

**Stroud District Council**

**Review of In-House Option vs. LATC**

**April 2023**

**1. Introduction**

- 1.1. Max Associates has been asked to review the potential cost impact of the In-House management option following the updated VAT guidance for local authority leisure services.
- 1.2. This paper provides an overview of the new guidance and sets out the financial impact on the leisure centre and central support services budgets and compares them to the LATC business case.

**2. 2023 VAT Guidance**

- 2.1. On 3rd March 2023 new guidance from the Government was released that confirmed that local authorities' leisure services are provided under a statutory framework and can be treated as non-business for VAT purposes. Therefore, Councils can benefit from VAT relief on sporting income, without risk of exceeding their diminimus value.
- 2.2. Currently local authorities are treated as undertaking business activity if they provide leisure services to members of the public. This treatment is based on the understanding that when local authorities provide leisure services they are not acting as a public authority.
- 2.3. A local authority acts as a public authority when they're carrying out their statutory public interest activities for the service of the community.
- 2.4. This treatment was challenged by a number of local authorities and the matter was considered by the courts.
- 2.5. This litigation has now concluded. The courts have found that local authorities' leisure services are provided under a statutory framework and can be treated as non-business for VAT purposes.
- 2.6. Before a public body, such as a local authority, can treat a supply as non-business it must be shown that this treatment would not significantly affect competition.
- 2.7. Consequently, HMRC conducted a detailed analysis of the leisure services sector and found that allowing local authorities to treat their supplies of leisure services as non-business would not significantly affect competition.

2.8. As a result of this change Local authorities that currently charge their customers VAT at the standard rate can apply the non-business treatment to their supply of leisure services.

2.9. This change excludes:

- catering
- adult or children's clothing
- water bottles
- sporting goods
- items from vending machines
- car parking
- sporting lets or other sporting activities previously treated as exempt.

2.10. The benefit of 'non-business' treatment of income is the ability to recover VAT on related expenditure but this is not subject to any limitations provided under Section 33 of the VAT Act 1994.

2.11. PSTAX has provided the following statement regarding the new guidance.

HM Revenue and Customs (HMRC) have recently issued a Brief - [Revenue & Customs Brief 3 \(2023\)](#) - on changes to the VAT treatment of Leisure Services supplied by Local Authorities. This note explains the background, what has changed, and what Authorities need to consider now.

### **Background**

HMRC have historically regarded the in-house provision of leisure services by Authorities to be a taxable business activity. Some Authorities have chosen to outsource leisure centres to Charitable Trusts, which were regarded by HMRC as eligible bodies for a VAT exemption on sport supplies, meaning that they don't need to charge VAT to users of the sports facilities covered. However, the Trusts are also unable to recover much of the VAT incurred on related expenditure.

In 2017, following litigation by the London Borough of Ealing, HMRC accepted that Authorities could also be treated as eligible bodies for the VAT exemption used by the Trusts. They didn't force Authorities to apply VAT exemption, and many chose not to due to the impact on their Partial Exemption calculations – which could have adversely affected VAT recovery on expenditure across the whole Authority.

More recently, Chelmsford City Council, Midlothian Council and Mid-Ulster Council all successfully contested that leisure services were provided under a special legal regime, which was applicable only to Authorities. Within England, this is Section 19 of the Local Government (Miscellaneous Provisions) Act 1976 (“the Act”). Charges under special legal regimes can only be treated as non-business if doing so would not significantly distort competition. However, HMRC issued their Brief conceding this aspect before the courts could consider it.

The advantage of non-business treatment under Chelmsford (or Midlothian in Scotland and Mid-Ulster in Northern Ireland), rather than VAT exemption under Ealing, is that income is still relieved from VAT - but without the same risk of affecting the recovery of VAT on expenditure.

### **What is covered by the Brief?**

HMRC say that it covers Authorities' provision of in-house leisure services to members of the public. Our interpretation of the Brief is that non-business treatment applies to:

- Charges for the casual use of Authorities' sports facilities – within leisure centres, schools, or elsewhere.
- Bookings of such facilities, where the criteria for the existing series of lets or continuous let VAT exemptions aren't met.

Where the above supplies are made by a third party acting as the agent of an Authority, we consider that non-business treatment applies to charges made to the public. However, it would not apply to charges made by third parties acting as principal. Care should be taken to determine the structure in place.

We consider that the Brief also **excludes**:

- Lettings of sports facilities which meet the criteria for a series of lets or a continuous let, or any non-sporting lets. **These remain exempt from VAT unless the option to tax has been exercised by the Authority.**
- Charges for classes/tuition provided by the Authority. **These remain exempt from VAT.**
- Catering/vending, and other supplies of goods. **These remain business activities, mainly subject to VAT, although some charges for cold takeaway food may be eligible for zero rating.**
- Car parking. **Any charges for off-street parking remain subject to VAT.**

Some of the exclusions in HMRC's brief would appear to be covered by the Act – so there may be potential for further changes in the future.

### **Action to be taken by Authorities**

Authorities no longer need to charge VAT on supplies covered by the Brief. When they stop, there is no requirement to reduce the prices charged to customers.

The change in VAT treatment applies retrospectively, as HMRC now accept that non-business treatment should have always applied. If they have not already done so, Authorities can submit a claim to HMRC for any VAT declared on charges for the supplies covered over the past four years and request statutory interest. Where income that is now regarded as non-business was previously treated as VAT-exempt, Authorities may wish to revisit past years' Partial Exemption calculations.

The consequences of the revised VAT treatment should be considered as part of any future evaluation over whether to outsource or insource leisure services. In-house operation is now likely to be more VAT-efficient than outsourced, as Authorities' will largely be able to make the same supplies "VAT-free" as Trusts can, but with the benefit of VAT recovery on expenditure. However, HMRC's Brief still leaves income sources as VAT-exempt (so some impact on Partial Exemption calculations).

*This note is intended to be a general guide to the changes and does not constitute VAT advice. Arrangements for the provision of leisure services can vary considerably and PSTAX are happy to work with individual Authorities, so they can understand the implications of the changes to their specific circumstances.*

### **3. LATC vs. In-House**

- 3.1. We have set out below the key financial differences between the LATC and In-House models, including the impact of the new VAT guidance.
- 3.2. **Income between the two models will be comparable** – Given Stroud District Councils approach to in-house management at The Pulse, it is evident that the centre is operated in a commercially successful way, which is not always typical of in-house delivery. In some cases it could be argued that a LATC would operate more commercially, however due to current in-house performance we would anticipate income generation to be comparable.
- 3.3. **Irrecoverable VAT** – A LATC will be required to pay irrecoverable VAT, an in-house delivery model will not have any irrecoverable VAT costs. This is a significant financial benefit to the in-house operation compared to the LATC.
- 3.4. **NNDR** – The LATC will be able to apply for 80% NNDR relief and the in-house model will have to pay full rates. Whilst this is somewhat of a circular calculation across different Council budgets at a leisure centre budget level the LATC will be able to show savings against NNDR.
- 3.5. **Pensions and Salaries** – If operated in-house all staff would be employed on SDC terms and conditions and would enter into the Local Government Pension Scheme. The pension scheme has an average contribution rate of 18% which is higher than that expected of a LATC which is projected to be c.7%. Additionally, in-house management typically offers higher salary bands and implements more costly terms and conditions e.g. sick leave and annual leave entitlement, resulting in higher staff costs for the in-house model.
- 3.6. **Central Support Costs** – The LATC is required to establish a central support team including a Managing Director and Finance Director, they would also need to pay for support services such as HR, IT and auditing. If operated in-house there would not be a requirement for a senior management team and instead would require a Leisure Services Manager. Whilst some additional costs may be required for finance and HR support it would not be as significant as the LATC option.
- 3.7. **LATC Reserves** – The LATC business plan included reserves at 2% of income, whilst the in-house model does not need to build up reserves, a comparable cost has been included for contingency with the assumption that if it is not required any surplus within the budget would be reinvested back into the leisure centres.
- 3.8. **Set Up Costs** – the in-House option would not require as significant set up costs as the LATC, however there would be the requirement to deliver the TUPE transfer of SLM staff, rebranding, redecoration, new marketing material etc.

#### 4. LATC Financial Summary

- 4.1. Based on the business plans the overall management fee expected to be paid to the LATC based on the existing leisure centres is £589k in year 1, reducing to £510k in year 5. This includes 20% NNDR costs, which were excluded in the original business plan for the LATC.

LATC Summary - Existing	Year 1	Year 2	Year 3	Year 4	Year 5
<b>Total Income</b>					
SPLC	2,062,847	2,101,099	2,108,233	2,108,270	2,108,287
Lido	61,832	61,832	61,832	61,832	61,832
Pulse	1,588,199	1,609,698	1,609,721	1,609,732	1,609,737
Central Support	0	0	0	0	0
<b>Total</b>	<b>3,712,877</b>	<b>3,772,629</b>	<b>3,779,786</b>	<b>3,779,834</b>	<b>3,779,856</b>
<b>Total Expenditure</b>					
SPLC	2,149,587	2,144,534	2,104,238	2,117,609	2,131,380
Lido	169,585	170,535	171,505	172,494	173,502
Pulse	1,450,589	1,440,740	1,444,743	1,448,825	1,452,988
Central Support	532,123	532,123	532,123	532,123	532,123
<b>Total</b>	<b>4,301,884</b>	<b>4,287,932</b>	<b>4,252,608</b>	<b>4,271,051</b>	<b>4,289,993</b>
<b>Deficit (Management Fee)</b>	<b>-589,007</b>	<b>-515,303</b>	<b>-472,823</b>	<b>-491,217</b>	<b>-510,137</b>

#### 5. In-House Financial Summary

- 5.1. Taking into account the impact of the new VAT guidance the financial business plan has been amended to include the new VAT benefit as well as the other financial amendments set out in section 3 above.
- 5.2. It can be seen that under in-house management the deficit/subsidy is projected to be c.£526k in year 1 reducing to £464k by year 5.
- 5.3. Consequently the in-house model is expected to deliver a saving of £40-£45k in a mature year against the LATC model.

<b>In-House Summary - Existing</b>	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
<b>Total Income</b>					
SPLC	2,062,847	2,101,099	2,108,233	2,108,270	2,108,287
Lido	61,832	61,832	61,832	61,832	61,832
Pulse	1,588,199	1,609,698	1,609,721	1,609,732	1,609,737
Central Support	0	0	0	0	0
<b>Total</b>	<b>3,712,877</b>	<b>3,772,629</b>	<b>3,779,786</b>	<b>3,779,834</b>	<b>3,779,856</b>
<b>Total Expenditure</b>					
SPLC	2,268,826	2,296,106	2,247,714	2,259,342	2,271,316
Lido	161,474	162,300	163,144	164,004	164,881
Pulse	1,441,806	1,430,973	1,434,454	1,438,004	1,441,624
Central Support	368,873	368,873	368,873	368,873	368,873
<b>Total</b>	<b>4,237,662</b>	<b>4,254,996</b>	<b>4,210,928</b>	<b>4,226,965</b>	<b>4,243,437</b>
<b>Deficit/Subsidy</b>	<b>-524,785</b>	<b>-482,367</b>	<b>-431,143</b>	<b>-447,132</b>	<b>-463,581</b>

5.4. The updated individual business plans for each centre are set out below.

**5.5. Stratford Park Leisure Centre - In-House**

<b>SUMMARY</b>	<b>YEAR 1</b>	<b>YEAR 2</b>	<b>YEAR 3</b>	<b>YEAR 4</b>	<b>YEAR 5</b>
<b>INCOME</b>					
Health & Fitness Membership	885,589	885,735	885,804	885,837	885,852
Health & Fitness Casual	41,670	46,300	46,300	46,300	46,300
Health & Fitness Group Exercise	68,220	68,220	68,220	68,220	68,220
Swimming - Casual	46,282	48,854	51,425	51,425	51,425
Swimming - Lessons/Courses	495,999	522,104	522,104	522,104	522,104
Swimming - Hire	32,481	34,286	36,090	36,090	36,090
Sports Hall	121,560	121,560	121,560	121,560	121,560
Squash	27,699	27,699	27,699	27,699	27,699
Outdoor - 3G Pitch	75,116	75,116	75,116	75,116	75,116
Outdoor - Tennis	15,834	15,834	15,834	15,834	15,834
Secondary - Catering & Vending	211,051	213,503	215,703	215,706	215,708
Secondary - Retail	41,345	41,890	42,378	42,379	42,380
<b>TOTAL INCOME</b>	<b>2,062,847</b>	<b>2,101,099</b>	<b>2,108,233</b>	<b>2,108,270</b>	<b>2,108,287</b>
<b>EXPENDITURE</b>					
Salaries	1,239,379	1,251,847	1,192,236	1,192,236	1,192,236
Utilities	358,050	368,792	379,855	391,251	402,988
NNDR	171,000	171,000	171,000	171,000	171,000
Insurance	21,083	21,083	21,083	21,083	21,083
Lifecycle	50,000	50,000	50,000	50,000	50,000
Repairs & Maintenance	71,610	71,610	71,610	71,610	71,610
Cleaning	9,548	9,548	9,548	9,548	9,548
Equipment	11,935	11,935	11,935	11,935	11,935
Gym Equipment Lease	50,000	50,000	50,000	50,000	50,000
Other Supplies	10,314	10,505	10,541	10,541	10,541
Advertising & Marketing	30,943	31,516	31,623	31,624	31,624
Communications	61,885	63,033	63,247	63,248	63,249
Other Administration	12,394	12,518	11,922	11,922	11,922
Costs of Sales	126,198	127,696	129,041	129,043	129,044
Capital Costs	0	0	0	0	0
Irrecoverable VAT	0	0	0	0	0
<b>OPERATIONAL EXPENDITURE</b>	<b>2,224,340</b>	<b>2,251,084</b>	<b>2,203,641</b>	<b>2,215,041</b>	<b>2,226,780</b>
Central Costs	0	0	0	0	0
Contingency	44,487	45,022	44,073	44,301	44,536
<b>TOTAL EXPENDITURE</b>	<b>2,268,826</b>	<b>2,296,106</b>	<b>2,247,714</b>	<b>2,259,342</b>	<b>2,271,316</b>
<b>SURPLUS / DEFICIT</b>	<b>-205,980</b>	<b>-195,007</b>	<b>-139,481</b>	<b>-151,072</b>	<b>-163,029</b>



**5.6. The Pulse, Dursley - In-House**

<b>SUMMARY</b>	<b>YEAR 1</b>	<b>YEAR 2</b>	<b>YEAR 3</b>	<b>YEAR 4</b>	<b>YEAR 5</b>
<b>INCOME</b>					
Health & Fitness Membership	621,410	640,258	640,280	640,290	640,295
Health & Fitness Casual	28,013	28,013	28,013	28,013	28,013
Health & Fitness Group Exercise	42,117	42,117	42,117	42,117	42,117
Swimming - Casual	156,116	156,116	156,116	156,116	156,116
Swimming - Lessons/Courses	539,793	539,793	539,793	539,793	539,793
Swimming Lessons - Private	80,000	80,000	80,000	80,000	80,000
Swimming - Hire	77,913	77,913	77,913	77,913	77,913
Secondary - Vending	14,280	15,164	15,164	15,164	15,164
Secondary - Retail	28,559	30,327	30,328	30,328	30,328
<b>TOTAL INCOME</b>	<b>1,588,199</b>	<b>1,609,698</b>	<b>1,609,721</b>	<b>1,609,732</b>	<b>1,609,737</b>
<b>EXPENDITURE</b>					
Salaries	901,529	884,942	884,942	884,942	884,942
Utilities	167,200	170,544	173,955	177,434	180,983
NNDR	62,000	62,000	62,000	62,000	62,000
Insurance	16,097	16,097	16,097	16,097	16,097
Lifecycle	25,000	25,000	25,000	25,000	25,000
Repairs & Maintenance	45,600	45,600	45,600	45,600	45,600
Cleaning & Chemicals	21,280	21,280	21,280	21,280	21,280
Equipment	18,240	18,240	18,240	18,240	18,240
Gym Equipment Lease	21,000	21,000	21,000	21,000	21,000
Other Supplies	11,117	11,268	11,268	11,268	11,268
Advertising & Marketing	23,823	24,145	24,146	24,146	24,146
Communications	71,469	72,436	72,437	72,438	72,438
Other Administration	4,508	4,425	4,425	4,425	4,425
Costs of Sales	21,419	22,745	22,746	22,746	22,746
Depreciation	0	0	0	0	0
Irrecoverable VAT	0	0	0	0	0
Other					
<b>OPERATIONAL EXPENDITURE</b>	<b>1,410,283</b>	<b>1,399,723</b>	<b>1,403,135</b>	<b>1,406,615</b>	<b>1,410,165</b>
Central Costs	0	0	0	0	0
Contingency	28,206	27,994	28,063	28,132	28,203
<b>TOTAL EXPENDITURE</b>	<b>1,438,489</b>	<b>1,427,717</b>	<b>1,431,198</b>	<b>1,434,748</b>	<b>1,438,368</b>
<b>SURPLUS / DEFICIT</b>	<b>149,710</b>	<b>181,981</b>	<b>178,523</b>	<b>174,984</b>	<b>171,369</b>

**5.7. Stratford Park Lido - In-House**

<b>SUMMARY</b>	<b>YEAR 1</b>	<b>YEAR 2</b>	<b>YEAR 3</b>	<b>YEAR 4</b>	<b>YEAR 5</b>
<b>INCOME</b>					
Swimming - Casual	57,927	57,927	57,927	57,927	57,927
Swimming - Lessons/Courses	0	0	0	0	0
Swimming - Hire	0	0	0	0	0
Secondary - Vending	3,905	3,905	3,905	3,905	3,905
<b>TOTAL INCOME</b>	<b>61,832</b>	<b>61,832</b>	<b>61,832</b>	<b>61,832</b>	<b>61,832</b>
<b>EXPENDITURE</b>					
Salaries	69,895	69,895	69,895	69,895	69,895
Utilities	41,328	42,155	42,998	43,858	44,735
NNDR	0	0	0	0	0
Insurance	618	618	618	618	618
Lifecycle	16,000	16,000	16,000	16,000	16,000
Repairs & Maintenance	8,500	8,500	8,500	8,500	8,500
Cleaning & Chemicals	5,000	5,000	5,000	5,000	5,000
Equipment	14,000	14,000	14,000	14,000	14,000
Other Supplies	1,237	1,237	1,237	1,237	1,237
Advertising & Marketing	927	927	927	927	927
Communications	618	618	618	618	618
Other Administration	1,398	1,398	1,398	1,398	1,398
Costs of Sales	1,952	1,952	1,952	1,952	1,952
Depreciation	0	0	0	0	0
Irrecoverable VAT	0	0	0	0	0
Other					
<b>OPERATIONAL EXPENDITURE</b>	<b>161,474</b>	<b>162,300</b>	<b>163,144</b>	<b>164,004</b>	<b>164,881</b>
Central Costs	0	0	0	0	0
Contingency	0	0	0	0	0
<b>TOTAL EXPENDITURE</b>	<b>161,474</b>	<b>162,300</b>	<b>163,144</b>	<b>164,004</b>	<b>164,881</b>
<b>SURPLUS / DEFICIT</b>	<b>-99,642</b>	<b>-100,469</b>	<b>-101,312</b>	<b>-102,172</b>	<b>-103,049</b>

## 5.8. Central Support Costs

5.8.1. The table below sets out the staff costs associated with the central support team under the in-house management option.

In-House Central Support Team	Salary	Total Salary	FTE	Total Cost
Leisure Services Manager	46,549	65,076	1	65,076
Fitness Manager	30,000	41,940	1	41,940
Swimming Development Officer	25,000	34,950	1	34,950
Sales Manager	30,000	41,940	1	41,940
Sales Advisors	22,000	30,756	2	61,512
Business Administrator	25,000	34,950	1	34,950
Business Apprentice	20,000	27,960	1	27,960
<b>TOTAL</b>		<b>277,572</b>	<b>8.00</b>	<b>308,328</b>

5.8.2. In addition to the staff costs above an allocation has been included for additional HR and Finance support from the Council. This totals £60.5k bringing the total central support costs to **£368,873**.

## 6. Set Up Costs

- 6.1. The set up costs for both options are set out below. As Stratford Park Leisure Centre and the lido is currently managed by Everyone Active, staff would need to transfer to the Council. The centre would also require re-branding and new marketing material to ensure constancy across the portfolio.
- 6.2. The set up costs also included the implementation of a new management system and some equipment replacement costs which would apply to all management models.
- 6.3. It is also the intention that under the in-house model the centres would operate to a service specification, with performance monitoring and reporting requirements. Therefore Legal costs have been retained to ensure this is delivered properly and in line with current industry practise.
- 6.4. The in-house set up costs assume that the Leisure Services Manager would be in post for 12 months prior to the transfer to manage and support the transfer process.

LATC Set Up Costs	2023/24	In-House Set Up Costs	2023/24
IT	£95,960	IT	£95,960
Marketing/Branding	£40,000	Marketing/Branding	£40,000
Re-decoration	£20,000	Re-decoration	£20,000
Staffing Support	£90,043	Staffing Support – Leisure Services Manager (12 months)	£65,076
HR Support - TUPE	£17,279	HR Support - TUPE	£17,279
Gladstone	£50,000	Gladstone	£50,000
Equipment	£45,000	Equipment	£45,000
Legal - Contracts Leases etc.	£40,000	Specification and Performance Monitoring documents	£0
<b>Total</b>	<b>£398,282</b>	<b>Total</b>	<b>£333,315</b>
Contingency	£39,828	Contingency	£33,331
<b>Total Cost</b>	<b>£438,111</b>	<b>Total Cost</b>	<b>£366,646</b>

- 6.5. The In-House option would result in set up cost savings of c. £71k.

## **7. Summary**

- 7.1. Taking into account the new VAT guidance and applying this to an in-house model, results in a lower annual cost to the Council than originally projected during the management options appraisal process.
- 7.2. Given the Council's current performance, the VAT benefit on income and irrecoverable VAT savings offset the additional costs associated with in-house management (NNDR, staffing etc.) and therefore the applying the new guidance results in projected savings of c. £40- £45k in a mature year against the LATC model.
- 7.3. The in-house model also has reduced set-up costs compared to the LATC.