VAT issues around membership

In the last two years many membership organisations have been forced to reduce the proportion of zero rated membership income within their subscriptions following a visit from HM Customs & Excise. This in turn reduces the amount of vatable income they have and so they then incur additional irrecoverable VAT. This follows a change in policy by Customs.

Those organisations who are still following an old apportionment method should expect to have to recalculate it before long if Customs have not yet contacted them.

Membership subscriptions can be treated in different ways for VAT. They can be:

- Exempt
- Non-business (outside the scope of VAT)
- Taxable i.e. subject to standard or zero rate VAT
- A mixture of some or all of the above!

The VAT treatment depends on the VAT status of the benefits of membership. An extra statutory concession allows not for profit organisations to agree with Customs & Excise an apportionment of the subscription to treat it as a multiple supply of the various benefits, with each benefit carrying its applicable VAT or exempt status. This is usually more beneficial than treating the subscription as a single supply as this is likely to be exempt and so reduce the VAT the organisation can reclaim on its purchases.

Since 1 December 1999, an amendment to current legislation tried to change the presumption that subscriptions are non-business to the presumption that they are exempt. This applies to non-profit making organisations whose aims are in the public domain and are of a political, religious, patriotic, philosophical, philanthropic or civic nature. Such bodies may or may not be charitable. The subscriptions of trade unions and professional bodies were already classified as exempt. Where the only benefits are those such as the right to vote at the AGM and to receive the annual report, then the subscription will be exempt.

Membership schemes that are just a means of raising donations will be classified as non-business and therefore outside the scope of VAT. There will be no benefits in this situation.

The apportionment basis has to be agreed in advance with the VAT office before it can be applied. The organisation would need to monitor changes in the package of benefits being offered to members. In addition, the impact on the VAT recovery would need to be monitored and factored into the annual adjustment at the end of the tax year.

Many membership subscriptions include a significant element of zero rating as membership benefits include magazines. This provides a good VAT result for the membership organisation, as it is able to reclaim more VAT than if the subscriptions were all exempt. In the past Customs & Excise had often agreed a fairly generous zero rated element based on a cover price of the magazines, even though most were given away as a membership benefit and only a very small number sold at cover price.

However in the past couple of years Customs has been taking a much harder line and is seeking to have the zero rated element based on the costs of the benefits, rather than, for example, the cover price of the magazine. Customs issued a policy document to its staff setting out the basis on which membership subscriptions should be apportioned at the end of 2002. Since then they have written to and visited membership organisations to ask them to recalculate the VAT apportionment based on underlying costs, with a view to reducing the zero rated percentage and therefore the organisation's ability to recover VAT.

The basic method Customs requires is to find the cost of zero rated and standard rated benefits and then to assume everything else is exempt. It is up to the organisation to decide whether to leave the indirect costs out of the calculation or apportion them. Be aware that ignoring the indirect costs does not give a good result for the membership organisation.

This is best illustrated by an example.

ABC Membership Organisation	£m		
Subscription income	1.5		
		Apportion overheads pro rata	All costs apportioned
Expenditure			
Direct costs of zero rated benefits	0.4	.22	0.62
Direct costs of exempt benefits	0.5	.28	0.78
	0.9	0.5	1.40
Indirect costs	0.5	(.5)	
Total expenditure	1.4	0	1.40
Surplus for the year	0.1		
Customs' basic method			
Zero rated subscription = 0.4 / 1.5 =	27%		
Customs' basic method with apportioned indirect costs			
Zero rated subscription = 0.62 / 1.5	41%		
Fairest method - use apportioned costs as percentage of total costs			
Zero rated subscription = 0.62 / 1.4	44%		

In Customs' basic method the organisation would only be able to recover 27% of its general VAT whereas this is significantly improved if indirect costs are apportioned (41%) and is even better if the proportion is taken as a percentage of total costs (44%) – very important if the organisation is making a surplus. This would seem to be the fairest method as it is comparing like with like i.e. vatable costs with total costs. The basic methods compare costs with income.

The Royal College of Anaesthetists recently went to a VAT tribunal arguing that their whole membership subscription should be zero rated for VAT as the market value of the two magazines provided to members equalled the subscription paid. The tribunal rejected this argument as the College provides other valuable, although intangible, benefits to members including the prestige of membership and the use of post nominals such as FRCA (Fellow of the Royal College of Anaesthetists). Therefore the tribunal agreed with Customs that the College should use a cost based method and base the zero rated part of subscriptions on the cost of zero rated benefits (the magazines) as a proportion of total membership costs.

A further complication for membership organisations is likely to be that they now have websites and the provision of a members' only area is a standard rated benefit. So many organisations whose subscriptions were a mix of zero rated and exempt in the past, now need to include a standard rated element and related VAT. An example of this follows:

DEF Membership Organisation			
	£m		
Subscription income	1.0		
		Apportion overheads pro rata	All costs apportioned
Expenditure			
Direct costs of zero rated benefits	0.2	.06	0.26
Direct costs of standard rated benefits	0.1	.03	0.13
Direct costs of vatable benefits	0.3	.09	0.39
Direct costs of exempt benefits	0.4	.11	0.51
	0.7	.20	0.90
Indirect costs	0.2	(.20)	
Total expenditure	0.9	0	0.90
Surplus for the year	0.1		
Customs basic method with apportioned indirect costs			
Vatable subscription = 0.39 / 1.0	39%		
Fairest method - use apportioned costs as % of total costs			
Vatable subscription = 0.39 / 0.9	43%		
VAT would need to be charged part of the subscription			
Standard rated element = 0.13/0.9	14%		

In this example, if the annual subscription was previously £100, then it would now need to be £100 plus VAT on 14% or £14 of it. The VAT would be £2.45, giving a total subscription of £102.45 including VAT. A VAT invoice should also be provided to members to reflect this.

Benefits in the form of discounts, such as on conferences, can be calculated on the basis of the cost to the organisation, and therefore dependent on the past level of uptake of discount. If the admission charges to such conferences are standard rated then this benefit is also standard rated.

Where organisations have different categories of membership, with different subscription rates and benefits it is necessary to allocate the appropriate costs to each class of membership to establish the zero rated and standard rated elements of each rate of subscription.

The organisation may also have other income from examinations, training, conferences or other activities that members and others pay for separately. Where this is the case the direct costs must be apportioned across all activities and the indirect costs allocated pro rata to all these activities to establish the costs of vatable membership benefits as a proportion of total costs of membership benefits.

Then in future years the organisation needs to reallocate the latest costs to ensure the correct apportionment percentages continue to be used. These are likely to change slightly from year to year. In addition if membership benefits change then the apportionments need to be recalculated.

Customs & Excise can only refuse a method of cost allocation if they believe another method gives a fairer and more reasonable outcome. In practice VAT officers do have views about what proportion of the subscription should be zero rated and so are likely to ask an organisation to try other methods until they obtain an outcome the officer feels satisfied with. It is necessary to think clearly about what is fair and reasonable and whether the resulting vatable percentage seems appropriate based on the benefits. The organisation should keep negotiating with Customs & Excise until agreement is reached on an apportionment that both sides feel is fair.

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