made simple guides

Made Simple guides are aimed at finance professionals working in charities. They cover technical areas such as risk assessment, accounting, tax and VAT treatments and aim to provide practical guidance to busy accountants in charities.

The content of guides is correct at the time of going to print, but inevitably legal changes, case law and new financial reporting standards will change. You are therefore advised to check any particular actions you plan to take with the appropriate authority before committing yourself. No responsibility is accepted by the authors for reliance placed on the content of this guide.

Where the text refers to a book or other reference material, the name of the publication is highlighted ***like this*** and listed at the end in Reference and Further Information. The names and contact details of organisations from whom the publications and further information can be obtained are also listed.

Other guides in the series

Risk assessment made simple
Reserves policies made simple
Trading issues made simple
Subsidiaries made simple

VAT made simple

CFDG

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consultants and auditors

Acknowledgements

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CFDG (Charity Finance Directors' Group) is the professional body for finance directors within the sector, and has over 1,400 members. CFDG provides assistance to charities on a range of issues, such as accounting, taxation, audit and other finance-related functions. CFDG's mission is to deliver services that are valued by members and enable those with financial responsibility in the charity sector to develop and adopt best practice.

For more information go to **www.cfdg.org.uk**

Sayer Vincent only works with charities and not-for-profit organisations. We have built up a wealth of sector experience as business consultants in the voluntary sector over the last 20 years. Working with a diverse portfolio of charities, we deliver rapid insights into your issues and problems and help you to find effective solutions to them.

We are keen to help charities find more effective ways of working; collaborating with other charities, sharing back-office functions and outsourcing are some of the options. We can help with each stage of the process, from feasibility through implementation to evaluation of performance.

For more information, go to **www.sayervincent.co.uk**

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Introduction

VAT is a sales tax charged by businesses on certain goods and services they provide. You have to add VAT to your customer invoices ('output VAT') and pay this VAT over to HM Revenue & Customs (HMRC). However, you are allowed to deduct the VAT you incur in making your VATable sales and only pay over the net amount. Deducting VAT charged by suppliers is referred to as 'recovering VAT' and the VAT incurred on business purchases is referred to as 'input VAT'.

For VAT purposes activities are divided into three broad categories:

- **Outside the scope or non-business activities** **VAT does not apply to these activities. VAT is not charged, but the VAT incurred by the activity cannot be recovered.**
- **Exempt** **These activities are within the scope of VAT, but are specifically exempted. VAT is not added to any charges, but VAT incurred by the activity cannot be recovered, except in very limited circumstances. Most of the exemptions are for activities in the public interest and include services commonly provided by charities such as health, welfare, education and cultural services.**
- **Taxable** **These activities are within the scope of VAT. VAT is added at the appropriate rate and VAT incurred by the activity can be recovered. The UK currently has three rates of VAT, the standard rate (17.5%), the reduced rate (5%) and the zero rate (0%). It is important to note that zero-rated activities are taxable, they just carry VAT at a zero rate. No VAT is added to any charges but VAT incurred by the zero-rated activity *can* be recovered.**

1 Registering for VAT

You have to register for VAT if the turnover on taxable activities exceeds the VAT registration threshold £67,000 from April 2008.
You must register if either:

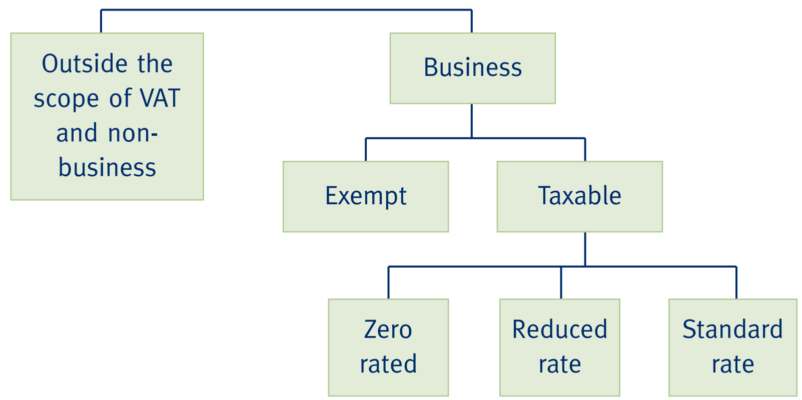
- At the end of any calendar month, the value of taxable supplies in the last 12 calendar months has exceeded the VAT registration threshold. You must notify HMRC within 30 days of the end of the month and will be registered from the first day of the second month
- At any time, there are reasonable grounds for believing that the value of taxable supplies in the next 30 days alone will exceed the VAT registration threshold. You must notify HMRC within 30 days of becoming aware that the threshold will be exceeded. The registration is effective from the date you became aware.

HMRC may permit an organisation to be exempted from registration if it makes mainly zero-rated supplies, so that it would normally recover VAT from HMRC rather than pay it. An organisation can also register voluntarily as long as it makes or will make some taxable supplies. It may have to provide evidence of an intention to make taxable supplies.

You register by completing form VAT 1 or online. Once you are registered you must provide your customers with proper VAT invoices and complete quarterly VAT returns. You can recover input VAT on pre-registration purchases for:

- Goods that have been purchased for taxable activities and are still 'on-hand' at the date of registration either as fixed assets or stock providing they were not purchased more than three years prior to registration.
- Services supplied up to six months prior to the date of registration.

2 VAT categories of activity



Outside the scope and non-business activities

An activity is outside the scope of VAT when:

- There is no supply in return for consideration, for example, activities funded entirely by donations and activities provided for free.
- The supply is not made in the course or furtherance of a business activity.

'Business' is not really defined in VAT legislation, but the intention is to distinguish between the activities of businesses, which are subject to VAT, and the private activities of individuals, which are not subject to VAT. Many activities of charities sit in the grey area between these two extremes. Case law suggests that business implies a certain degree of commercial intent and that the following factors may indicate that an activity is non-business:

- The nature of the activity is clearly charitable or social
- Fees are set to be as low as possible to maximise affordability
- The activity possesses important features that would be very unusual in a 'commercial' environment

Exempt activities

Exempt supplies are not subject to VAT and do not count towards the registration threshold. Many activities undertaken by charities are exempt including:

- Medical care by registered health professionals such as doctors, dentists and nurses. The medical care must be provided within the terms of the registration, but can include supervised nursing care.
- Education and vocational training when provided by eligible bodies including schools, colleges, universities and charities which apply any profits from the education and vocational training to the continuance or improvement of such supplies.
- Care, treatment or instruction designed to promote the physical or mental welfare of elderly, sick, distressed or disabled persons including services in registered care homes.
- Care or protection of young persons, for example services provided by a children's home, nursery, playgroup, after school club or fostering service.
- Admission charges to a museum, gallery, art exhibition, zoo or to a theatrical, musical or choreographic performance. The charity must be managed and administered (at the trustee level) on a voluntary basis by persons who have no financial interest in its activities.
- Renting out property is generally exempt, but property transactions are considered further below.
- Fundraising events (considered further below).

The above list is not exhaustive.

Zero-rated supplies

Zero-rated supplies are taxable, but the rate of VAT is 0%. This is in many ways the ideal situation if your customers are unregistered or using the supply for non-business or exempt activities. All your input VAT is recoverable, but the price to customers is not increased by VAT.

Some supplies are always zero-rated including:

- Printed books, booklets, leaflets, brochures, newspapers, journals and periodicals
- Children's clothing or footwear
- Unprepared food and animal feed, with exceptions
- Certain supplies of passenger transport

Some supplies are zero-rated when supplied *by* a charity. Examples include:

- Sale of donated goods, which must be available for sale to the general public or more than one disabled person or person in receipt of specified benefits.
- The export (to a country outside the EC) of goods. The export is treated as a zero-rated supply, even if the goods are given away for free, for example as aid.

Some supplies are zero-rated when supplied *to* a charity. Here the charity does not have to be registered for VAT to benefit from the zero-rating, but does have to give the supplier a certificate confirming eligibility for zero-rating. Various goods and services qualify for zero-rating, each with specific conditions attached. Examples include: advertising, collecting tins, aids for disabled people, medical goods and services, and construction of new buildings (see property below). See VAT Notices 701/1, 701/58, 701/6 and 701/7 for more details.

Reduced rate supplies

Reduced rate supplies include:

- 'Qualifying' supplies of fuel and power. These include fuel for domestic use, use below certain de-minimis levels, use for relevant residential purposes (children's and old peoples homes, hospices etc) or use for a charity's non-business activities. If a supply is partly qualifying, then provided that 60% or more of the supply is for qualifying purposes, the whole supply can be considered qualifying.

- Supply and installation of certain energy saving materials in a qualifying building
- Renovation or alteration of certain residential premises if the premises have not been lived in for two years or more. Qualifying residential premises include single and multiple occupancy dwellings, such as bedsits, and certain relevant residential buildings such as children's homes and hospices.
- Conversion of premises into one or more single household dwellings, a multiple occupancy dwelling such as bedsits, or premises intended for use solely for a relevant residential purpose (children's homes etc)
- Goods to provide welfare advice supplied by a charity or state-regulated private welfare institution, for example DVDs and information to promote awareness of the health risks of taking illegal drugs to young people.
- Contraceptives and certain smoking cessation products.
- Supply and installation of certain mobility aids when installed in domestic accommodation occupied by a person aged 60 or over. The reduced rate does not apply to installations in residential care homes and similar.

Standard-rated supplies

Business supplies that are not exempt and do not qualify for zero or reduced rating are standard-rated.

Standard-rated, reduced rate and zero-rated supplies together comprise the taxable supplies. If the total (VAT exclusive) turnover from taxable supplies exceeds the VAT registration threshold you must register for VAT.

3 Recovering VAT

A VAT registered business can recover the VAT it incurs on purchases that are used in making taxable supplies. It recovers this 'input VAT' by deducting it from the VAT it charges to customers ('output VAT') and paying over the balance to HMRC. If input VAT exceeds output VAT it receives a repayment from HMRC.

To recover input VAT you must be VAT registered. There are certain special grant refund schemes for national museums and galleries, listed places of worship and memorials. Where an organisation has a mix of non-business, exempt or taxable activities it cannot usually recover the VAT incurred by the non-business or exempt activities. To calculate the recoverable VAT:

1. First you must directly attribute the VAT on purchases to non-business, exempt or taxable activities.
2. VAT on purchases that cannot be directly attributed to one activity is 'residual VAT'. Typically the VAT on overheads such as fuel, telephone bills and central function costs is residual. The residual VAT must be apportioned to the different types of activity on a 'fair and reasonable' basis.
3. VAT that is directly attributed and apportioned to non-business activities is irrecoverable.
4. VAT that is directly attributed and apportioned to exempt activities is irrecoverable unless it is *de minimis* – this means under £1,875 in a VAT quarter *and* less than 50% of total business VAT. If exempt input VAT is de minimis it can be recovered. If not it is irrecoverable.
5. VAT directly attributable and apportioned to taxable activities is recoverable.

Apportioning residual VAT

This is a two-stage process.

1 Residual VAT must first be apportioned between non-business and business activities. There is no prescribed apportionment method, but it must be fair and reasonable and reflect the extent to which the residual purchases are used by business and non-business activities.

2 The residual VAT apportioned to business activities must then be apportioned between exempt and taxable activities. You must use the 'standard method' unless this does not produce a fair and reasonable result or you may obtain permission from HMRC to use a 'special method'. The standard method uses the VAT exclusive turnover on exempt and taxable activities as the basis of apportionment. Special methods are commonly based on the number or cost of staff working in the different types of activity, floor area or expenditure.

Annual adjustment

You have to apportion residual VAT each quarter, then again annually using whole year figures. This is the 'annual adjustment' which allows for changes and seasonal variations in activity. Any resulting adjustment is made in the first VAT return of the following year.

The Children's Society case

This court case changed the treatment of VAT on purchases relating to fundraising activity where the money raised was used to support the general activities of the charity. This VAT can be treated as residual rather than irrecoverable non-business VAT. As well as fundraising from individuals, this can include legacy generation, investment management and the costs of generating core grant funding.

4 Fundraising events

All sorts of fundraising events organised by charities and their trading subsidiaries qualify for exemption from VAT (and direct tax) providing the fundraising purpose is clearly advertised. The exemption covers admission charges, sponsorship for the event, the sale of goods, food and drink at the event and advertising in brochures.

You can hold up to 15 events of the same kind in the same location in one year. If you go over the limit, none of the events qualify. However, you can also run small scale fundraising events providing the gross takings do not exceed £1,000 per week.

Overseas challenge events cannot usually be exempt. If an event includes a package of both travel and accommodation or bought-in accommodation or more than two nights' accommodation from a charity's own resources (for example in a building owned by the charity) then the event does not qualify as a fundraising event. Most challenge events must instead be dealt with under the special 'Tour Operators' Margin Scheme' (see VAT Notice 709/5).

Problems can also arise with events organised by for-profit companies such as the London Marathon. They do not qualify as fundraising events because they are not organised by a charity, so fees for places in the event are standard-rated. This is extended to charities charging registration fees and any requirement for participants to raise a minimum amount of sponsorship. HMRC do, however, accept that where participants pledge to raise a specific amount this is not binding and so can be treated as an outside the scope donation.

5 Membership subscriptions

The VAT status of a charity's membership subscription depends on what, if anything, is supplied in return for the subscription. This can be a problematic area for a membership charity. The package of membership benefits often changes over time and even when a charity has an agreement with HMRC as to the VAT status of its subscriptions, this can quickly become out of date.

Where nothing is supplied in return for the subscription, so the subscription is effectively a donation to the charity, it is likely to be regarded as outside the scope of VAT. Nominal benefits such as the right to vote at an AGM and receive the annual report are unlikely to affect this. There is a specific exemption for subscriptions charged by non-profit making professional associations, learned societies, trade associations, trade unions and organisations whose aims are in the public domain and are of a political, religious, patriotic, philosophical, philanthropic or civic nature.

Where neither of these situations applies and a charity provides its members with a package of benefits, it is allowed to apportion the subscription between the benefits provided. So, for example, if a charity provides its members with standard-rated and exempt benefits, the subscription must be apportioned between standard-rated and exempt supplies. The subscription is assumed to include any VAT due on the standard-rated benefits. The apportionment should generally be undertaken using information about the cost of the benefits. It is sometimes possible to agree with HMRC that part of a membership subscription is consideration for the benefits provided, with the remainder being a donation. In all cases you should agree the apportionment in advance with HMRC.

6 Property

The VAT implications of property transactions (land, buildings and civil engineering works) can be extremely complex, especially for charities where special property rules apply in some areas. Given the substantial amounts usually involved, charities should consider taking professional advice when purchasing, selling, constructing or renovating property.

As a very basic rule, property transactions are exempt. However, there are many exceptions:

- A person with an interest in property can 'opt to tax' the property. Supplies of the property then become standard-rated. However, the option to tax can be 'dis-applied' when the property is to be used for a 'relevant residential' or 'relevant charitable' purpose. Relevant residential purposes includes use as a home or institution and relevant charitable use means use by a charity for its non-business activities or as a village hall or similar. Under proposed changes to the option to tax rules, charities will have to serve a certificate on the supplier before an option is dis-applied.
- The construction of a new building is zero-rated if it will be used for relevant residential or relevant charitable use, which can include annexes if they meet the definitions.
- Repairs, refurbishment and building extensions are subject to VAT at standard rate, but approved alterations to protected buildings are zero-rated if the building will be used for a qualifying residential or charitable purpose after alteration.
- In general, supplies of holiday accommodation, parking facilities and sports facilities are standard-rated, but with exceptions. For example, block lets of sports facilities to clubs are exempt if various conditions are met.

7 Conclusion

VAT is a complex tax for charities because they often have activities in all categories of VAT – outside the scope, exempt and taxable. If you are currently unregistered for VAT, you will need to monitor the turnover from potentially taxable activities to ensure that you do register at the right time if you do go over the threshold.

It may be possible to arrange your affairs to plan for VAT to a certain extent. You will certainly need to consider VAT even if you are unregistered. For example, when budgeting, your costs have to include VAT where it applies. You may also have to consider a new activity for its VAT consequences and new premises should always trigger a review of your VAT position.

All charities can benefit from the many special zero-rating concessions for charities when purchasing goods and services. Check that all relevant staff in the charity know about the concessions and how to get them when placing orders.

VAT registered charities cannot usually recover all the VAT they incur on purchases and must attribute and apportion this VAT. It worth considering the best method for your charity and agreeing this with HMRC. You then need to keep this under review as your activities may change and affect the VAT position.

Legally, a charity is responsible for managing its tax affairs in the same way as any other person or entity, so ignorance of the law is no excuse if you get it wrong. And, as it is difficult to put things right for VAT after the event, it is better to ensure that you think about it at the planning stage.

Further information

HMRC website www.hmrc.gov.uk.
This is a vast and confusing website. The easiest way to navigate it is, from the homepage, click the Practitioner Zone button at the top right. From the Library section in the practitioner zone you can find the following links:

- Public Notices and Information Sheets: most of the VAT rules are covered in the VAT Public Notices. VAT Notice 701/1 is specifically for charities and is a good starting point for anyone new to charity VAT.
- Revenue & Customs Briefs: these announce new developments and changes in HMRC policy, often following court cases.
- What's New: a daily listing of new developments and changes to the HMRC website

HMRC charity enquiries 08453 02 02 03

Charity written enquiries
HMRC Charities, St John's House, Merton Road, Bootle, Merseyside L69 9BB.

National Advisory Service 0845 010 9000
HMRC National Advice Service, Written Enquiries Section, Southend on Sea, Alexander House, Victoria Avenue, Southend, Essex SS99 1BD

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