ENTRUST

Income Derived

March 2015

1. Introduction

1.1 This report details the outcome of ENTRUST's consultation on the regulation of Income Derived (ID).

1.2 The ID consultation sought stakeholders' views upon the continuation of the current reporting requirements in relation to ID and the option of an assurance that all income generated from the running of an amenity will be spent on the maintenance and operation of the Landfill Communities Fund (LCF) amenity (the assurance proposal). This helps to assure the continued sustainability of a project by allowing future revenue costs of the facility to be funded.

1.3 The consultation paper was published on 1 November 2013 and the consultation closed on 24 January 2014. We also held a well attended focus group (14 attendees) on 16 January 2014 and received 30 consultation responses.

1.4 The questions we asked of stakeholders are attached at Appendix A. A summary of the responses we received is set out at Appendix B.

2. Summary of issues, conclusions and recommendations

Issues

2.1 In analysing the responses to the consultation, we noted the following issues:

2.1.1. A number of the responses from Environmental Bodies (EBs) demonstrated a restricted understanding of how ID arises, how it should be accounted for and how it can be spent. This lack of understanding was disappointing to note as our current policy position was set out in the consultation paper.

2.1.2. One point which arose in the focus group was some EBs' views that they need only report the ID which they receive (and not the ID received by a project applicant whose project has been funded by the EB). We therefore believed that it was appropriate to inform HMRC of this point. Following our discussions with HMRC, they were concerned that this did not accord with their legal advice. HMRC's subsequent advice confirmed EBs' understanding of the Landfill Tax Regulations 1996 (Regulations) but set out the obligation on a funding EB to monitor appropriately a project undertaken by a non EB project applicant. We therefore considered it was appropriate to incorporate HMRC's advice into this report.

Conclusions

2.2 After our analysis of the responses to the consultation exercise, we conclude:

2.2.1 The assurance proposal (as described in paragraph 1.2 above) was the preferred option for all stakeholders who expressed a preference for accounting for ID. This option would have the benefit of significantly reducing administration costs for a large number of EBs without leading to any significant increase in compliance risk (as our inspectors will check the EB's expenditure of LCF monies and the upkeep of amenities at post project visits). Those who responded in favour of the assurance proposal pointed to EBs' desire to render their project sustainable as additional assurance that ID would be spent on the maintenance of any amenity created or purchased with LCF funds.

2.2.2 Further clarification and guidance is required on what constitutes ID, and the period over which ID should be reported, due to identified misconceptions in the responses provided to the consultation. These included the notion that ID could be spent on "any worthy activity, such as meals for the elderly".

2.2.3 There was very little demand for introducing a de minimus level of reporting of ID, and no agreement as to how any such de minimus level could be operated. Therefore we do not recommend the implementation of this proposal.

Recommendations

2.3 As a result of the response to this consultation exercise, we intend to revise our policy and procedures to enable EBs to give an assurance at project registration that any ID from the project will be spent solely on the maintenance and running costs of that project. This will involve a change to our current forms and guidance, and is subject to HMRC approval.

2.4 In order to implement these changes, we are in discussion with HMRC to identify the regulatory changes which would be required to support this proposal. The effect of the regulatory changes would be:

2.3.1 Where an EB gives an assurance for a project, the EB will be required to keep its own record of the ID from that project but will not be required to report to us the ID.

2.3.2 Where an assurance has been given at project registration we will check compliance with that assurance at our usual compliance visits by asking questions about how the ID has been spent and by checking the upkeep and maintenance of LCF amenities.

2.5 As the assurance option will only apply to projects which are registered after the introduction of regulatory changes, we will also consider what options (if any) can be provided for EBs whose projects were registered prior to the introduction of the new assurance option but whose ID is spent solely on project maintenance.

2.6 We intend to clarify our guidance to make it clear to EBs that:

2.6.1 Monies which accrue to an EB due to the use, or investment, of LCF monies constitute ID but there must be a link between the use or investment of the LCF monies and income received by the EB for that income to constitute ID.

2.6.2 In accordance with the Regulations, ID can only be spent in the same way as other LCF monies.

2.6.3 ID does not need to be returned to the original funder (unless this is a term of the funding agreement) or given to ENTRUST.

2.6.4 ID is a positive outcome for a project and should be considered as making a positive contribution to the sustainability of that project.

2.7 As a result of the consultation exercise, we will revise our guidance on what constitutes ID and we will work to improve the examples used in order to better reflect real life scenarios. We will place more emphasis on ID in our training events and the training materials we make available to EBs. In preparing these materials we will take into account stakeholders' responses in relation to the types of ID which they considered should be reported.

2.8 We will also make it clear in our revised guidance that the current reporting obligation falls upon the EB which receives the ID. Where an EB has funded a project undertaken by an organisation which is not enrolled as an EB, the funding EB is not required to report ID which it does not itself receive. However, that funding EB will still be subject to a general obligation to monitor projects which it has supported for an appropriate period to ensure that those projects remain in compliant use.

2.9 When issuing revised guidance we will also take into account the many comments in the responses regarding the current position where ID is expected to be reported indefinitely.

2.10 In conjunction with our current training strategy and planned move towards more online training resources, we will introduce further training support in relation to ID in conjunction with the implementation of the measures taken as a result of this report

2.11 We do not recommend the introduction of a de minimus level for reporting ID.

3. Next steps

Changes to the Regulations

3.1 We sought advice on the appropriate procedure to effect change, and received advice from our legal advisors that in order to introduce the assurance proposal it would be necessary to introduce changes to the Regulations.

3.2 We hope that it will be possible to introduce the necessary changes to the Regulations as part of the reform to the LCF which was under discussion by the Reform Working Group (set up as a result of the outcome of the Challenge).

3.3 Once we have secured HMRC's agreement that the Regulations can be amended to implement the assurance proposal, we will work on the further changes to processes, guidance and forms necessary to bring the assurance proposal into effect.

Changes to Form 2

3.4 As part of this supporting work to effect the assurance proposal, we will work on updating Form 2: Applying to register a project so that the assurance option is available for all new projects registered after the Regulations have been amended. However, this is unlikely to be before 1 April 2015.

Draft and issue revised guidance

3.5 We will also begin work on updating our guidance on ID. This will be delivered in two stages. The first stage will be a general update on ID to provide more clarity on the current rules. This stage will be delivered irrespective of the discussion regarding regulatory change. As part of this guidance, we will also provide further examples of situation when ID can arise. This is as a result of the comments provided by stakeholders in response to the consultation. This guidance will be tested with EBs whilst in draft and then issued once final.

3.6 The second stage will begin once HMRC consider it is appropriate to make any regulatory changes. This stage will consist of revising and updating our ID guidance to take account of the assurance proposal and the changes this will bring. The stage two updates to our guidance will also include any necessary revisions to our guidance on how to complete Form 2.

Develop and deliver update and exchange session by way of training

3.7 Once we have agreement that regulatory change can be made, we will develop an information session for EBs on the introduction of the assurance proposal. This training session will be open to all EBs and will be delivered shortly before the implementation of the assurance proposal and the required changes to Form 2. This session will include an opportunity for feedback to be given on the revised guidance we plan to issue on ID.

ENTRUST
February 2015

Appendix A

The questions asked in the consultation

	Question asked	Paragraph in consultation paper
1.	We propose that only EBs whose income derived is above a certain level, should account for this additional LCF funding. Would you agree with this proposal?	4.1
2.	If you answered 'yes' to question one, what would you consider, as an amount, to be a reasonable de minimus level to adopt and why? If you answered 'no' to question one, why do you not agree?	4.1
3.	Do you agree that greater significance should be given to income derived at ENTRUST training events?	4.1
4.	Do the proposed amendments to the Form 2 clearly set out the principles of identifying and accounting for LCF income derived?	Inset table and 6.1
5.	Do you think that the proposed amendments to the Form 2 clearly explain the basis for calculating income derived, which is generated from an LCF project?	Inset table and 6.1
6.	Do you think that the proposed amendments to the Form 2 will help EBs to ensure that they spend LCF income derived compliantly?	Inset table and 6.1
7.	Are there any further improvements that could be made to the questions asked at the project application stage to help EBs recognise LCF income derived and how to calculate it?	6.1
8.	Do you agree with the principles that are used for calculating income derived outlined in paragraph 7.1?	7.2
9.	Do you agree with the methodology for determining the proportion of income derived, which is attributable to the LCF? If yes, why do you agree? If not, why do you not agree?	7.2
10.	Is the methodology for calculating, or determining income derived clearly explained? If not, what suggestions would you make to improve the clarity?	7.2
11.	Are there any issues, for example interpreting the definition of income derived, which you encounter when reporting and recording income derived?	8.3
12.	Are there any problems that you currently face when ensuring that income derived is spent only on approved objects?	8.3
13.	If your organisation is an EB which funds projects, what methods have you found effective to ensure that income derived is spent compliantly by project applicants?	8.3
14.	Do you agree that the list in paragraph 10.2 provides examples of the types of projects which could potentially generate income derived?	10.2
15.	If you answered 'no' to question thirteen, please explain why and provide more information to support your response including examples of projects.	10.2

16.	Are there any other types of projects that you have delivered, where you consider they generated income derived?	10.2
17.	Have you sought approval for a project where you found it difficult to determine if LCF income would be classified as income derived? If yes, please give details.	10.2
18.	Are there any other issues that you would like to raise in relation to projects that generate income derived?	10.2
19.	Do you agree with the proposal that EBs should not be required to report income generated from the running of projects on their Form 4?	11.4
20.	If you answered 'yes' to question nineteen, why do you think this income should be excluded? If you answered 'no' to question nineteen, why do you not agree?	11.4
21.	If you answered 'yes' to question nineteen, do you think there any other sources of income that EBs should report as income derived on their Form 4 other than: interest, sale of assets, royalties and return funds?	11.4
22.	Do you consider the proposed amendments to the project registration Form 2 to ask how income generated from the project will be spent and the insertion of a declaration of understanding of how the income must be spent is a sufficient safeguard to ensure income generated from the operation of LCF facilities will be spent only on the continued running of the facility or other approved objects?	Inset table and 11.7
23.	If you answered 'yes' to question twenty two, how do you think this will ensure the income is spent compliantly? If you answered 'no' to question twenty two, why do you not consider it sufficient?	11.7
24.	Ultimately, which proposal (1 or 2) for reporting and accounting for income derived do you think ENTRUST should pursue?	11.7
25.	Why do you consider your answer to question twenty four to be the better proposal?	11.7

Appendix B

The responses to the consultation questions

Reporting Income Derived only above a de miminus level

1.1 Those who responded on this point were fairly evenly divided between those who favoured a de minimus level for reporting and those who did not.

1.2 Amongst those who were in favour there was no consensus as to the appropriate level. Suggestions for the appropriate de minimus level ranged from £5,000 to £15,000. One EB suggested that the de minimus level should depend on the level of funding received by the EB in the preceding year, one EB suggested that ID below 5% of an EB's other funding need not be reported, and another EB suggested that the de minimus level for a project should depend on the funding that project had received and the period over which the project's assets were required to be protected.

1.3 EBs who were opposed to a de minimus level identified that it would still be necessary for an EB to calculate its ID in order to know whether it was over or under the de minimus level. Therefore the level of administration would be similar irrespective of the reporting.

1.4 A few EBs responded that they did not agree that ID should be reported at all, or suggested that only certain categories (such as royalties) should be reported. The latter responses have been incorporated into the responses on the ID which should be reported, below. Whilst the former responses are helpful to understand the views of EBs, as such opinions do not respond to any of the proposals outlined in this consultation we will not be taking this point further in this report.

Greater significance given to Income Derived at ENTRUST training events

1.5 Approximately half of the respondents consider that more prominence should be given to ID at our basic training events. Given our concern with EBs' understanding of how ID is currently framed, we consider that more guidance would be helpful.

1.6 As our current training strategy is to move towards more online training resources, we will plan to introduce further training support in relation to ID in conjunction with the implementation of the measures taken as a result of this report.

Proposed amendments to Form 2: registering a project

1.7 A majority of those who responded considered that the proposed amendments to Form 2 did clearly set out the principles of identifying and accounting for ID, and also clearly explained the basis for calculating ID.

1.8 However, fewer EBs considered that the proposed amendments would help EBs spend their ID compliantly. One EB suggested that many project applicants would exaggerate the amount of ID to be expected in order to show their proposed project in the best possible light, without appreciating the need to report ID at a later stage.

Further improvements to the project application stage

1.9 EBs who responded to this section suggested that further clarity would assist project applicants to understand what constitutes ID and how such income could be spent. EBs also requested further examples of projects with ID.

Principles used for calculating Income Derived

1.10 Of those who responded, just over half disagreed with the principles used for calculating ID (as set out in paragraph 7.1 of the consultation paper). Of those who disagreed and supplied further detail, two EBs suggested it was inaccurate to presume that income attributable to the LCF contribution had a direct relationship with the proportion of the project funded by LCF funds. Another EB suggested that LCF funding was often given to a part of a project which would not, by itself, be capable of generating additional income

1.11 EBs who responded to this section agreed that further clarity would assist project applicants to understand what constitutes ID and how such income could be spent.

Methodology for calculating Amendments to Form 2: registering a project

1.12 The majority of those who responded considered that our methodology (appended as Appendix A to our consultation paper) was clearly explained. One EB noted the need for the guidance to make clear that it was the EB which received the ID which is required to record and report it.

1.13 However, the majority of those who responded also considered that the examples given were too simplistic and that more detailed guidance was required to reflect the more complicated scenarios which actually emerged in real life. We have taken heed of this point and will update our guidance in this regard. We will also invite EBs to provide us with scenarios they consider to be more representative of common projects and upon which they would like guidance.

1.14 Some EBs also noted at this point that in calculating ID no account was taken of external factors (such as weather, increased publicity or inflation) which might affect income levels.

Issues with the interpretation of Income Derived which are encountered when recording and reporting

1.15 In response to this question, EBs suggested that more clarity would assist them in reporting ID. Many of the responses to our consultation came from EBs who fund other organisations (including other EBs) and, as they do not receive ID, they do not themselves have to report ID. However, they suggested a list of examples might be of assistance to the EBs whom they fund.

1.16 One EB suggested that ID be redefined and restricted to certain specific categories (interest received, sale of assets, royalties and returned contributions); another EB suggested assistance should be provided in calculating interest on contributions held for a significant period prior to a project commencing.

Issues with spending Income Derived only on approved objects

1.17 The majority of those who responded did not report issues with ensuring that ID is spent only on approved objects where the project applicant is an EB. However, there were concerns that where the project applicant was not enrolled then any ID which was received would not necessarily be identified during the funding EB's compliance checks.

1.18 Additionally, a few EBs sought more clarity on what constituted "maintenance" of an amenity. One EB conflated the maintenance of an amenity with its own administration costs (an issue occasionally found at compliance visits).

Funding EBs ensuring compliant spend by project applicants

1.19 The majority of those who responded to this question highlighted a combination of: clauses in their funding agreements, seeking declarations from those funded, project monitoring checks, data questionnaires and making sure sufficient information had been given to project applicants in advance.

1.20 One funding EB noted in response to this question that it had decided not to fund certain projects due to their propensity to create ID.

Examples of projects which could generate Income Derived

1.21 A slight majority of those who responded considered that the list in paragraph 10.2 of our consultation paper did not provide examples of the types of projects from which income could potentially be derived.

1.22 The most frequent comment from those who did not agree that the list provided examples was that it was often very difficult to identify whether any income generated was ID from the project. Therefore the list given was misleading and an over-generalisation. EBs reported that in some instances income could be generated but that there was no connection between the income and the injection of LCF monies (for example, greater admission fee income due to improved weather). EBs also reported that in the case of renewable energy, the project applicant would enjoy a reduction in its heating bills but if the renewable energy source did not create a surplus then there was nothing to report as ID.

1.23 When asked if there were other projects which should be added to the list at paragraph 10.2, one EB suggested that enhancements to existing buildings should be added (although enhancements were cited by other EBs as examples of projects which should not be treated as generating ID due to the difficulty in identifying the true source of the additional income). Another EB suggested that biodiversity examples should also be included, such as sale of timber from a coppicing project funded by the LCF. Other suggestions included the rental charges from letting machinery and other equipment purchased with LCF monies, renewable energy projects which qualified for the Renewable Heat Incentive or which generated electricity which was sold back to the Grid and the sale of livestock/produce as a by product of land management.

Difficulties in determining if Income Derived arises

1.24 The majority of those who responded identified refurbishment and enhancement projects as ones where it was difficult to identify if income was derived from the contribution of LCF monies. Admission fees and community cafes/shops were also raised due to the difficulties in linking increased admissions to the LCF contribution.

1.25 Those who responded also identified the period of time over which ID should be calculated as causing them concern. The current guidance does not specify the periods of time for which ID should be reported. Those who responded also identified that there is no guidance on calculating ID when the asset from which the income is derived has depreciated down to zero, is no longer required to be on an asset register or is outside its required monitoring period.

1.26 More than one funding EB responded that they had avoided giving funding to certain projects where they were unsure about ID solely because of the difficulties with identifying ID.

Other issues arising with projects which generate Income Derived

1.27 The majority of those who responded indicated their frustration at what they perceived to be unnecessary bureaucracy in relation to ID, particularly as the amounts involved were often relatively minor. Many EBs considered that, as they were not for profit organisations focused on benefitting communities and the environment, they should be free to spend the ID in ways they considered would provide most benefit for their community (which would include on projects which would not comply with the Regulations such as subsidised meals for the elderly).

1.28 Those who responded also pointed to the discrepancy between EBs, who must report and account for their ID, and project applicants who are not enrolled and so do not need to report ID.

Proposal that EBs should not be required to report income generated from running projects

1.29 Two stakeholders indicated they were against this proposal on the basis that it is a regulatory requirement to report all ID.

1.30 All other stakeholders who responded indicated that they were in favour of this proposal. The overwhelming response from this group of stakeholders was that the assurance proposal would reduce bureaucracy by removing the requirement to report ID from a project which would be spent compliantly on maintenance of the amenities created or purchased under that project. It was considered that the reporting was unnecessary where the recipients of the ID were, in any event, not for profit organisations which were working for the benefit of communities and the environment. It was also considered that the assurance proposal would demonstrate how ID is intended to support the sustainability of projects.

Income which should be reported other than: interest, sale of assets, royalties and return funds

1.31 Almost all of those who responded considered that the only sources of ID which should be reported were interest, proceeds of sale of assets, royalties and returned LCF funds. In particular it was considered that, as it was too complicated to calculate the ID element of admission fees and hire charges, these sources should not be included.

1.32 One stakeholder commented that all sources of ID must be reported, in accordance with the Regulations.

Proposed amendments to Form 2 under assurance proposal

1.33 The majority of those who responded considered that the proposed amendments to Form 2 which were set out in the consultation paper would be a sufficient safeguard to ensure that ID would be spent on the maintenance of the project.

1.34 Some variations to the wording helpfully were suggested, for added clarity.

1.35 A number of those who responded commented that clearer guidance on what constituted ID would assist compliance as it was considered that the majority of breaches in this regard were through EBs misunderstanding their obligations rather than deliberate action.

Preferred proposal

1.36 All stakeholders who expressed a preference indicated they were in favour of the assurance proposal, i.e. that ID which is spent on the running costs of the project need not be reported. This preference was also the view of those EBs who attended the focus group.

1.37 The main reason expressed for preferring the assurance proposal was the perceived reduction in the administration burden on organisations. It was considered to be a more proportionate response to the risk, and also a sensible means by which sustainable projects could be supported.