


Agenda Item No:	11	
Committee:	Cabinet	
Date:	27 April 2026	
Report Title:	Change in Freedom Leisure contractual arrangements to an Agency approach	

This item comprises EXEMPT INFORMATION within Appendices D and E which is not for publication by virtue of paragraphs 3 and 5 of Part 1 of Schedule 12A of the Local Government Act 1972 (as amended).

1 Purpose / Summary

- 1.1 The existing contractual arrangement with Freedom Leisure for the management of the four leisure centres in Fenland is based on the Sport England template leisure operating contract. Freedom operates the facilities as "principal", meaning that Freedom is the entity that provides leisure services to the public.
- 1.2 Following a legal ruling this approach can be adjusted to an Agency agreement whereby Freedom delivers services as an Agent of the Council, with the Council being the Principal to provide a more VAT efficient way of managing the leisure facilities.
- 1.3 The expected saving for both parties by switching to this approach is in the region of £219,000. Approximately £2,000 each per week, using a 50:50 split of the total savings value.
- 1.4 This report covers why a switch is possible and the benefits of such a change.

2 Key Issues

- 2.1 One of the reasons FDC outsourced leisure services was to deliver a more financially efficient delivery model to the Council. This was partially achieved by a reduction in the level of VAT-exempt activities and, therefore, the potential threat to its VAT recovery under the partial exemption rules. This was based on the understanding that a local authority was seen as making business supplies when providing leisure facilities and that a relatively high proportion of those supplies were exempt from VAT.
- 2.2 Outsourcing eased the threat of non-recoverable 'exempt' input VAT by using a leisure operator to deliver the exempt activities instead.
- 2.3 FDC and Freedom are considering the switch to an Agency agreement to capitalise on the ruling in HMRC v Chelmsford City Council UT-2021-000024 and UT-2021-000076 (the Chelmsford Ruling) in order to deliver benefits to the existing leisure operating arrangements between Freedom and Fenland.
- 2.4 Following the issue of HMRC Brief 3 of 2023 in March 2023 (HMRC Guidance), where a local authority provides leisure services directly to the users, the services can be treated as 'non-business' for VAT purposes. Local

authorities undertaking non-business activities are not required to account for VAT on the associated income but can recover VAT in full on associated costs with no partial exemption implications.

- 2.5 To take full advantage of the Chelmsford Ruling and the HMRC Guidance, a change from the current contractual arrangements where Freedom acts as Principal delivering the services, to one where Freedom would act as an Agent for the council, and the council would become the Principal providing leisure services to the public (the Agency Model) is proposed.

3 Recommendations

- 3.1 That Cabinet notes the report and the financial benefits of switching to an Agency Agreement with Freedom Leisure.
- 3.2 That Cabinet delegates authority to the Monitoring Officer, in consultation with the Portfolio Holder for Leisure, to vary the Leisure Management Contract between the Council and Freedom Leisure in order that Freedom will run the leisure centres as an Agent rather than a Principal for the remainder of the contract.
- 3.3 That Cabinet authorises the Monitoring Officer to execute and complete all requisite legal documentation in relation to the matters outlined above.

Wards Affected	All	
Forward Plan Reference	KEY/27NOV25/01	
Portfolio Holders	Cllr Sue Wallwork Cllr Chris Boden	Portfolio Holder for Leisure Leader and Portfolio Holder for Finance
Report Originator	Phil Hughes	Head of Leisure Services
Contact Officers	Sian Warren Carol Pilson	Chief Accountant Corporate Director and Monitoring Officer
Background Papers	<p>PSTax presentation: Pop-up Training – VAT & Leisure Services</p> <p>Trowers and Hamlins LLP briefing paper: HMRC revises treatment of VAT on in house leisure services – welcome news for many local authorities</p> <p>Agency Agreements in Leisure: presentation from MAX Associates, PSTAX, Trowers and Hamlins</p>	

Confidential Background Papers	PS TAX - VAT advice: Management and operation of leisure facilities under an agency model Freedom Leisure: Briefing paper on Agency Proposals
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4 This item comprises exempt information within Appendices D and E which is not for publication by virtue of paragraphs 3 and 5 of Part 1 of Schedule 12A of the Local Government Act 1972 (as amended) in that it contains information about the legal advice concerning the proposed variation to an Agency Agreement contract. The public interest test has been applied and it is considered that in order to achieve best value and for members to take an informed decision in relation to this matter that the public interest is best served in maintaining the exemption rather than publicising and openly debating the information contained within Appendices D and E.

5 Background and Intended Outcomes

Summary

5.1 Leisure Management Contract Agency Model – Concept

5.2 The Council's Contract with Freedom Leisure is a "traditional" (concession) leisure contract, where the Council leases the leisure facilities to Freedom Leisure for a peppercorn rent, and Freedom Leisure operates the facilities as principal providing the leisure services to the public. Freedom Leisure retains the income from the leisure facilities and pays the Council an agreed annual fee.

5.3 As Freedom Leisure provides the leisure facilities to the public as principal, the VAT liability of the sporting income is defined by Freedom Leisure's status. As a Charitable Trust, some of Freedom Leisure's supplies are exempt from output VAT and some are liable to output VAT at the standard rate. Freedom Leisure is therefore required to undertake a partial exemption calculation to determine how much input VAT it is able to reclaim on the costs incurred in running the services. The irrecoverable portion of input VAT is incurred as a cost and is reflected in the costs of the services between Freedom Leisure and the Council.

5.4 It is believed that up to 2023, the above arrangement represented the most VAT efficient route legally available, with the benefit of VAT exempt income outweighing the irrecoverable portion of input VAT.

5.5 However, following a court ruling in favour of local authorities and the determination that treating leisure services as non-business would not distort competition, HMRC issued Brief 3 in March 2023. The Brief makes it clear that a local authority's income direct from users from the provision of leisure services can be treated as 'non-business' for VAT purposes, rather than 'exempt'. This is the key change of circumstances from which the Agency Model opportunity is derived.

- 5.6 The change to HMRC policy potentially provides the Council, and its current partner Freedom Leisure, with an opportunity to implement an arrangement, the 'Agency Model', with benefits to both parties by way of reduced costs, whilst protecting the Council's risk position.
- 5.7 Under the Agency Model, Freedom Leisure would become the Council's agent for income collection. Freedom Leisure would continue to provide services and staff to run the centres. The Agency Model would result in Freedom Leisure providing a standard rated, taxable service to the Council - that is the combination of the management of the leisure facilities and the provision of staff and services.
- 5.8 This would then allow Freedom Leisure to reclaim all of the input VAT it incurs on attributable expenditure.
- 5.9 Due to the changes in the VAT liability of supplies of leisure services by local authorities, there would be no adverse impact on the Council's VAT recovery position such that VAT should remain recoverable in full and therefore there will be an overall 'saving' on the basis of moving from a position where Freedom Leisure can recover VAT only partially, to one where full VAT recovery is achieved for both parties, with no additional cost for the users.

5.10 Leisure Management Contract Agency Model – In Practice

- 5.11 Under the Agency Model, the income from the leisure facilities would be income for the Council and any VAT that is due on that income would need to be paid by the Council to HMRC as part of its VAT returns.
- 5.12 As the provision of leisure by a local authority is now considered to be a non-business supply, any VAT charged by Freedom Leisure to the Council for running the leisure facilities, and in relation to the costs of the facilities themselves, should be recoverable.
- 5.13 Under the Agency Model, Freedom Leisure would still collect all customer sales income but will be acting on behalf of the Council. Freedom Leisure would provide a remittance note to the Council for this income.
- 5.14 Freedom Leisure would also invoice the Council for service costs plus Freedom Leisure's margin as per the Contract; adjusted by any income under or over-performance to ensure Freedom Leisure retains this key element of risk. The Council would be able to recover the VAT on this invoice.
- 5.15 The actual movement of funds (cash) will be an off-set between the points made above - whose quantum would be similar to those in the current arrangement, with the added financial benefit of the impact of the Agency Model. The surplus share mechanism would be retained under the Agency Model.

6 Consultation

- 6.1 Not applicable.

7 Alternative Options Considered

- 7.1 Do nothing:

Freedom Leisure would continue to operate the Council's leisure facilities for the remaining term of the current contract. However, the Council would not benefit from the significant financial savings to be achieved from implementing the 'Agency Model'.

8 Legal Implications

- 8.1 Informal legal advice confirms that a move to the Agency Model is legal and would also satisfy the procurement under which Freedom was procured to manage the Council's leisure facilities.
- 8.2 Formal written legal advice is in train. No switch to the Agency Agreement will take place, if agreed by Cabinet under the Recommendations of this Report, until the Monitoring Officer receives written legal advice confirming the informal advice already received regarding both procurement and the legality of a change to an Agency approach.

9 Financial Implications

- 9.1 As detailed above implementing the Agency approach to the Contract with Freedom Leisure will increase revenue income to FDC as part of the contract by approximately £109,500 p.a.
- 9.2 The General Fund Budget Estimates and Medium-Term Financial Strategy (MTFS) Report, agreed by Cabinet and Council in February, projects a financial shortfall for 2026/27 of £2.856m rising to £2.903m in 2027/28.
- 9.3 Although there are currently many uncertainties regarding the budget for 2026/27 and the MTFS, there remains a significant structural deficit which the Council will need to address.

10 Equality Implications

N/A

11 Appendices

- 11.1 Appendix A - PSTax presentation - Pop-up Training –VAT & Leisure Services
- 11.2 Appendix B - Trowers and Hamblins LLP briefing paper:
HMRC revises treatment of VAT on in house leisure services – welcome news for many local authorities
- 11.3 Appendix C - Agency Agreements in Leisure – presentation from MAX Associates, PSTAX, Trowers and Hamblins

12 Confidential Appendices

- 12.1 Appendix D - Freedom Leisure – briefing paper on Agency Proposals
- 12.2 Appendix E - PS TAX - VAT advice – Management and operation of leisure facilities under an agency model

A photograph of a swimming pool with several lanes. The lane lines are colorful: blue, red, yellow, and black. The water is clear and blue. The perspective is from above, looking down into the pool.

APPENDIX A

Pop-up Training – VAT & Leisure Services

PRESENTED BY PSTAX

28 NOVEMBER 2023



Questions

- Any queries you have please email the **helpline:**
helpline@pstax.co.uk

Programme

- Brief history of VAT and local authority leisure services
- Recent changes
 - Non-business litigation
 - HMRC Announcement March 2023 and subsequent clarification
 - Where we are now
- In-house leisure: what should you do now?
 - Refund claims – leisure services
 - Refund claims – leisure attractions
- Outsourced leisure arrangements
 - Standard versus agency model
 - Agency model – residual risks?

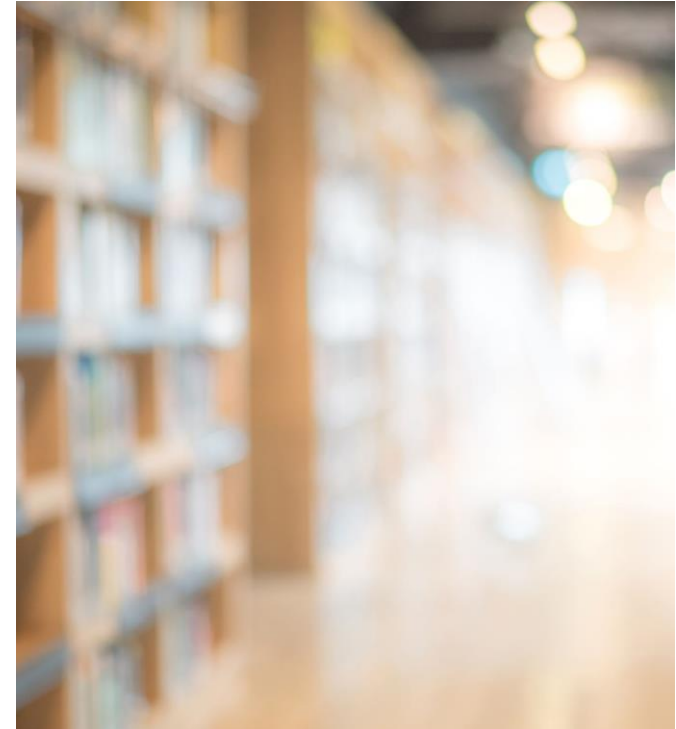




Local Authority Leisure Services

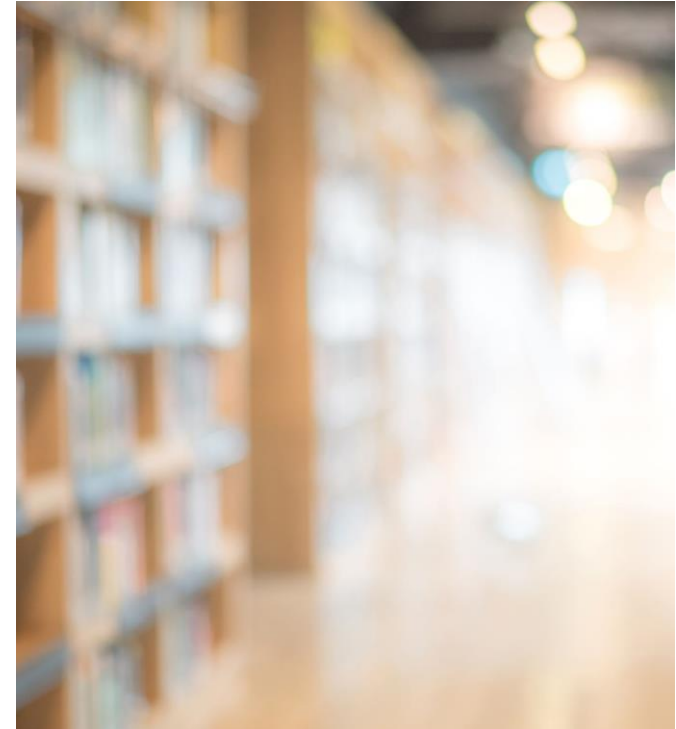
History of VAT and Local Authority Leisure

- Historically, leisure services were standard-rated
- Exemption for sporting services (leisure services) was introduced in 1994 for non-profit making bodies (an EU requirement)
- Following representations from local authorities, they were expressly excluded from the exemption



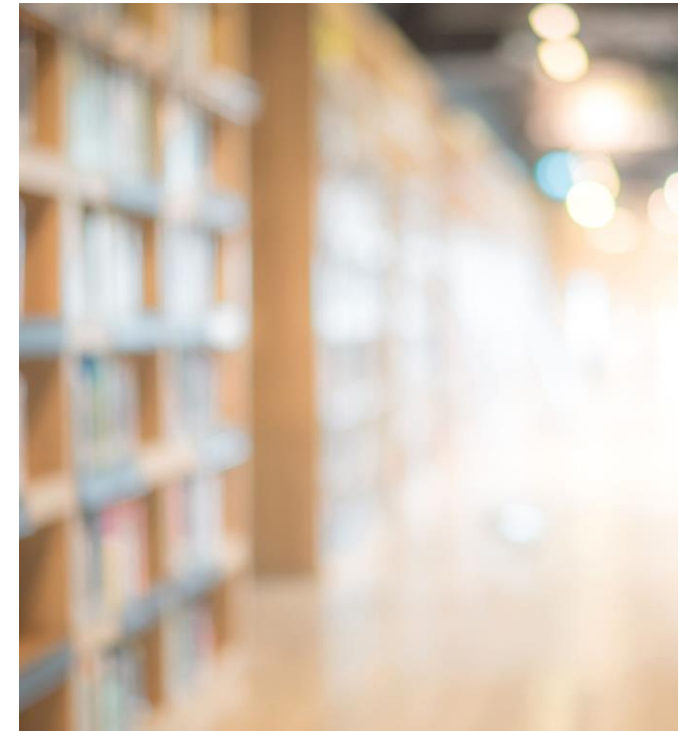
History of VAT and Local Authority Leisure

- In July 2017, the CJEU held local authorities must be included in the exemption
- HMRC introduced an “optional” exemption



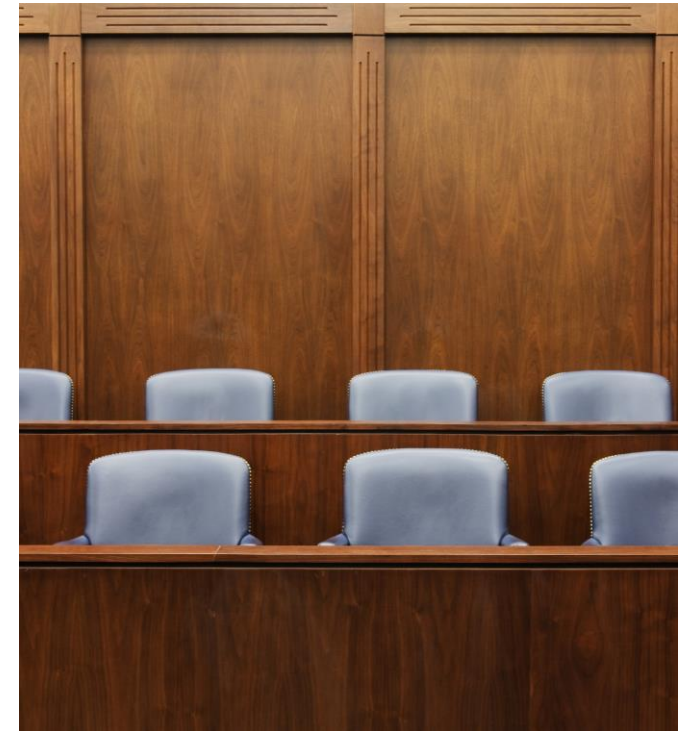
History of VAT and Local Authority Leisure

- Following litigation (Chelmsford), HMRC announced in March 2023 non-business treatment for some supplies
- In November 2023, HMRC's guidance changed to include more services as non-business



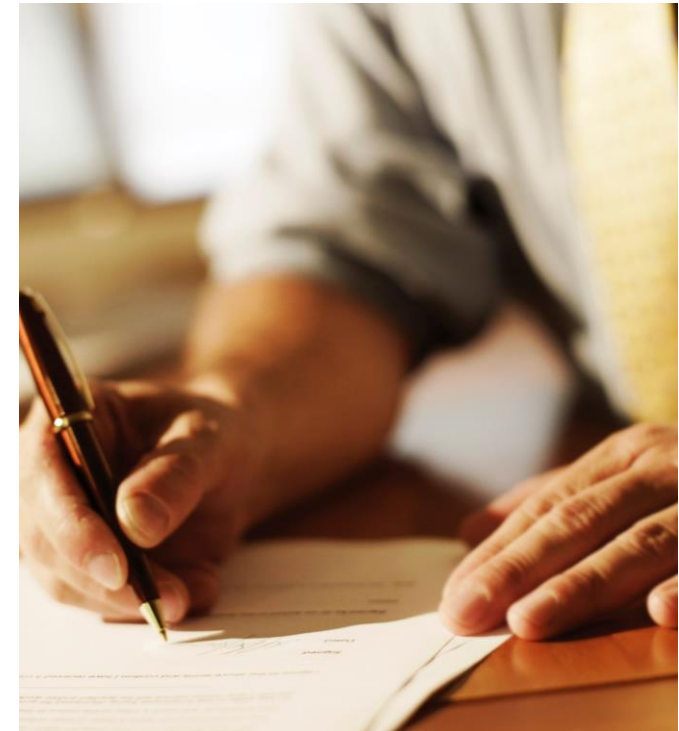
City of Chelmsford (and others) Case

- Three separate special legal regimes
 - Local Government (Miscellaneous Provisions) Act 1976 Section 19
 - Northern Ireland Act 1998 s75 and Recreation and Youth Service (NI) Order 1986 Article 10
 - Local Government and Planning (Scotland) Act 1982 Section 14



City of Chelmsford Case – Action?

- Is there anything local authorities should be doing?
 - Have you operated any in-house leisure facilities in the past four years?
 - Have you accounted for output VAT on leisure supplies in the past four years?
 - If yes, then you should submit a claim to HMRC to request a refund

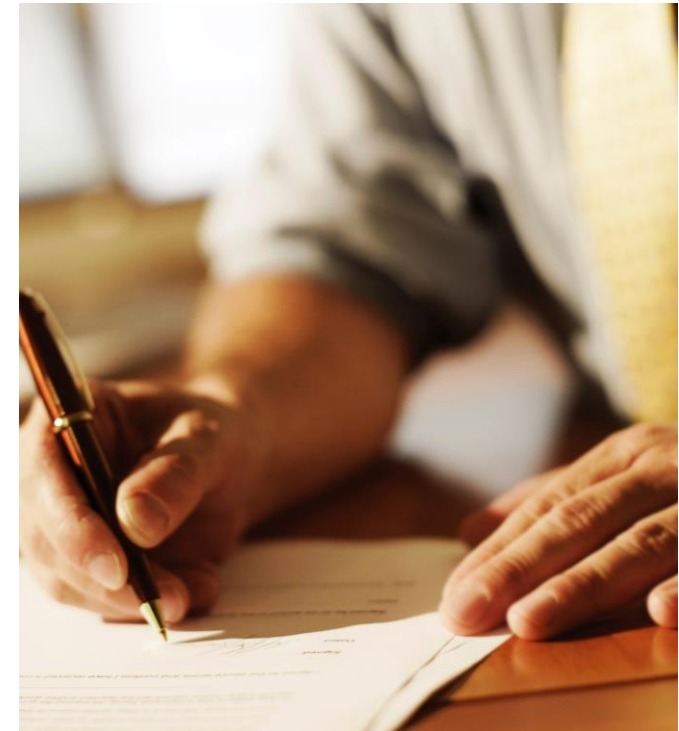


Local Authority Leisure Services

Common supplies by a local authority	VAT Liability
<i>Ad hoc</i> sessions (swimming, squash, badminton, gymnasium, soft play, etc)	Non-business
<i>Ad hoc</i> pitch/court hire (football, basketball, netball, volleyball)	Non-business
Pool hire	Non-business
Sports hall hire (for sport)	Non-business
Block bookings (sports facility)	Non-business
Party hire (pool or hall)	Standard Rate
Sports tuition (swimming lessons, gym induction, fitness classes etc)	Non-business
Creche	Exempt (Welfare)
Room hire (including catering concession leases and lettings)	Exempt (unless OTT)
Catering and retail sales	Standard/Zero Rate

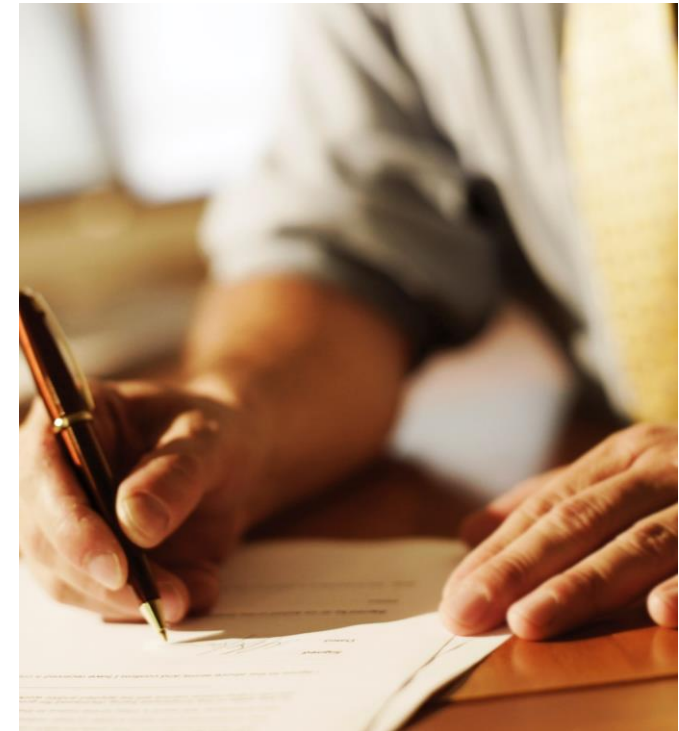
Leisure Attractions – Reduced Rate

- The temporary reduced rate (TRR) was:
 - 5% from 15 July 2020 to 30 September 2021
 - 12.5% from 1 October 2021 to 31 March 2022
- HMRC only accepted certain attractions qualified



Leisure Attractions - Reduced Rate

- HMRC now seems to accept TRR also applies to
 - Climbing centres
 - Crazy golf
 - Go-karting
- Refund claims possible



Leisure Attractions - Reduced Rate

- HMRC now seems to accept TRR also applies to
 - Soft play
 - Ten pin bowling
 - Trampolining
- Refund claims possible



Outsourcing



Outsourcing - History

The VAT reasons for doing it

- Can outsource VAT-exempt activities to protect the local authority's partial exemption position
- Removes the VAT recovery risk for capital investment



Outsourcing - History

- CIPFA/HMRC Memorandum of Understanding (“MoU”)
- TISonline ‘Local Authorities and Similar Bodies VAT’
- Concept is based on putting the right conditions in place



Outsourcing - History

- Someone else delivers the services – in their own name (as principal)
- They occupy the premises free of charge
- Local authority replaces its mixture of taxable and exempt supplies with a single ‘non-business’ (or taxable) supply



Outsourcing - Concept

- The Provider is acting as Principal in making supplies of leisure services
- The Provider's status (type of entity it is) will determine the VAT liability of its supplies



Outsourcing - Concept

- Most take the form of Non-Profit Distributing Organisations (“NPDO”)
- An NPDO contractor’s supplies of admission to leisure facilities are generally VAT-exempt (Schedule 9 Group 10)



Non-profit Providers' Leisure Services

UK Law – Common supplies by an NPDO Provider	VAT Liability
<i>Ad hoc</i> sessions (swimming, squash, badminton, gymnasium, soft play etc)	Exempt
<i>Ad hoc</i> pitch/court hire (football, basketball, netball, volleyball)	Exempt
Pool hire	Exempt
Sports hall hire (for sport)	Exempt
Block bookings (sports facility for sports use by a school or club etc)	Exempt (unless OTT)
Party hire (pool or hall)	Standard Rate
Sports tuition (swimming lessons, gym induction, fitness classes etc)	Exempt (Education)
Creche	Exempt (Welfare supplies by a charity)
Room hire (including catering concession leases and lettings)	Exempt (unless OTT)
Catering and retail sales	Standard/Zero Rate

Outsourcing - The Lease

- The grant of occupational rights under a lease in return for consideration is a VAT-exempt business supply (unless the option to tax applies)



Outsourcing - The Lease

- All input VAT on the authority's premises-related costs would affect the partial exemption calculation
- To protect the partial exemption position, the grant of the lease must be a non-business or taxable supply



Outsourcing - The Lease

- To be a non-business supply, the local authority must not receive consideration in return for the grant of occupational rights
- Consideration means payment in any form and includes monetary payments such as premiums, rent, services charges, and insurance rent



Outsourcing - The Lease

- It also includes non-monetary arrangements such as a reciprocated supply of services, or a right to use the premises for a discounted price
- HMRC accepts that a peppercorn or £1 per annum rent can be overlooked



Outsourcing - Management Contract

- This sets out the service specification and the contract price
- It must also set out the capacity in which the Provider makes services available to the public
- It is vital that the Provider delivers the services to the public in its own name (as principal)



Outsourcing - Management Contract

- Previously, if the Provider acted as the local authority's agent, outsourcing would not achieve the available VAT efficiency
- The local authority would still be making the VAT-exempt supplies
- Has this changed now?



Outsourcing - Agency Model



Agency Model - A Type of Insourcing

- If a local authority has outsourced, the agency model is a type of insourcing
- The agency model reverses the principles of traditional outsourcing
- The local authority makes the supplies of leisure services

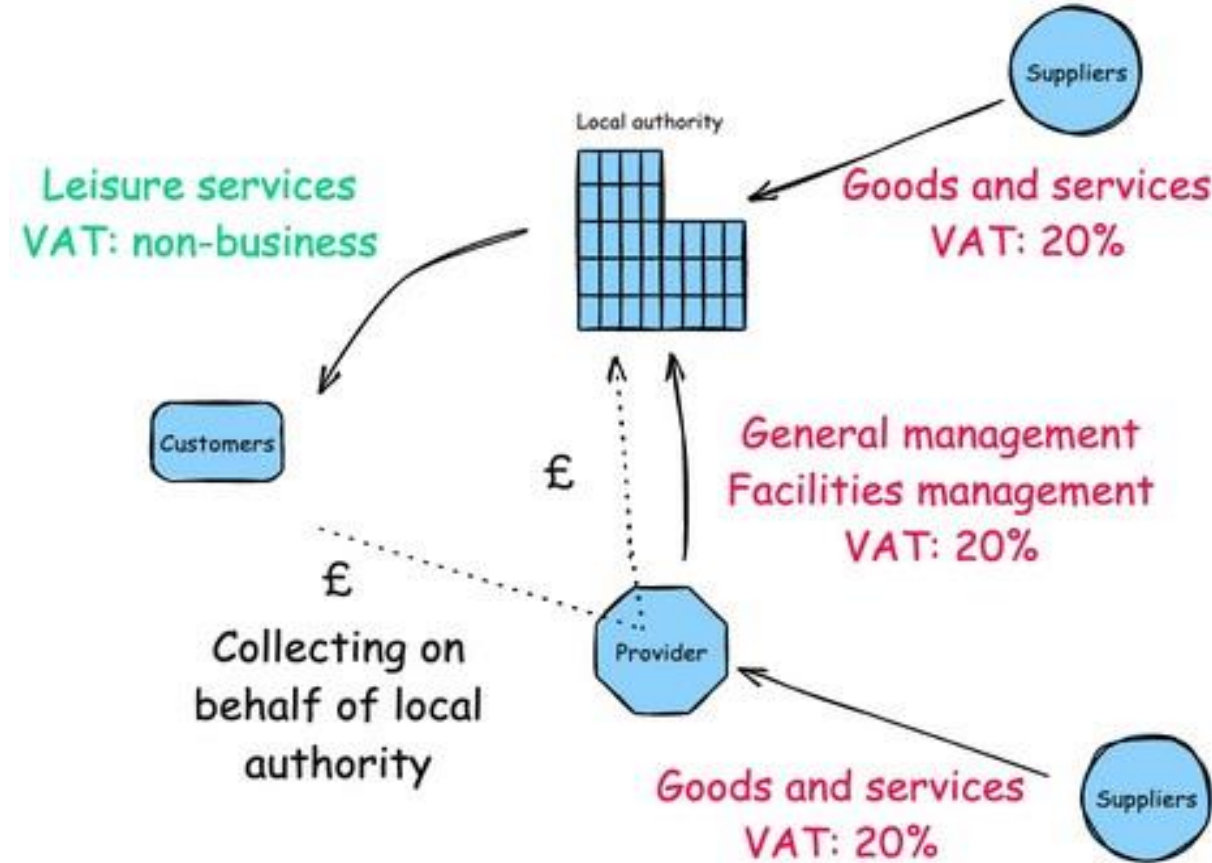


Agency Model

- The Provider acts as the local authority's agent
- Is every activity covered by the agency agreement?



Agency Model



Agency Model - Concept

- The Provider is local authority's agent for income
- The Provider remains principal for expenditure
- Alternatively, the Provider can run the full leisure service (income and expenditure) as an agent of the local authority



Agency Model - Concept

- Provider collects customer income on behalf of the local authority
- Income retains non-business treatment
- Provider makes a standard-rated service to the local authority - management of the leisure facilities and services



Agency Model - Concept

- Local authority reclaims VAT charged to it by the Provider and suppliers
- The Provider reclaims VAT charged to it by suppliers



Agency Model - Concept

- The Agency model already operates in local authorities
 - Outsourced school catering
 - Bulky waste collection
 - Commercial property estate management services



A close-up, slightly blurred photograph of a person's hands and arms. The person is wearing a white long-sleeved shirt and is seated at a wooden desk. They are holding a black pen in their right hand and are in the process of writing on a document. The document has some faint text and a signature. The lighting is warm and focused on the hands and the desk.

Agency Model – Risks

Partial Exemption

- What (if any) exempt supplies will remain?
- What margin does the local authority have under the 5% limit?
- Does the local authority need to take steps to reduce exempt supplies?
- What about the Capital Goods Scheme (“CGS”)?

Agency Model - Risks

Capital Goods Scheme (“CGS”)

- Has the local authority incurred capital expenditure on the facilities in the last ten years?
- Was the capital project value >£250,000 (net of VAT)?



Agency Model - Risks

Capital Goods Scheme (“CGS”)

- Even if this was undertaken during an old outsourced model
- The agency model will create a ‘change of use’ for the purposes of the CGS





Agency Model - Risks

Capital Goods Scheme (continued)

- The input tax on the capital project was recovered, either because it related wholly to an intention to make non-business or taxable supplies, or
- Because the attributed exempt input VAT was contained within the local authority's *de minimis* limit



Agency Model - Risks

Capital Goods Scheme (continued)

- Under the CGS, the VAT recovery was only 'provisional'
- It is potentially subject to repayment to HMRC if the VAT-exempt use of facilities increases

Agency Model - Due Diligence

- Review proposals from the Provider and take advice
- Analyse remaining VAT-exempt supplies from facilities and the effect on partial exemption and CGS
- Contract and procurement position?



Agency model - market view

- Suits some operators more than others
- Impact on typical leisure operating contracts
 - Trading risk

Agency model - market view

- Procurement considerations
 - Existing contracts/agreements
 - New procurements - comparing like-for-like basis



HMRC revises treatment of VAT on in house leisure services – welcome news for many local authorities

This timely bulletin outlines the changes and how agency arrangements might pass this benefit on to outsourced leisure services.

In March this year, HMRC announced a significant change to the VAT treatment of local authority leisure services that could add hundreds of thousands of pounds onto revenue lines.

Prior to March 2023, local authorities managing in-house leisure centres were required to treat services such as gym memberships and other facility visits as business activities for VAT purposes and pay VAT to HMRC from the income. Now, a revised treatment of VAT states these services are classified as non-business supplies for VAT purposes. This means local authorities pay no VAT on their income, as well as reclaiming all the VAT they incur on the related costs (revenue and capital) unconditionally.

Currently more than 20% of leisure facilities are owned and managed in-house by local authorities across the UK. Qualifying local authorities do not need to take any action; the transfer of VAT payments is automatic, resulting in an immediate financial uplift.

It is estimated there are 2,700 leisure centres in the UK, so roughly 500 are still managed in-house. The potential VAT benefit for each centre (given type of facilities) is in the region of £100,000 – £150,000, so across the sector the savings would be £54 million – £81 million per annum.

In consideration of this change, several operators who manage centres on behalf of local authorities are considering how this VAT ruling could also improve the VAT position between themselves and their local authority clients.

Many are not for profit and therefore gain no further benefit on income, as they account for no VAT on activity income, however, they must pay corresponding irrecoverable VAT on expenditure. Some are considering a new 'agency' model, whereby they collect income on behalf of the local authority so income remains 'non-business', which would mean they too would not have to pay irrecoverable VAT on expenditure.

The sector impact of this would also be significant; it is estimated that circa 780 leisure centres are managed by not-for-profit organisations, (members of Community Leisure UK). If all benefited from an agency agreement model with their local authority client, the financial benefit could be in the region of £50,000 – £100,000 per centre, that equates to circa £39 million – £78 million per annum.

In total, the VAT ruling could improve the public sector leisure centre finances by circa £100 million – £150 million per annum.

Given the sizable financial benefits of this VAT ruling, Max Associates have posed the question to leading tax advisors and local government lawyers to assess, whether it is likely that these financial benefits can be realised and how an 'agency' agreement would impact a typical leisure management contract held between operators and local authorities?

VAT analysis

When a local authority carries out a non-business activity, it does not account for VAT on its income and can reclaim all the related VAT costs.

Following the conclusion of long-running litigation, HMRC's March 2023 announcement and subsequent discussions, we understand HMRC now might accept non-business treatment applies to:

- Memberships;
- facility visits (for sport or recreation purposes, e.g., not to visit a catering facility);
- letting of sports facilities;
- lettings of non-sports facilities for sports, such as a community centre in some cases;
- leases of local authority-run sports facilities;
- letting local authority recreation grounds (such as parks) for sports events;
- sports tuition and education.

Agency model

The concept of principal and agent in VAT is that where an organisation acts as the agent of a principal, the principal is still making and receiving the supplies of goods and services, with the agent arranging them.

For outsourced leisure services, an agency model would mean that as the supplies of the leisure services would still be made by the local authority (as principal), the local authority's favourable VAT status would apply both in terms of the non-business treatment of the income and the ability to recover VAT on the related expenditure.

There are well-established VAT rules determining whether an agency/principal relationship exists. For services, HMRC will start with these tests:

- **Identity** – the services bought or sold by the agent on behalf of the principal must be identifiable.
- **Value** – the principal must know the exact value at which goods or services have been bought or sold on its behalf.
- **Separation** – the value of the agent's service must be separately identifiable from the main supply and should generally be known to the principal
- **No change** – the agent's intervention cannot alter or change the direction of the main supply between buyer and seller.
- **Nature and value** – agents generally cannot alter the nature or value of supplies which they arrange for their principal.

HMRC will look at the written contracts between the parties. However, even after considering these tests, the position can be inconclusive. Here, HMRC will look at the substance and reality of the overall position.

This type of HMRC-sanctioned arrangement for non-business supplies already exists in local authorities. One example is outsourced school catering contracts.

The supply of education is non-business in a local authority school, and the supply of catering to students will also be non-business if it's made at or below cost. Many local authorities outsource their school catering to contractors in arrangements where they act as the school's agent in providing catering.

Simplistically, the contractors provide the catering and collect the income, offsetting the collected income against the charges for their catering services. There are two supplies. First, the local authority's supply of catering to its students, which is non-business. Secondly, the contractor's supply to the local authority of running the catering service, which would be standard rated for VAT.

Significant structural differences might exist between an agent/principal for school catering and leisure services. However, clearly it is feasible that a local authority could appoint a provider to run its leisure centres as its agent.

Therefore, an agent/principal arrangement could maximise the benefits of a local authority's favourable VAT status, i.e., VAT-free income and the full recovery of related VAT costs.

Implementing an agency model carries risks that HMRC does not accept the agent/principal arrangement. However, with careful planning and advice, the agency model can provide significant VAT benefits for a local authority and the providers.

Contract issues

The local authority leisure sector has developed a well understood outsourcing model where an Operator provides leisure services to the Authority usually under a Sport England template contract. If an agency model were to apply, the agent would provide services on behalf of the Authority. The local authority leisure sector has become accustomed to this concept for carrying out capital works at the local authority's centres in a VAT-efficient manner.

The Sport England template suite of contracts needs fairly extensive additions to be acceptable to HMRC as a legitimate agency arrangement. This would usually include introducing an Agency Agreement setting out the scope of the agent's role (including what the agent can do in the name of the principal), what the agent will do on the principal's behalf including service standards and an agency fee (including how it is calculated), along with other common risk allocation. If a provider was essentially to provide the full (or majority of the) leisure service specification as an agent, this would require a much broader scope of the agent's role and therefore likely more focus on the Agency Agreement.

In order for an agent to take the benefit of the recent VAT ruling, the local authority would need to be VAT principal for the purpose of providing leisure services. In order to demonstrate that relationship, the main Sport England agreement would reserve that the local authority is responsible for the leisure services.

If the agency arrangement is proven to be an accepted model by HMRC for the broad set of leisure services set out in the VAT-ruling then the contractual arrangements would have to be carefully crafted to ensure a lawful agent/principal relationship is established whilst at the same time importing the right level of risk transfer to the operator (acting as agent).

Procurement issues

Some leisure operators are already proposing this agency model and local authorities who have run, are running or planning to run procurements for leisure services will be considering whether to accept the model following this VAT ruling. There will also be issues to

work through to ensure bidders are being evaluated on a like for like basis where some operators propose an income agency approach and others don't.

If approached by an incumbent leisure operator wishing to switch from their current contractual arrangement to an income agency model, the authority will need to be satisfied that the requirements of Regulation 72 of the Public Contracts Regulations regarding modifications of contracts during their term are complied with. Regulation 72 provides a number of safe harbours for modifications of existing contracts, and these would need to be worked through to ensure a compliant change to current arrangements.

Conclusion

An agent/principal arrangement could maximise the benefits of a local authority's favourable VAT status, i.e. VAT-free income and the full recovery of related VAT costs.

Authorities can now expect queries at an early stage of procurements about whether an agency model will be accepted. With that being said, procurement decisions are better made up front rather than in response to a specific bidder's request (to avoid complaints of bias) so the authority's position is best considered and communicated from the outset.

If the agency model proves financially attractive, then ensuring the risk position is not jeopardised by the agency agreement would be well worth the time and resource investment during the procurement.

Local authorities will also carefully need to consider how to respond to incumbents' requests to change existing arrangements to an income agency one or indeed whether the authority might introduce the potential change itself having regard to the financial benefits of doing so in a procurement-compliant way.

The authors of this article are working with operators and local authorities, on individual cases to assess whether an application of an agency agreement could bring savings to the partners in a way which could satisfy HMRC and legal and procurement requirements.

Key contacts



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APPENDIX C

Agency Agreements in Leisure

22 January 2025



- **Presenting today**

- Lisa Forsyth - Managing Director, Max Associates

- Richard Strevens – Associate Director, PSTAX

- Louis Sebastian – Partner, Trowers & Hamlins LLP



Agency model – context and market view



- Context to growth of the agency model in public leisure sector
- What we are seeing happen in the market;
 - Local authorities
 - Existing contacts and new tenders
 - Operators
 - Sport England



Agency model – context and market view



- Some operators have invested into researching into it more than others
- Impact on typical leisure operating contracts
 - Trading risk / can I still make decision about how to manage the business for example pricing
 - Practical considerations of implementation
 - Who benefits from financial savings
 - What is the sector benefit?



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Local Authority Leisure Services

Richard Strevens – Associate
Director

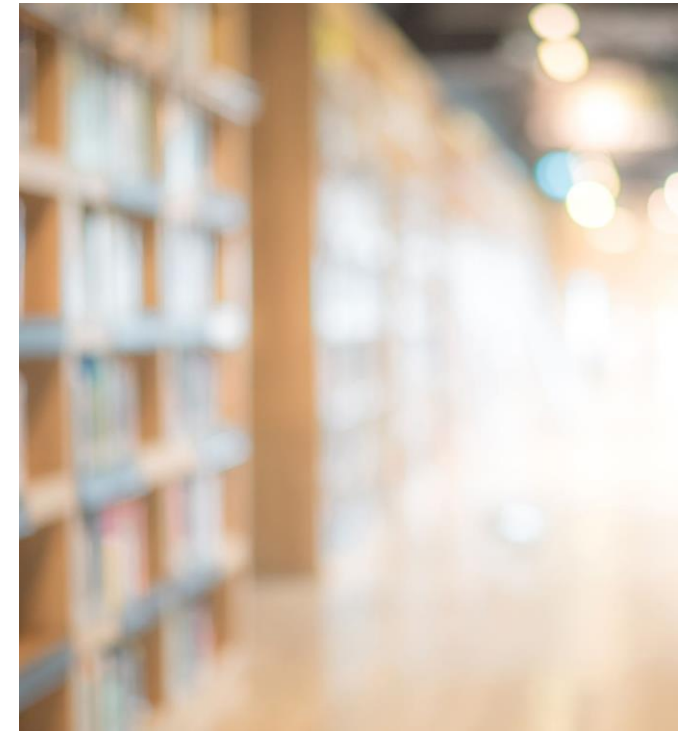
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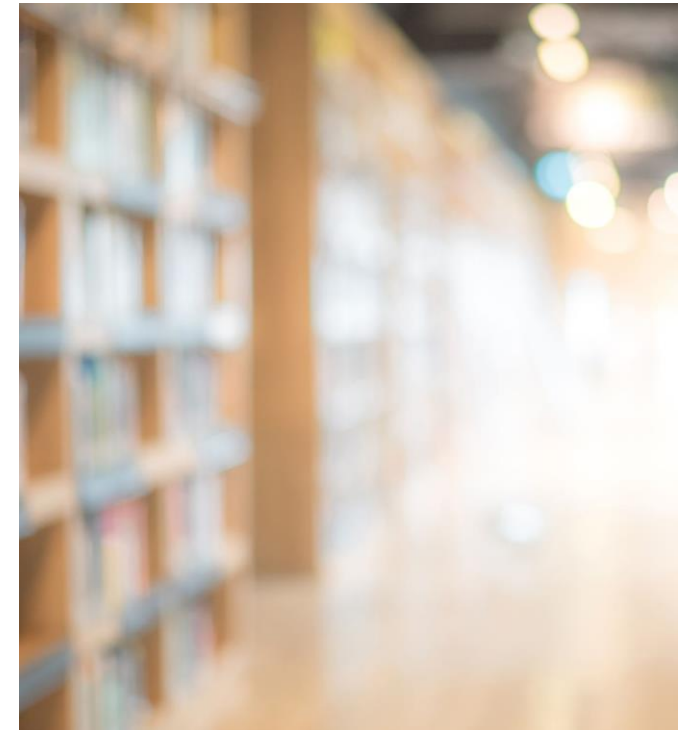
History of VAT and Local Authority Leisure

- > Historically, leisure services were standard-rated
- > Exemption for sporting services (leisure services) was introduced in 1994 for non-profit making bodies (an EU requirement)
- > Following representations from local authorities, they were expressly excluded from the exemption



History of VAT and Local Authority Leisure

- > Following litigation (Chelmsford), HMRC announced in March 2023 non-business treatment for some supplies
- > In November 2023, HMRC's guidance changed to include more services as non-business



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Outsourcing



Outsourcing - History

The VAT reasons for doing it

- > Typical leisure centres had both standard rated leisure services and VAT-exempt services (classes, room hire, block bookings)
- > Local authorities can reclaim
 - > all VAT costs relating to taxable and non business activities
 - > only a limited amount of VAT relating to VAT-exempt activities



Outsourcing - History

The VAT reasons for doing it

- > Can outsource VAT-exempt activities to protect the local authority's VAT recovery position
- > Removes the VAT recovery risk for capital investment



Outsourcing - Concept

- > The Operator is acting as Principal in making supplies of leisure services
- > The Operator's status (type of entity it is) will determine the VAT liability of its supplies



Outsourcing - Concept

- > Most take the form of Non-Profit Distributing Organisations (“NPDO”)
- > An NPDO contractor’s supplies of admission to leisure facilities are generally VAT-exempt



Outsourcing

- > A typical outsourcing arrangement will be contained within two documents
 - > A premises lease
 - > A management contract



Outsourcing - The Lease

- > The grant of occupational rights under a lease in return for consideration is a VAT-exempt business supply (unless the option to tax applies)
- > All VAT costs on the premises-related costs would affect the VAT recovery position
- > To protect the local authority's VAT recovery position, the grant of the lease must be a non-business or taxable supply



Outsourcing - The Lease

- > To be a non-business supply, the local authority must not receive “consideration” for the grant of occupational rights
- > Consideration means payment in any form and includes monetary payments such as premiums, rent, services charges, and insurance rent
- > HMRC accepts that a peppercorn or £1 per annum rent is not consideration



Outsourcing - Management Contract

- > This sets out the service specification and the contract price and the capacity in which the Operator makes services available to the public
- > It is vital that the Operator delivers the services to the public in its own name (as principal)
- > HMRC accepted that the Operator could act as agent, but there was no VAT benefit for the local authority



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Outsourcing - Agency Model



Agency Model - A Type of Insourcing

- > If a local authority has outsourced, the agency model is a type of insourcing
- > The agency model reverses the principles of traditional outsourcing
- > The local authority continues to make the supplies of leisure services



Agency Model

- > The Operator acts as the local authority's agent in delivering the services (and goods)
- > In principle, the agency arrangement can cover all or just some activities



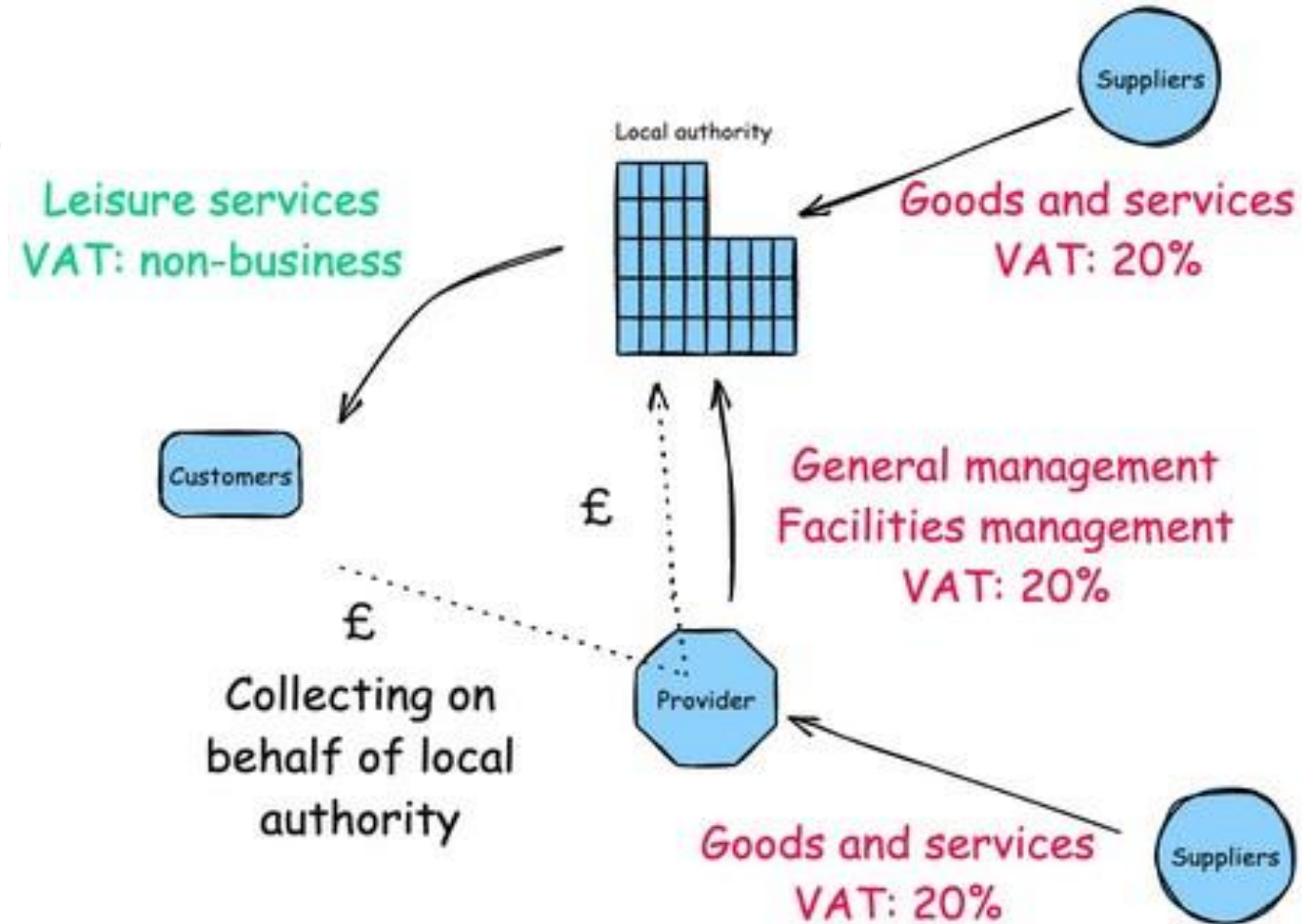
Agency Model - Concept

- > Operator collects customer income on behalf of the local authority
- > Income retains non-business treatment
- > Operator makes a standard-rated service to the local authority - management of the leisure facilities and services



Agency Model

- > Local authority reclaims VAT charged to it by the Operator and suppliers
- > The Operator reclaims VAT charged to it by suppliers



Agency Model - Concept

- > The Agency model already operates in local authorities
 - > Outsourced school catering
 - > Bulky waste collection
 - > Commercial property estate management services



Agency Model - Risks

VAT recovery for local authority

- > What (if any) VAT-exempt supplies will remain?
- > What headroom remains for recovering VAT costs related to VAT-exempt activities
- > Does the local authority need to take steps to reduce VAT-exempt supplies?
- > What about the Capital Goods Scheme ("CGS")?



Agency Model - Risks

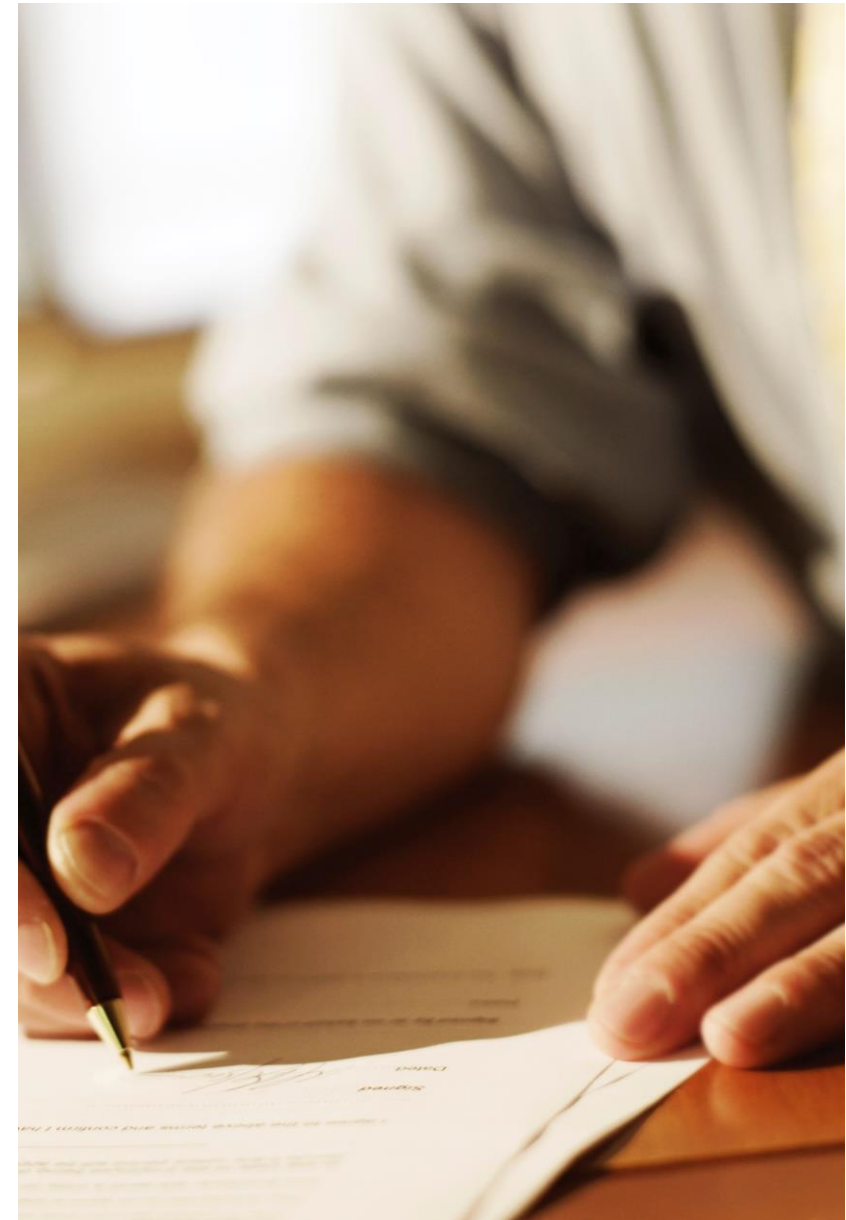
Capital Goods Scheme

- > Where a local authority
 - > reclaims VAT on capital costs relating to taxable or non-business activities; and
 - > within 10 years the activities change to VAT-exempt, some of the VAT originally reclaimed might need to be repaid



Agency Model - Due Diligence

- > Review proposals from the Operator
- > Analyse remaining VAT-exempt supplies from facilities and the effect on partial exemption and CGS
- > Verify Operator savings?

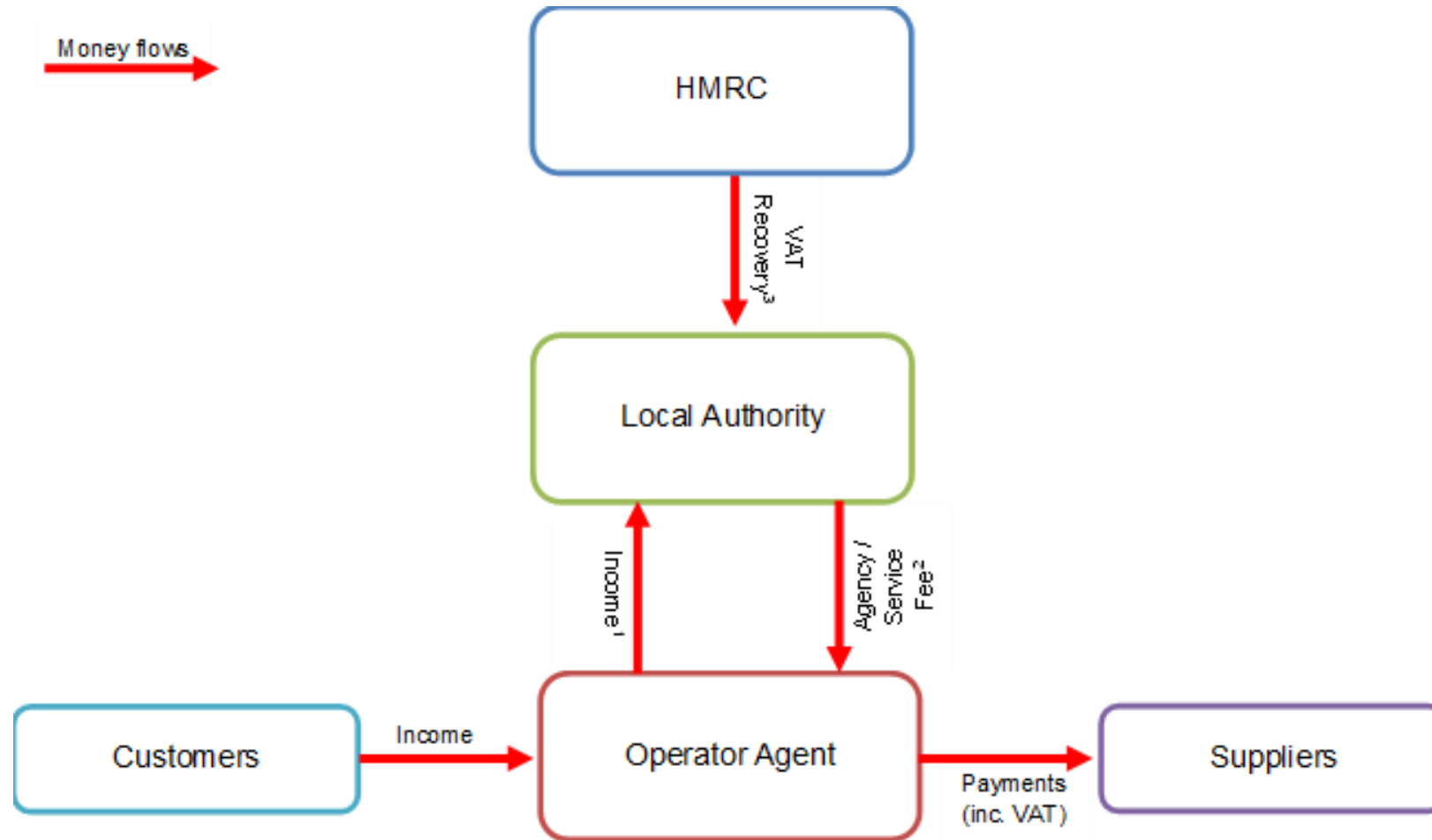


Legal Issues - Leisure Agency Structure

Louis Sebastian - Partner

22 January 2025

Legal Issues



Notes:

1. All Income belongs to the Local Authority but it is held by the Operator Agent day-to-day.
2. Agency / Service Fee – fee for the management and services provided in running facilities:
 - a. Includes Operator's Margin, Head Office Costs etc.
 - b. Standard rated for VAT
 - c. Adjusted to reflect performance deductions and underperformance or surplus share
3. The income could be made up of Standard Rated Income (e.g. catering); exempt income (e.g. non-sport education/training) and non-business income (e.g. leisure and sport). Local authority will need to consider its partial exemption calculation.

Legal Issues

- Local Authority Vires
- Procurement
 - Variation of existing contract
 - New contract
- Risk allocation - implementation
 - Procurement challenge
 - HMRC challenge

Legal Issues

- Contract drafting
 - Must clearly describe agency structure
 - Appointment as agent
 - Split of services (contractor agent/principal)
 - Risk allocation by adjusting Agency Fee
 - Payment clauses
 - Reporting rights
 - Pricing
 - "Control" over agency services
 - Revised financial model (LOBTA)

Legal Issues – common questions

- Lease or Licence?
- How does the Paymech Work?
- Contract amendments in live procurements?
- Do Council's take on additional risk?
 - Contracts with users
 - Employment
 - Liability/Insurance

Questions and Answers

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