body corporate must not be consolidated as a subsidiary in the consolidated accounts of a third party. Paragraph (2) requires certain assumptions to be made for this purpose. These assumptions concern, inter alia, the period for which accounts are prepared and they allow the test to be applied to persons who have not prepared accounts, or are not required to. Paragraph (3) defines generally accepted accounting practice by reference to definitions used for income and corporation tax purposes.

Article 7 contains interpretative and other provisions. Paragraph (1) applies where the specified body is the sole general partner of a limited partnership (one of the bodies article 3(3) provides is capable of being a specified body). It requires certain of the tests to be applied to the partnership, rather than the body. Paragraph (2) defines a third party as a person who does not control the whole VAT group, and is not controlled by a person who does. Paragraph (3) excludes certain individuals for this purpose. Paragraph (4) defines the “group” as the VAT group of which the body corporate is already a member, or which it has applied to join. Paragraph (5) ensures that the Order applies in the same way when the VAT group is controlled by a partnership.

A full regulatory impact assessment of the effect that this instrument will have on the costs of business is available from the House of Commons and House of Lords Libraries and from the

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