

VAT AND CHARITIES: BACK TO BASICS

VAT and charities is a complex area. Many cases have been heard by the VAT Tribunal concerning charities frequently with significant sums at stake which if the charity loses its arguments with HMRC are often difficult to fund.

Complexity arises because:

- There is no general relief from VAT for goods and services supplied to charities and usually the normal VAT rules apply to business supplies made by charities;
- This basic regime, however, is overlaid by a range of special reliefs (zero rating and exemptions) which cover many supplies to and by charities; and
- Charities often carry on a wide range of activities.

CORRECTLY ACCOUNTING FOR VAT

A charity may have the following activities with the following VAT consequences:

- receipts of donations, legacies and Government grants – i.e. **non-business**;
- health & welfare services, education, one-off fund raising events, lotteries and domestic property rents – i.e. **exempt supplies**;
- commercial lettings, sale of goods, catering and conference facilities – i.e. **standard rated supplies**.

See figure 1 overleaf

ARE YOU A “BUSINESS”?

Business is a wider concept than trading i.e. is an economic activity carried on? Whilst all **trading** is business not all business is trading.

Factors which indicate whether a **business** is carried on include whether the activity:

- is seriously and earnestly pursued;
- is pursued with reasonable or recognisable continuity;
- is substantial in terms of value;
- is conducted in a regular manner and on sound and recognised business principles;
- is predominantly concerned with obtaining consideration; and
- is similar to activities made by persons seeking a profit.

Accurate categorisation of activities will ensure that the charity correctly:

- charges VAT on its taxable supplies;
- recovers input VAT; and
- takes advantage of any reliefs on the purchase, lease or construction of property.

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FIGURE 1 - VAT LIABILITY OF INCOMES/ACTIVITIES

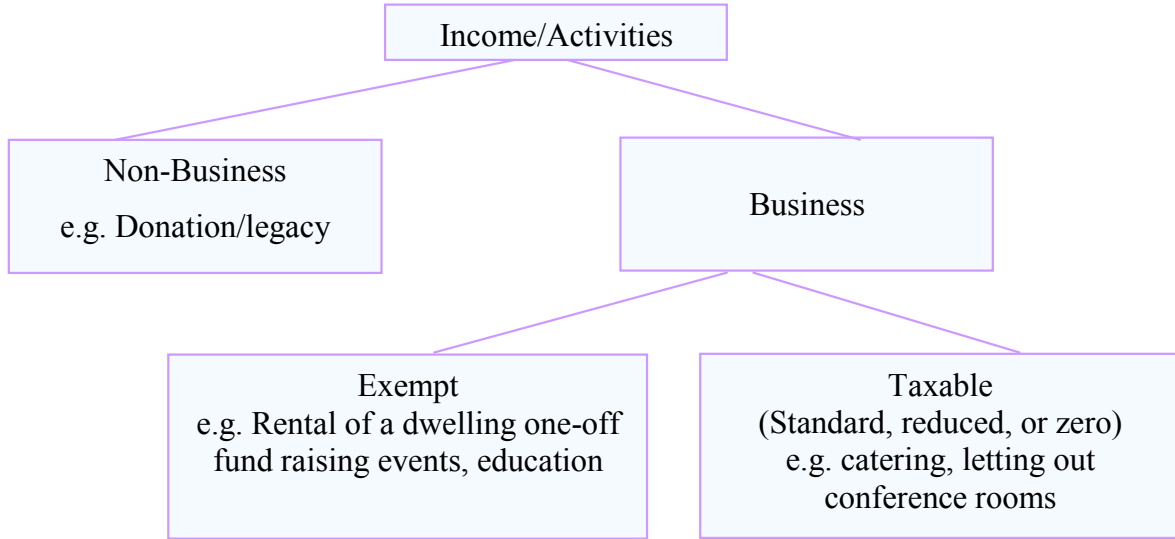
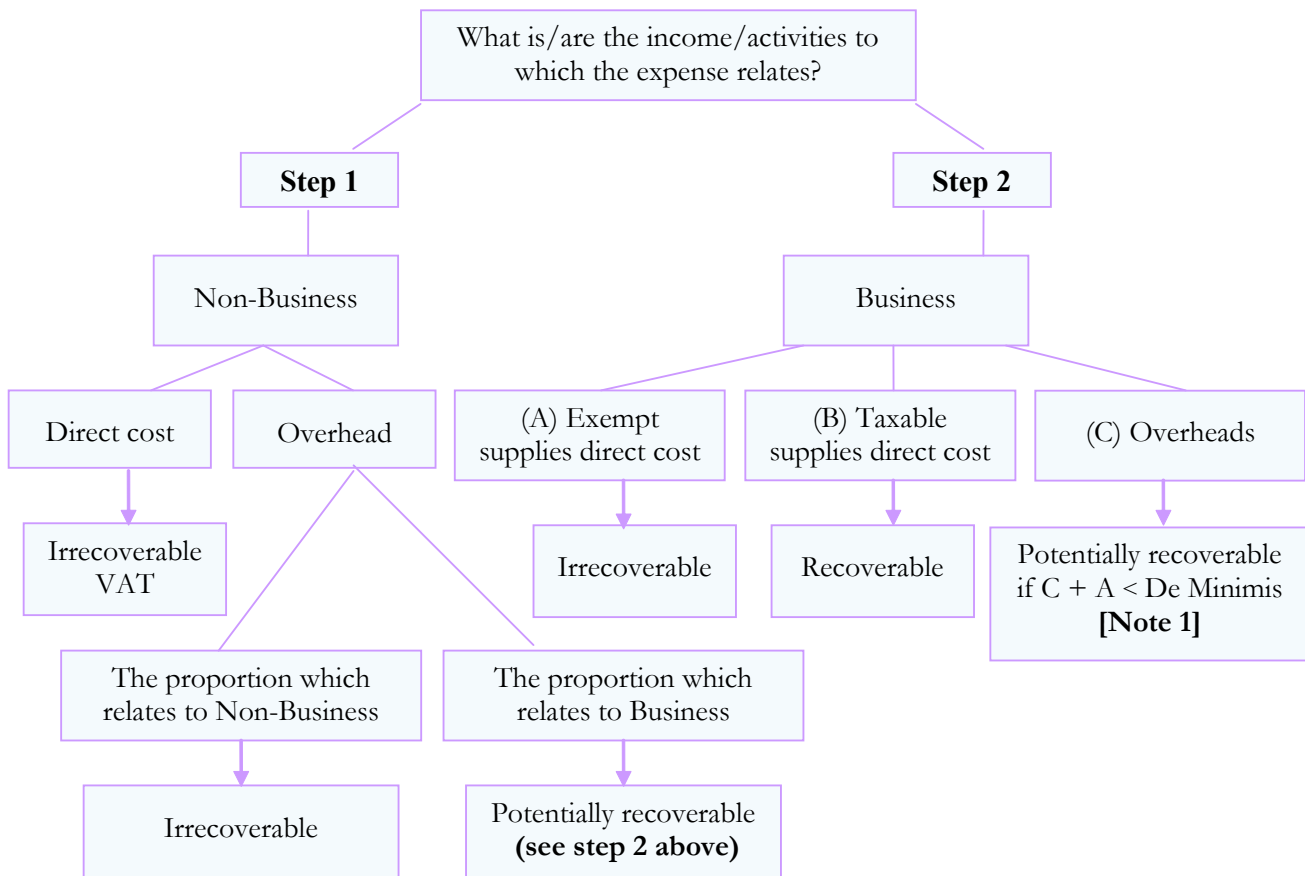


FIGURE 2 - VAT RECOVERY PRINCIPLES



Note 1: de minimis

If exempt input < (a) £625pm i.e. £7,500 and
(b) 50% of total input VAT

MAXIMISING ALLOWABLE INPUT VAT

Irrecoverable VAT is a real cost to a charity because it cannot pass the cost to an end customer.

The recoverability of VAT incurred on costs and expenses is determined by the activity to which it relates. A charity has to go through a series of calculations:

See figure 2 on previous page

Mitigating irrecoverable VAT involves:

- knowing exactly what type of income and activity the charity is involved in;
- using the most beneficial apportionment methods; and
- where possible, not incurring VAT in the first place.

PROPERTY

The most significant cost that any charity is likely to incur will be with regard to property and often this should result in no VAT being charged to the charity.

Two different regimes apply:

- where a new building is constructed for a charity: this may be a **zero rated supply**; and
- where a charity buys or leases an existing building: this may be an **exempt supply**.

To obtain these favourable treatments the charity must issue the necessary certificate to the builder, vendor or lessor before the supply takes place. Since sometimes the payment of a deposit can trigger the date of supply, charities should always issue certificates as soon as practicable.

If the seller/lessor was not aware that the recipient was a charity when the price was initially negotiated, the seller/lessor may try to increase the price. This will be to take account of any irrecoverable VAT the seller/lessor will incur on professional fees in connection with the sale or lease together with any payments of VAT it may have to make to HMRC pursuant to the capital goods scheme (“CGS”) as a result of making an exempt supply to the charity.

Case law has extensively reviewed the meaning of all the words and phrases in quotation marks and thus the following is a very brief overview. (The term **business** was discussed above).

There are also special rules which deal with approved alterations to listed buildings which may also be relevant for charities.

CONSTRUCTION OF NEW BUILDINGS

The construction of a “new building” that is intended for “use” “solely” for relevant charitable purposes (“RCP”) is a **zero rated supply**. RCP means either:

- otherwise in the course of “business”; or
- as a “village hall” or where “similar facilities” are provided for a “local community.”

EXISTING BUILDINGS

The supply of land is generally **exempt**. Where the supplier has opted to charge VAT the supply becomes **standard rated** unless the option to tax is disapplied. An option to tax can be disapplied where the purchaser or tenant is a charity which intends to use the building “solely” for a “RCP” but not as an office.

NEW BUILDINGS

Zero rating does not apply to enlargements or extensions of existing building but can, however, apply to “relevant charitable annexes” (“RCA”). The key is that the RCA and the existing building would form two separate parts of a single building that would operate independently of one another.

So a careful distinction has to be drawn between, say, classrooms or sports halls that are added to an existing school (**standard rated** supplies) and a nursery added to a school building (**zero rated**).

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USE

Usually, HMRC looks to the use to which the property owner puts the building. In a very narrow range of circumstances, however, zero rating is possible even if the charity lets to another person (i.e. makes a business supply) where the tenant occupies for non-business purposes.

SOLELY

Before 1 July 2010 there was an HMRC extra statutory concession that allowed **zero rating** if the building was used as to at least 90% RCPs. From 1 July 2009 HMRC will accept that **solely** means at least 95% RCP use using any method e.g. time, floor space, head count) to measure use provided it is fair and reasonable.

Because of the decrease in the *de minimis* threshold from 10% to 5%, HMRC will be looking very carefully at certificates which are being issued in the run up to 1 July 2010 and will not accept as valid any certificates unless:

- construction services: there is a meaningful start to construction before 30 June 2010; and
- in the case of a sale or a lease: contracts have been exchanged and a meaningful deposit paid.

VILLAGE HALL ETC

The building does not have to look to the interested bystander like a typical village hall and can be something much more substantial like a leisure complex. Similar facilities can include a theatre. The term “local community” is not restricted to persons who live in an area and can include persons who spend their working lives in the locality but there has to be some degree of connection, attachment, commitment or sense of belonging and this has to be considered very carefully by charities in large cities such as London, Manchester or Glasgow.

This briefing offers general guidance only. It reflects the law as at November 2009. The circumstances of each case vary and this article should not be relied upon in place of specific legal advice.

For further information, please contact:

[Elizabeth Small on 020 7863 8380 or elizabeth.small@forsters.co.uk](mailto:elizabeth.small@forsters.co.uk)

CONCLUSION

VAT and charities is a complex area where subtly different facts can dramatically change the analysis often with the result that large amounts of VAT can become payable/irrecoverable.