

Charities VAT Guidance



A guide for charities on VAT



V2 - April 2023

TABLE OF CONTENTS

| | |
|--|----------|
| 1. VAT – THE BASICS | 1 |
| 1.1 VAT types of supply | 1 |
| 1.2 VAT registration | 2 |
| 1.3 Voluntary registration | 2 |
| 1.4 VAT grouping | 2 |
| 1.5 De-registration | 3 |
| 1.6 Exemption from registration | 3 |
| 1.7 Business Vs. Non-business | 3 |
| 2. NON-BUSINESS VAT | 4 |
| 2.1 Education | 4 |
| 2.2 Palliative care charities..... | 4 |
| 3. LIABILITY OF INCOME TO VAT | 4 |
| 3.1 Grants and donations..... | 4 |
| 3.2 Other income streams..... | 4 |
| 4. BUSINESS SUPPLIES - LIABILITY | 5 |
| 4.1 General | 5 |
| 4.2 Zero-rating – Schedule 8 of VAT Act..... | 5 |
| 4.3 Reduced rate – Schedule 7A of VAT Act | 5 |
| 4.4 Exempt – Schedule 9 of VAT Act..... | 5 |
| 4.5 Cost sharing exemption..... | 5 |
| 5. ZERO-RATED SUPPLIES TO CHARITIES | 5 |
| 6. LAND, BUILDING AND CONSTRUCTION SERVICES | 6 |
| 6.1 General | 6 |
| 6.2 New buildings | 6 |
| 6.3 Repairs and maintenance | 6 |
| 6.4 Capital Goods Scheme | 6 |
| 6.5 Option to tax and disapplication..... | 6 |
| 7. SUPPLIES OF STAFF AND STAFF SERVICES | 6 |
| 7.1 Supplies of staff | 7 |
| 7.1.1 Joint employment | 7 |
| 7.1.2 Secondment of staff to other charities | 7 |
| 7.2 Supplies of services | 7 |
| 7.2.1 Supply of secretarial, administrative or financial management services | 7 |
| 7.2.2 Supplies of specialised services | 7 |

8. FUNDRAISING AND CULTURAL EVENTS 7
8.1 Fundraising events7
8.2 Admission to plays & concerts8
9. SUPPLIES OF FUEL & POWER 8
10. NON-BUSINESS APPORTIONMENT AND PARTIAL EXEMPTION..... 8

Charity VAT can be rather complicated. This briefing highlights the main areas to consider when determining if VAT should be charged or reclaimed on certain transactions.

1. VAT – THE BASICS

Input VAT = VAT on purchases made by the Charity (goods/services coming **IN**)

Output VAT = VAT on sales made by the Charity (goods/services going **OUT**)

1.1 VAT types of supply

VAT is generally recoverable on taxable business activities. There are 5 types of supply:

Standard rate Output VAT is chargeable at 20% and input VAT is recoverable on purchases related to the standard rated supply.
For example: Computers and office equipment. This is the default if no other rate is relevant.

Reduced Rate Output VAT is chargeable at 5% and input VAT is recoverable on purchases related to the reduced rated supply.
For example: Domestic fuel; certain residential conversions/renovations; children's car seats.

Zero Rate VAT is chargeable at 0% and input VAT is recoverable on purchases related to the zero-rated supply.
For example: Food, books, newspapers and construction of certain buildings.

Exempt No output tax is payable, but no input VAT is recoverable on purchases related to the exempt supply (subject to other taxable supplies and de-minimis limits).
For example: Insurance, education (by way of business) and land.

Outside the scope No output or input VAT is payable under any circumstance.
A transaction is outside the scope if it is:

- made by someone who is not a taxable person
- not made in the course or furtherance of business
- potentially subject to other taxes.

For example: Wages payments and fees fixed by law (congestion charge, MOT).

The examples given are only indications of a general supply. VAT legislation is quite specific about how the law applies to individual items.

Output VAT may only be charged by a charity if it is registered for VAT.

VAT incurred may only be treated as Input VAT where:

- it has been correctly charged
- the supply has been made to the Charity
- the required evidence is retained (for example the invoice)
- it relates to taxable activities.

NB There may be non-business and/or partial exemption considerations.

1.2 VAT registration

There are two tests that need to be considered:

Historic test - If, at the end of any month, your business taxable income (standard, reduced and zero-rated supplies) in the 12-month period then ended has exceeded the threshold (£85,000 from 1 April 2017) then you must register within 30 days of the end of that month. The registration would take effect from the end of the month following the month in which the threshold is exceeded. For example, if the threshold is exceeded in November 2016, you must register by 31 December 2016 and the registration would take effect from 1 January 2017.

Registration under the historic test may not be required if the taxable turnover during the next 12 months will not exceed the de-registration threshold (£83,000 from 1 April 2017), but this does need HMRC permission.

Future test - If, at any time, your business taxable income is expected to exceed the threshold (£85,000 from 1 April 2017) within a period of 30 days alone then you must register. Registration is required by the end of the 30-day period in which the threshold is expected to be exceeded and will take effect immediately.

If a charity is likely to be in a regular repayment position (i.e., input tax exceeds output tax), you can opt to submit either monthly or quarterly VAT returns, whichever most suits your circumstances. By moving to monthly returns, a charity can help ease the pressure on its cash flow; however, this means submitting 12 returns a year instead of 4 which increases the admin burden on the Charity.

VAT registered entities have to submit their VAT returns electronically. The registration and submission process is operated through the [HM Revenue & Customs Online Services](#) portal.

Dealing with VAT returns can be a time-consuming process, depending upon the number and complexity of the transactions involved. If you have very few taxable supplies and the business specific VAT is minimal, then you may decide not to register and suffer a small loss in recoverable input VAT on those taxable supplies.

1.3 Voluntary registration

If you are making taxable supplies below the registration threshold, you may apply for voluntary registration. You will then become VAT registered from a mutually agreed date with HM Revenue & Customs (HMRC). This will allow you to recover input VAT even though your taxable supplies may be minimal.

1.4 VAT grouping

Two or more corporate bodies may be eligible to form a VAT group registration and are effectively treated as a single taxable person.

Since 2019 individuals, partnerships and Scottish partnerships are also entitled to join VAT groups if they control the corporate bodies within the group.

The effect is that intra-group supplies are disregarded for VAT purposes and only a consolidated VAT Return is required. VAT group members are held jointly and severally liable for any VAT due to HMRC but VAT grouping can be a useful mechanism to minimise VAT liability or maximise VAT recovery.

In particular for charities, VAT grouping overcomes the burden of creating taxable supplies between entities where only exempt supplies are made to third parties. A VAT group can be created in these circumstances even though it will only submit nil returns.

1.5 De-registration

VAT registration is no longer required if at any time HMRC are satisfied that the value of your taxable supplies in the next 12 months will fall below the threshold (£83,000 wef 1 April 2017). You may however opt to remain VAT registered if it is in your best interest.

1.6 Exemption from registration

Where a business or charity makes, or intends to make, mostly zero-rated or reduced rate supplies resulting in all VAT returns being a net repayment, HMRC may allow exemption from registration.

Careful consideration will need to be given to any request for exemption from registration, though as the result is that the organisation has less VAT compliance and record keeping requirements but as a consequence, must forego input tax recovery.

If HMRC do allow exemption from registration, this is not a permanent approval and a liability for VAT registration may still arise in the future.

1.7 Business Vs. Non-business

There is no defined list of what is and is not a business activity and so charities are left to decide, based on an evolving and often confusing series of tests and indicators, which category each of their activities falls within.

Since 1981, the predominant tests have been those derived from Case Law, mainly the Lord Fisher and Morrisons cases, as follows:

1. Is the activity a **serious undertaking** and **earnestly pursued**?
2. Is the activity an **occupation or function** that is actively pursued with reasonable consistency?
3. Does the activity have a certain measure of substance in terms of the **value of taxable supplies** made?
4. Is the activity **conducted in a regular manner** and on sound and **recognised business principles**?
5. Is the activity predominantly concerned with the making of **taxable supplies for a consideration**?
6. Are the taxable supplies of a kind which, subject to differences of detail, are commonly made by those who seek to **profit** from them?

However, in 2022, HMRC issued new guidance in Revenue & Customs Brief 10/22 which states that the 'predominant concern' test is now irrelevant and that the focus must be on whether there is a direct link between the services the recipient receives, and the payment made rather than on the wider context of the organisation's charitable objectives or motives.

This is derived from the Court of Appeal decision in the case of Longridge on the Thames v HMRC.

Replacing the Lord Fisher tests HMRC have set out the following (not helpful) two-part test derived from the Court of Appeal decision in the case of Wakefield College:

Test One: The activity results in a supply of goods or services for consideration. This requires a legal relationship between the supplier and recipient. The initial question is whether the supply is made for a consideration. An activity that does not involve the making of supplies for consideration is not a business activity.

Test Two: The supply is made for the purpose of obtaining income therefrom (remuneration).

In short, the comment in the EC case of Tolsma is probably the most helpful and translates as follows:

'The question is whether services carried on by a person were carried on for the payment or simply with the payment.'

Although parts of the Fisher tests have been rendered invalid, HMRC have acknowledged that they can be used to help identify factors to be considered.

In summary, the likelihood is that the new tests will result in more of the activities undertaken by charities being classed as business.

2. NON-BUSINESS VAT

2.1 Education

Education is typically a non-business activity as there is no charge for the education provided; therefore, no taxable supply is made. VAT is not usually recoverable in relation to non-business activities. The Finance Act 2011 introduced a new section into the VAT Act (33B) which allows academies to reclaim VAT incurred from 1 April 2011 on the provision of non-business education.

2.2 Palliative care charities

From 1 April 2015, a new VAT refund scheme was introduced for eligible hospices allowing refund of the VAT incurred on purchases relating to eligible non-business activities. This applies to both VAT registered hospices and unregistered hospices.

3. LIABILITY OF INCOME TO VAT

3.1 Grants and donations

Grant funding and donations are classified as non-business; they are outside the scope of VAT and therefore not subject to any VAT. A true grant or donation is freely given with nothing done or expected to be done in return. Beware of Service Level Agreements or minimum donations.

3.2 Other income streams

These may include income from trading activities; the letting of buildings, rooms, sports facilities and sports fields or other sundry income sources. These income streams need to be looked at on an individual basis as they may be classified as non-business, taxable (standard, reduced or zero-rated), or exempt.

4. BUSINESS SUPPLIES - LIABILITY

4.1 General

The VAT status of income received for business supplies must be considered carefully. If VAT exemption, VAT zero-rating or reduced rating is to be relevant then the transaction must fall squarely within the relevant schedule of VAT legislation. Otherwise, VAT standard rating will be appropriate.

4.2 Zero-rating – Schedule 8 of VAT Act

There are a number of supplies that fall within the general scope of zero-rating i.e., the supplies are zero-rated regardless of the status of either the supplier or customer. These include food, books, certain construction services, public transport and children's clothing.

Other supplies that may be zero-rated are specifically targeted and the VAT zero-rating is dependent upon the status of either the supplier or the customer and may need specific eligibility declarations.

There is specific targeted zero-rating for supplies by charities of donated goods and exports.

4.3 Reduced rate – Schedule 7A of VAT Act

There are a number of different supplies that are subject to the reduced rate of 5% VAT. Specific to charities is the supply of welfare advice or information.

4.4 Exempt – Schedule 9 of VAT Act

As well as the general VAT exemptions for land and buildings, lotteries, finance, etc, there are specific exemptions for certain supplies by charities. These include welfare services and fund-raising events.

4.5 Cost sharing exemption

Provided that certain conditions are satisfied, two or more organisations with exempt and/or non-business activities can form a separate independent entity as a cost-sharing group (CSG), in order to supply themselves with certain costs that can benefit from VAT exemption.

This type of 'co-operative self-supply' arrangement enables a number of smaller organisations to create economies of a scale similar to those ordinarily enjoyed by larger organisations.

5. ZERO-RATED SUPPLIES TO CHARITIES

There are a number of specific reliefs targeted specifically for charities. Most of these are subject to strict conditions being satisfied. These are particularly useful if the charity is unable to claim any/all the VAT incurred.

The supplies covered by specific zero-rating are charity advertising; talking books; radios for the blind; goods specifically adapted for use by disabled people and services of making adaptations; lifeboats, including repair and maintenance; goods used to collect monetary donations; certain medicines and veterinary products and certain supplies of land, buildings and construction services – see 6 below.

6. LAND, BUILDING AND CONSTRUCTION SERVICES

6.1 General

Property purchase or disposal may not be a frequent transaction for a charity but is likely to be of high value as would the construction or major refurbishment of a property. As a consequence, the potential VAT on the transaction will be high and it would be prudent to seek specific professional advice.

Supplies can be VAT free (exempt or zero-rated) or standard rated at 20% so there is certainly scope for significant amounts of VAT and mistakes or poor planning can be costly.

6.2 New buildings

The construction of buildings to be used as dwellings, relevant residential purpose or relevant charitable purpose can be zero-rated. There are very strict definitions of dwelling, relevant residential purpose and relevant charitable purpose and there is a requirement for certification of eligibility for the latter two categories.

The construction of buildings for a 'relevant charitable use' may be zero-rated and VAT should not be charged on the bulk of the building. The building must be 'solely' (95% rule) for this relevant charitable purpose (if the building is frequently let out for a charge (even if not for profit)), then the building may not be eligible for zero rating but the VAT incurred may be recoverable in part.

6.3 Repairs and maintenance

Works of repair or maintenance carried out to an existing building are generally standard rated. There is however zero-rating available for certain supplies in respect of alterations to facilitate disabled access and the reduced rate of 5% is applicable to certain residential conversions or renovations.

6.4 Capital Goods Scheme

If a new building is constructed or existing building refurbished or extended (>£250,000 net of VAT) and is intended to be partly used for making exempt supplies, then only a proportion of the input VAT is recoverable. If, over the first 10 years of the building's life, the proportion of exempt supply of the building changes, then a VAT adjustment may be necessary.

6.5 Option to tax and disapplication

This is a complicated area of VAT and professional advice should be sought.

The option to tax is exercisable by any party with an interest in a particular building or land. The effect is that supplies that would otherwise be exempt from VAT become subject to 20% VAT. There are a number of situations when the option is disapplied including supplies for charitable non-business use.

7. SUPPLIES OF STAFF AND STAFF SERVICES

It is sometimes difficult to establish whether arrangements result in the supply of staff, or the supply of some other service and it will be necessary to consider the terms of employment and whether the individual comes under the direction of the supplier or the customer.

7.1 Supplies of staff

Income received for the supply of staff is a business activity and is normally taxable at the standard rate.

7.1.1 Joint employment

Where staff are jointly employed, there is no supply of staff for VAT purposes between the joint employers. Employment contracts and letters of appointment must clearly state that there is more than one employer.

7.1.2 Secondment of staff to other charities

Where staff are seconded from one charity or non-profit-making voluntary organisation to another by concession, the income can be treated as non-business and outside the scope of VAT, provided that the individual is engaged only in the non-business activities of both the lending and borrowing organisation and the payment for the supply does not exceed normal remuneration (total cost incurred including salary, NIC, pension costs, etc).

7.2 Supplies of services

Where staff are supplied to another person but continue to operate under the direction of the supplier, this is a supply of those services and not a supply of staff.

7.2.1 Supply of secretarial, administrative or financial management services

This supply would ordinarily be standard rated; organisations not already VAT registered should be conscious that this type of supply does mean taxable supplies may exceed the VAT registration threshold.

7.2.2 Supplies of specialised services

VAT exemption may be appropriate for supplies of education or examination services. For example, head teacher consultancy services, teaching staff or rescue services.

8. FUNDRAISING AND CULTURAL EVENTS

8.1 Fundraising events

[VATA 1994 Sch 9 Gp 12 Items 1 and 2](#)

Fundraising events are usually run by charities to generate income for future projects. A fundraising event is an event clearly organised and promoted primarily to raise money for the benefit of the charity or qualifying body. People attending or participating in the event must be aware of its primary fundraising purpose, otherwise it cannot be classified as a fundraising event i.e., social events that happen to make a profit do not qualify for exemption. Provided these conditions are met, the income generated from the event will be classified as exempt.

When more than 15 of the same kind of fundraising events are held within a single accounting year, at the same location (e.g., the charity grounds), then these would not be classified as exempt and VAT should be charged at the appropriate rate. This 12-month rule resets at the beginning of each accounting year.

However, goods that are normally zero-rated, such as brochures, books, childrens' clothing etc, can still be zero-rated even when sold at a qualifying event. The zero rating takes precedence over exemption. This means that if you are VAT registered you can recover the VAT you pay out on purchases relating to those zero-rated sales.

8.2 Admission to plays & concerts

[VATA 1994 Sch 9 Gp 13 Item 2](#)

Admission charges to theatrical, musical or choreographic performances of a cultural nature may be exempt from VAT provided the following three conditions are met:

1. The entity must be a non-profit making organisation
2. Any surplus made must be applied to the continuance or improvement of the facilities, or applied in connection with the making of related cultural supplies
3. The entity must be managed and administered on an essentially voluntary basis and by people who have no direct or indirect financial interest in the activities of the body.

If the above conditions are met, then the supply is exempt, no VAT should be charged on the admission fee and no input VAT can be recovered on associated costs, subject to the partial exemption rules.

Where a charity puts on performances that do not fall into one of these three categories (eg fashion shows) consideration should be given to classifying it as a fundraising event otherwise VAT should be charged on the admission fee at the standard rate, and any associated input VAT can be recovered.

Programmes that are printed for the event would normally be a zero-rated supply, therefore no VAT should be charged on their sale and all input VAT can be reclaimed on the printing cost (the printer should not charge VAT on the initial sale if you tell them you are a charity).

9. SUPPLIES OF FUEL & POWER

If the power supplied to the charity is used primarily (60% or more) for non-business activities, then you should receive all of the supply at the reduced rate of VAT (5%).

10. NON-BUSINESS APPORTIONMENT AND PARTIAL EXEMPTION

Input VAT relating directly to taxable activities is always recoverable. Input VAT directly attributable to exempt activities is not normally recoverable. Where a charity makes both taxable and exempt supplies there will also be residual input VAT (incurred on overheads relating to all the activities) which therefore relates to both taxable and exempt activities.

Where this is the case the charity will fall under the partial exemption rules, which involves complicated calculations to ensure that the correct input VAT is reclaimed.

There is however a de-minimis limit where the exempt input VAT can be recovered in full as long as certain criteria are met. This is generally where the total value of exempt input tax is not more than:

- £625 per month on average; **and**
- half of your total input tax in the relevant period.

Partial exemption rules are very complicated and professional advice should be sought to discuss your specific circumstances.

NB VAT incurred on non-business activities is not input tax. If a non-business apportionment is required, this must be done before the partial exemption calculation.

NB There is no de-minimis limit for non-business restrictions.

UK200Charities & Education Group members are available to assist with partial exemption methods and calculations.

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