

UHI SUBSIDIARY COMPANY GUIDANCE

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1. Introduction

The University of the Highlands and Islands (UHI) has one wholly owned subsidiary company, UHI Research and Enterprise Limited (UHI R&E Ltd) SC 359497 (formerly FREERAD LIMITED). UHI R&E Ltd was established by the University as a trading vehicle for the purposes of progressing commercial spin off developments, contract research, consultancy and other professional services. The company's registered office is 12b Ness Walk, Executive Office, Ness Walk, Inverness, IV3 5SQ.

2. Why do we need subsidiary companies?

The University is a charity and it is subject to charity law in determining what activities, as a charity, it is permitted to undertake. In Scotland the charitable status of the University is monitored by the Office of Scottish Charity Regulator (OSCR) under the Charities and Trustee Investment (Scotland) Act 2005. The extent to which the University can undertake non-charitable activities is constrained by charity law and by tax considerations, clarified through 'The Corporation Tax Treatment of UK Universities' agreed by HMRC and British Universities Finance Directors Group (BUFDG).

Activities that the University may carry out will either have the status, charitable or non charitable, and depending on the status the activity will be 'primary purpose' or 'non primary purpose' respectively:

Primary purpose 'pot'

This 'pot' is exempt from tax. The tax exemption for 'charitable' or 'primary' purpose trading applies since this activity contains only the trading activities of the University that are charitable in purpose **and** for the public benefit. The 'advancement of education' is defined in the Charities Act 2006 (the Act) as having charitable purpose and is therefore exempt from tax (Corporation Tax and VAT). Activities which would be incidental or ancillary to the above are included in the primary purpose 'pot' and exempted as part of that deemed trade e.g. provision of accommodation and catering to students being taught at a university.

Non primary purpose 'pot'

This 'pot' is not exempt from tax. This 'pot' contains all trading activities of the University which are not charitable in purpose i.e. non primary purpose trading activities for tax purposes. Examples of such income for a university include:

- Research – UK industry
- Accommodation vacation lets
- Sports hall
- Car park
- Closed courses

Corporation tax is potentially chargeable on the amalgamated results of all the activities in the non primary purpose 'pot' and not on the results for each separate non primary purpose activity.

Charities often set up wholly owned subsidiary companies to carry out trading activities that fall outside the scope of charitable status and the tax exemptions available. Generally where the single deemed non primary purpose trade is likely to be profitable and potentially give rise to a taxable profit it is considered prudent that the profitable activities are performed in a subsidiary company.

3. Determining activity to be channelled through subsidiary companies

It has been assumed at this stage that a proposed activity will have been properly costed and the Business Case approved in line with the University's procedures.

It then needs to be considered whether the activity is charitable. The definition of what is charitable and the tests that must be satisfied are laid out in the Charities Act 2006 (the Act). Each of the following three tests must be satisfied:

1. Is the activity within the University's objectives as set out in its Memorandum and Articles of Association – 'The object for which the Company is established is the advancement of education and in pursuance thereof' (Refer to Memorandum of Association for full listing).
2. Is the activity within one of the 13 areas of charitable activity as defined in the Act? In practice the main area that is likely to be relevant to the University is "the advancement of education".
3. Is the activity for the public benefit? Public benefit requires application of the following sub-tests and, again, each must be satisfied:
 - a) Is there an identifiable benefit to the public or a section of the public? This means that the ability to benefit from the activity should not be unreasonably restricted.
 - b) Are people on low incomes able to benefit? It is suggested that it may be sufficient that people on low incomes should be able to benefit from some of the activities of a charity (rather than from each specific activity).
 - c) Is any private benefit incidental? This means that the benefit to the public must be the main reason for undertaking the activity. Private benefits would include both benefits to individuals and benefits to the University or to other organisations.

If an activity fails to meet any one of these tests (and cannot reasonably be re-designed so that it does meet them), then it should be channelled through a subsidiary company.

Application of the above test to specific activities that are carried out by a University include:

Educational courses – most courses are charitable.

- Degree courses will nearly always be charitable given the financial support (SAAS and SLC funding) available to enable people on low incomes to benefit.
- Short/ part-time courses open to the public will also in most cases be charitable.
- Closed courses (those which are run for a particular employer and are not open to the public) are non-charitable because they only provide private benefits and should be channelled through a subsidiary company. Consideration needs to be made as to whether the closed course provides education that results in the subsidiary company acting as if it were a University – see section 5 ‘Vat and subsidiary companies’ - before determining whether this activity should be channelled through UHI R&E Ltd or whether another trading subsidiary would need to be established to deal with this activity.

Research – most research is charitable.

- Publicly funded research for use in the public domain i.e. through publication, is charitable.
- Surplus delivering research that is not disseminated to the public either through publication or further application is not charitable or contract research that is undertaken for a client who wishes to retain results solely for its own use is likely to be non-charitable and should be channelled through UHI R&E Ltd.

Consultancy and miscellaneous services – most such services are non-charitable as normally they yield only private benefits to the client and provider. Such services should be channelled through UHI R&E Ltd.

Conferences – most will be charitable where they involve the provision of education by the University.

Accommodation - will normally be charitable.

- Student accommodation is charitable because it is considered ancillary to the provision of education.
- The provision of accommodation to third parties will normally be non-charitable. This would include room hire, letting of accommodation to non-students, and hire of facilities to third parties running conferences. Such activities should be channelled through UHI R&E Ltd.

4. Corporation Tax and subsidiary companies

A subsidiary company being wholly owned by the University, can enter into a Gift Aid arrangement and use the gift aid relief to reduce or eliminate its profits and any tax liability, by making a gift of its taxable profits to the University by way of a donation.

The Company has nine months from the end of the accounting period in which to determine the amount to donate to the University as a qualifying donation. The payment must be made to the University within nine months of the end of the accounting period. This allows sufficient time for the Company to determine its precise corporation tax profits, to enable it to pay the University an amount equal to its entire profits and so reduce its corporation tax liability to nil. A claim needs to be made, within two years of the accounting period in which the gift aid payment is made.

The donation is not chargeable to tax in the University. This situation can be used to eliminate the potential tax charges that would have arisen on the profits from a non primary purpose trade had they arisen in the University. HMRC have confirmed that the use of subsidiary companies and the Gift Aid relief is an acceptable method of mitigating the potential tax liabilities arising on non primary purpose trading in Universities.

5. VAT and subsidiary companies

Details specific to the University's VAT position and the trading subsidiary company registered for VAT are contained in the 'VAT Manual'. VAT applicable to Research activity is detailed in Appendix I.

In summary, the University has eligible body status for VAT purposes and as a result certain supplies such as education is exempt from VAT. The University also has charitable status and can receive certain supplies zero rated for VAT purposes (certain advertising supplies) or at a lower rate (reduced rated building work). As the University is making exempt supplies it can only reclaim a proportion of its input VAT using the Partial Exemption Special Method agreed with HMRC.

A trading subsidiary company of the University is a commercial organisation and 100% of its input VAT is recoverable. HMRC have issued new guidelines on the VAT status of University trading companies, VAT Info Sheet 03/10. The guidelines look to whether University trading companies providing education or training are 'eligible bodies' for the purposes of VAT. There are 15 factors that must be considered and we must weigh these factors, consider their cumulative effect and reach a conclusion. There are three key themes that should be present however before a company can be treated as an eligible body:

- There must be a close relationship between the University and the company. In the case of 100% owned trading companies this will always be present.
- The company must provide University level education leading to a qualification awarded by the University. **This would include 'closed' University courses that will lead to a University qualification.**
- The students on the course are registered/ enrolled with the University, are subject to the University's rules and regulation and are awarded qualifications by it.

Once a subsidiary company carries out the supply of education or training that meets the eligible body status it is classed as acting as if it were a 'college institution, school or hall of a University' and **all of its supplies of education, including those not leading to a University qualification, are exempt**. As a result, a subsidiary company being classed as an eligible body and making exempt supplies, will only be able to reclaim a proportion of its input VAT using a Partial Exemption Special Method agreed with HMRC.

It is therefore essential that each activity identified as being relevant to a subsidiary company through the steps in section 3 'Determining activity to be channelled through subsidiary companies' is then assessed against the 15 factors in the 'VAT guidelines for subsidiary companies' to determine the relevant subsidiary company to channel the trade through.

The University would need to set up another subsidiary for the purpose of delivering closed courses that lead to a University-level qualification as this could not be channelled through UHI R&E Ltd.

6. UHI Research and Enterprise Limited

UHI R&E Ltd is a trading company, and the principal activities carried out by the company are the provision of commercial activities including training (CPD), consultancy and research.

UHI R&E Ltd is registered for VAT.

UHI R&E Ltd does not carry out exempt supplies therefore it recovers 100% of its input VAT.

VAT is applied to all sales invoices raised by the company.

Expenditure

Includes:

Direct Staff costs

UHI R&E Ltd does not have direct employees, rather employees of the University engage in the activities of UHI R&E Ltd. On notification of a project starting the Finance Office will transfer, on a pro rata basis, the payroll transfers between UHI and UHI R&E Ltd as detailed on the original costing forms.

The University raises a sales invoice to the Company for the salary costs on a monthly basis. VAT is applied to the sales invoices and is 100% recoverable in UHI R&E Ltd.

Management charge

In addition to the recharges for employees of the University being engaged in Project related work, a management charge is raised by the University to UHI R&E Ltd at the end of each financial year for:

The cost of the support services of Finance staff of UHI carrying out UHI R&E Ltd work,

The services of the Directors of the Company, and

The reimbursement of a proportion of Insurance costs paid by UHI.

VAT is applied to the management charge.

Audit Fee

The cost of the annual external audit of the Company is invoiced directly by the external auditors to UHI R&E Ltd. VAT is applied to the invoice and is 100% recoverable in UHI R&E Ltd.

Other costs

Other costs should be coded directly to the project.

For further advice please contact the Finance Manager or the Director of Finance.

Appendix 1

VAT applicable to Research activity

Research

Research is regarded by HMRC as the “original investigation undertaken in order to gain knowledge and understanding”. It can include:

- *Basic research - experimental or theoretical work undertaken primarily to acquire new knowledge without any particular application or use in view*
- *Applied research - original investigation undertaken to acquire new knowledge directed towards a practical aim/ objective*
- *Experimental development - drawing on existing knowledge gained from research and / or practical experience to produce new materials, processes, systems or services or improve those already in existence.*

It is therefore the intention at the beginning of a project that determines whether a supply qualifies as research. If the intention is to advance knowledge and understanding, the supply is one of research.

If work is carried out to simply confirm existing knowledge and understanding, then it is not research. For example testing the quality of water samples will not be seen as a research activity. Furthermore, the following are examples of work which will not qualify as research:

- Consultancy and business efficiency advise;
- Collection and recording of statistics where no analysis or interpretation is undertaken;
- Market research and opinion polling;
- Writing computer programmes; and
- Routine testing and analysis of materials, components or processes.

Research activities can be funded either by the award of a grant or the issue of a contract. When establishing the VAT treatment of a research activity it is necessary to look at the funding and then to determine whether it is to be released into the public domain (non business) or retained by use by the University or funder (business).

Grant funded

The University’s staff applies to external bodies to fund specific research proposals. Research is typically provided to and funded by Funding Councils, charities and under government grants. Such publicly funded research, where the University is receiving pure grant funding for research with no specific deliverables in return and which is intended to allow the results to be released into the public domain, is considered to be a non-business activity. This income is part of the University’s charitable activities so should be processed through the University. Such activities are outside the scope of VAT.

Contract funded

The funder will commission the University to carry out research. The research is for the benefit of the funder who *may* retain full ownership of the results. A service is therefore being provided to the funder and is considered to be a business activity.

Funder retains full ownership:

Where the funder retains full ownership of the research and associated IP, then it is likely that the research findings cannot be released into the public domain, this research activity is deemed commercial in nature and should be processed through UHI R&E Ltd and is liable to VAT at the standard rate.

Funder does not retain full ownership:

Where the results of particular research activity and the associated IP are not intended to be fully retained by the funder this can be processed through the University. It is liable to VAT at the standard rate unless:

a) Provided to (funded by) an Eligible Body

Research provided to another eligible body is exempt from VAT.

“Eligible bodies” for the purposes of research are as defined in the VAT Act 1994, Schedule 9, Group 6, Note 1, which is summarised in Appendix II. This will include commercial research to other universities.

b) Provided to (funded by) a Customer Outside the UK

Research provided to customers outside the UK is outside the scope of VAT.

If research is carried out under EC Framework 5 and 6 research programmes, the research provider can recover input VAT that directly relates to this research.

If research is carried out under EC Framework 7, VAT on costs are not recoverable and therefore VAT incurred will not be reimbursed by the EC.

Subcontract Research

Where the University has been contracted to supply research to a customer who itself has been commissioned to provide the research to the funding party, this is regarded as subcontract research. Such services will be provided by UHI R&E Ltd and will be taxable at the standard rate of VAT.

Research Fellowships

Fellowships are awarded to post doctoral researchers to enable them to progress their research career. These are typically awarded by Research Councils and Charities and while awarded to individuals they are administered by the University. The award may cover salary and expenses of the researcher. They are a University activity and are exempt from VAT.

Research Studentships

Studentships are awarded to allow students to undertake research and training to gain a PG degree. These are typically awarded by Research Councils and Charities and may be awarded to the University rather than individual students. The award will cover stipends and fees. They are a University activity and are exempt from VAT.

Appendix II

Eligible Bodies

For the purposes of educational exemption, an “eligible body” is a:

- School, University, sixth form college, tertiary college or further education college or other centrally funded higher or further education institution (defined as such under the Education Acts) or the governing body of one of these institutions;
- Local authority;
- Government department or executive agency;
- Non-profit making body that carries out duties of an essentially public nature similar to those carried out by a local authority or government department;
- Health authority;
- Non-profit making organisation that meets certain conditions; or
- Commercial provider of tuition in English as a foreign language.