



Making the Most of VAT

TRACEY
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Why VAT is important

There is no doubt that VAT is a complex area for charities and one which they can very easily get wrong, potentially resulting in project underfunding or missed opportunities to claim reliefs. As charities grow and develop, their activities may change. They may be able to apply for different types of funding, explore alternative sources of fundraising or need to move to larger premises. With the constant pressure on resources, there is a risk that the VAT implications of changes may not be explored fully, resulting in additional costs or reduced funding. It is therefore important that the VAT treatment of income and expenditure is regularly reviewed, particularly if something new is being considered.

Maximising reliefs

A number of areas of expenditure can be zero rated for charities. This may represent a rare opportunity to reduce costs on the following:

- Advertising and items connected with collecting donations - this covers all advertising, including advertisements for staff recruitment, and items such as branded envelopes and appeal letters.
- Aids for the disabled provided for personal or domestic use.
- Drugs and chemicals used for testing where a charity is involved in medical or veterinary research.
- Equipment for producing 'talking' books and newspapers.
- Supplies of medical and scientific equipment which are then donated to an eligible body, such as a UK health authority.

Charities are also able to pay a reduced rate of VAT on energy supplies provided that it is used in residential accommodation or in a non-business activity. To take advantage of these reliefs, charities must provide the supplier with an eligibility declaration. It may be useful to keep a list handy to make sure that any such opportunities are not overlooked.

Reviewing your income streams

Many charities have various different income streams, which may be outside the scope of VAT, exempt, standard or zero rated. A charity currently needs to register for VAT once its VATable income exceeds £83,000. Getting the VAT treatment right from the beginning will avoid potential interest and penalties and make sure that the calculation of partially recoverable VAT is correct. Some particularly complex areas are:

Grant or service level agreement?: grant income for which the funder receives no benefit, is not generally subject to VAT. However, where a service is provided under a service level agreement, VAT is likely to be charged unless the service is specifically exempt. If the charity has budgeted for a project on the basis that the income will not be subject to VAT and is then required to pay VAT out of the funding, the income received may be insufficient to cover the costs of the project.

Sponsorship: If a sponsor receives significant benefit, sponsorship is treated as taxable at the standard rate. Naming a donor in a list of supporters is not considered to be significant, but where they benefit from advertising as a result of the sponsorship it is likely that this will be subject to VAT.

Membership fees: The treatment of membership fees depends on the benefits to which the members are entitled. Where members of a charity obtain free tickets for events, then the membership is probably subject to VAT. If the member only receives a magazine, then it is likely that the income will be zero rated.

The VAT treatment of income is rarely definitive and often depends on the particular circumstances involved, so it is always beneficial to take professional advice.



Partial exemption

Partial exemption is an area much hated by charity staff but, given the variety of income streams and VAT treatments, is something that charities often have to deal with. Under partial exemption, charities must allocate expenditure to their income streams and can only reclaim in full the VAT on costs relating to taxable supplies. VAT on costs relating to exempt or outside the scope income cannot be reclaimed unless minimal. Costs that cannot be allocated directly to either of these categories must be apportioned. There are various ways to apportion costs, based on relative levels of income, the amount of floor space taken up by each activity or another reasonable basis. It is worth reviewing the allocation method periodically to ensure that it is still appropriate and is giving the best VAT recovery for the charity.

Property transactions

The construction of a building used by a charity solely for a “relevant residential or charitable purpose” can be zero rated. A relevant charitable purpose includes a purely non business activity, as well as a village hall or similar property providing social or recreational facilities. Given the scale of costs involved, getting this wrong could have serious consequences. A charity could complete construction of a building on which they thought there would be no VAT to pay, to then have the treatment challenged.

As an additional complication, care needs to be taken where a property originally built with a zero rating is subsequently altered. The VAT treatment depends on whether the further build is deemed to be an extension or an annexe. An extension will be standard rated but an annexe (capable of operating independently) will be zero rated.

With any property transaction, no matter how big or small, it is recommended that specialist advice is taken at the earliest opportunity as any mistakes can be difficult to rectify and could prove very costly.



Checklist for the month

- ✓ Review expenditure and ensure that any relevant reliefs have been claimed and invoiced correctly. Ensure that any suppliers of services to which reliefs apply are aware that those services are to be zero-rated.
- ✓ Review all income streams and ensure that the VAT treatment of each is correct. Is the VAT registration threshold likely to be exceeded?
- ✓ Revisit partial exemption calculations and ensure that they are still appropriate and that VAT recovery is being maximised.
- ✓ Consider any future plans relating to buildings and construction and take advice
- ✓ Ensure that consideration of VAT is part of a checklist for those individuals producing funding bids or budgeting for projects.



Where can I get more information?

HMRC manual for charity VAT

www.gov.uk/hmrc-internal-manuals/vat-charities-manual

VAT notice for charities

www.gov.uk/government/publications/vat-notice-7011-charities/vat-notice-7011-charities

If you have any questions arising from this article or would like to speak to a member of our team about how we can help. Please get in touch with your local MHA member firm.