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Guide to Charity VAT

What is VAT?

VAT is a tax on the sale of goods and services. It is paid by the end consumer. For example, when you go into a shop and buy a television the price you pay will include an element of VAT which will be paid over to the government.

In this section we are looking at VAT from the perspective of the business (or charity) rather than that of the consumer.

As a business, if your turnover exceeds a certain threshold you have to register for VAT. Once you are registered for VAT, you have to charge VAT on the goods and services that you supply (known as output VAT). You will also purchase goods and services as part of your business. You will pay VAT on these purchases (known as input VAT). The business is required to keep records of the value of all its sales and purchases, and the VAT charged and incurred. At the end of each quarter, the business must submit a return to HM Revenue and Customs (HMRC). The return shows the total output VAT charged and the total input VAT incurred during the quarter. If the output VAT is greater than the input VAT, the difference is paid over to HMRC. If the input VAT is greater than the output VAT, the difference is reclaimed from HMRC.

Example:	Total (incl VAT)	Net Amount	VAT Amount
Sales for the quarter	11,750	10,000	1,750
Purchases for the quarter	8,225	7,000	1,225

In the example above, the output VAT is £1,750 and the input VAT is £1,225. Output VAT exceeds input VAT by £525, so this amount must be paid to HMRC.

So, for a business that is registered for VAT, the VAT on purchases does not cost the business anything as it is simply offset against the VAT on sales. Similarly the VAT on sales does not count as income to the business because it has to be paid over to HMRC. All

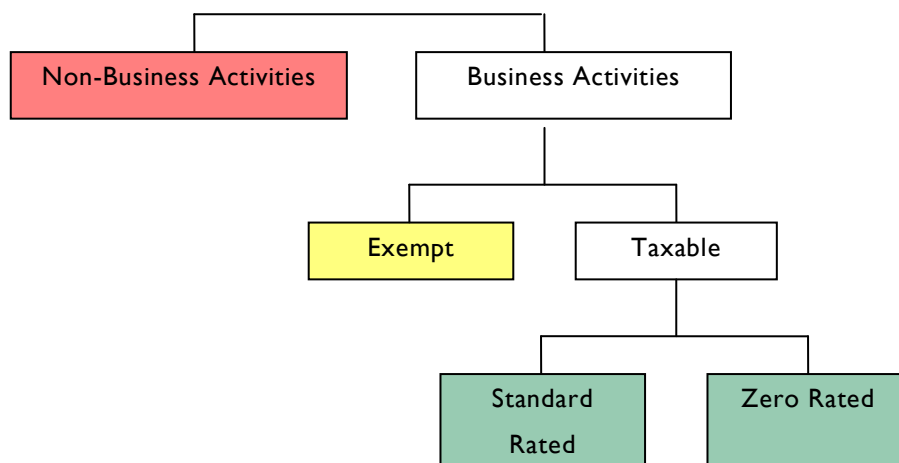
income and expenditure for a VAT registered business with no exempt activity is therefore stated net of VAT in its accounts.

However, if a business is not registered for VAT it does not charge VAT on its sales, and equally it cannot reclaim VAT on its purchases. This means that it suffers the full, VAT inclusive price for goods and services, and VAT becomes a cost. Many charities find themselves in this situation. If you are in this situation, it is not possible to simply register for VAT so that you can reclaim the VAT on your purchases. You must be undertaking “business activities” to register for VAT.

When to register for VAT

In simple terms, an organisation must register for VAT if its taxable turnover exceeds the registration threshold (currently £67,000 for financial year 08/09) in any 12-month period. However, for charities, establishing what counts as “taxable turnover” is not always straightforward.

Charities need to split their income between business and non-business activities. The business element needs to be split into taxable and exempt. The taxable element then needs to be split between standard-rated and zero-rated. Taxable turnover is made up of the standard- and zero-rated elements (shaded in green in the diagram below). So if the total income in the green categories exceeds £67,000 in a year the charity must register for VAT.



A charity can voluntarily register for VAT if its taxable turnover is below the compulsory threshold. This can be advantageous in some cases (for example a charity makes zero rated supplies for which the associated purchases are standard rated). However it should be noted that the charity must be undertaking at least some business activities in order to voluntarily register.

Classifying income for VAT purposes

When working out whether to charge VAT on income, a charity must analyse its income streams into one of the following categories using the diagram above:

- Non-business
- Exempt
- Standard-rated
- Zero-rated

Business vs. Non-Business?

For VAT purposes, “business activities” has a very wide meaning. If a charity supplies goods or services in exchange for payment (i.e. there is a mutual benefit for the charity and the customer) then it is deemed as a business activity. If there is no commercial intention, and only the charity benefits, then the activity is non-business.

Non-business activities are outside the scope of VAT so no VAT is charged.

Example of a business activity within a charity

XYZ Charity produces a monthly magazine for its members. Companies pay to advertise in the magazine. There is a mutual benefit (the charity receives payment, the company receives advertising space) so the sale of advertising space is a business activity and is therefore subject to VAT at 17.5%.

Example of a non-business activity within a charity

ABC Charity receives a donation from a member of the public. The donation is freely given and the donor receives no benefit in return for the donation. There is no mutual benefit, so the transaction is a non-business activity and is therefore outside the scope of VAT.

Taxable vs. Exempt?

Activities considered as exempt are set out in schedule 9 of the VAT Act 1994. The exemptions most likely to affect charities are listed below. The HMRC leaflet providing further information is included in brackets.

- Education - including vocational training, New Deal, youth clubs and research (Notice 701/30)
- Health and Welfare - including care homes, medical and health work, child protection and nurseries (Notice 701/2)
- Cultural Services - including admission charges to museums, galleries, zoos, theatrical and musical performances (Notice 701/47)
- Fundraising Events by Charities (CWL4 Fundraising events: exemption for charities and other qualifying bodies)

In each case there are criteria that must be met before the exemption applies, so charities must establish whether or not they meet these criteria before they assume their activities are exempt. The HMRC leaflets provide details of the criteria that must be met.

No VAT is charged on exempt activities.

Examples of exempt activities

(1) Charity XYZ provides complementary therapies to people living with HIV and AIDS. A small charge is made for the services. This is a business activity because the charity is providing a service in exchange for payment, however it is not taxable as the activity falls under the Health and Welfare exemption. So no VAT is charged on the therapy fees.

(2) Charity ABC offers vocational training courses to ex-offenders to help them return to work. The charity has a contract with the local authority to provide these services. This is a business activity because the local authority is purchasing training services from the charity, however it falls under the Education exemption. So no VAT is charged on the contract income.

Standard-rated or Zero-rated?

Activities considered as **zero-rated** are set out in schedule 8 of the VAT Act 1994. The categories most likely to affect charities are as follows:

- Books and printed matter (publications, newsletters, etc)
- Sale of donated goods (e.g. charity shops)
- Transport services (for vehicles designed to carry 12+ passengers, or vehicles adapted for wheelchairs)

No Vat is charged on zero rated activities.

There are some special zero-rating concessions available to charities. These are covered in the section below on “Saving VAT”.

Example of a zero-rated activity

A wildlife charity sells books on the local wild animals and their habitats. This is a business activity because the charity is receiving payment for supplying goods. It is not covered by any of the exemptions, so it is taxable. However, books are zero-rated so no VAT is charged on the sale price of the books.

Activities commonly undertaken by charities that fall under the **standard-rated** category are as follows:

- Sale of advertising space
- Sale of goods (other than printed matter or donated goods) – e.g. merchandise
- Consultancy services
- Admission fees (not covered by Cultural Exemption)
- Sponsorship (where the company receives a benefit such as free PR)
- Commission (such as charity affinity credit cards)
- Contracts to provide services (not education, health or welfare)

VAT is charged at 17.5% (except for fuel and power which is charged at a reduced rate of 5%).

Reclaiming VAT on Purchases

In most commercial companies, the VAT position is relatively straightforward: all of their income is taxable and they can reclaim all of the VAT incurred on purchases.

However, charities often find themselves in a more complicated position because they undertake a mixture of activities, some of which are non-business or exempt. This limits the amount of VAT they can reclaim.

The process of working out how much VAT a charity can reclaim can be complex, so rather than go into detail, an overview of the general principles is set out below. It may be helpful to refer to the diagram in the previous section. Charities should obtain knowledgeable professional advice before negotiating their exemption arrangements with HMRC.

When deciding whether you can reclaim input VAT or not, you have to consider which activity the purchase relates to and whether that activity is classed as non-business, exempt, standard-rated or zero-rated.

Where VAT is not directly attributable to an activity (i.e. it relates to central overheads or administration) it must be apportioned to the activities using a percentage method. There is a standard method, or alternatively charities can agree a special method with HMRC.

- VAT incurred on purchases relating to non-business activities can never be recovered (shaded RED in the diagram)
- VAT incurred on purchases relating to standard-rated activities can always be recovered (shaded GREEN in the diagram)
- VAT incurred on purchases relating to zero-rated activities can always be recovered (shaded GREEN in the diagram)
- VAT incurred on purchases relating to exempt activities can be reclaimed if it falls below the partial exemption de minimis limits (see below). But if it exceeds these limits, none of it can be reclaimed. (Shaded YELLOW in the diagram)

The partial exemption de minimis limits are as follows:

- Input VAT relating to exempt activities must be less than £7,500 per year, AND
- Input VAT relating to exempt activities must be less than 50% of total input VAT (excluding non-business VAT)

Fundraising and VAT

The straightforward collection of donations is not a business activity and is clearly outside the scope of VAT. However, charities are becoming more and more creative in their pursuit of raising funds. Fundraising initiatives range from sponsored treks in the Himalayas, to charity concerts and charity auctions. In many of these cases, there is effectively a supply of goods or services – even if the proceeds go to charity – so the VAT implications must be considered.

There is a VAT exemption for charity fundraising events but the following criteria must be met:

- No more than 15 events of the same kind in the same location to be held in one year
- Events must have a clear fundraising purpose which is made known to the public
- Small scale events (proceeds less than £1,000 in one week) can be ignored

The following fundraising events are not automatically exempt, and professional advice on VAT implications should be sought at the planning stage of such events:

- Sponsorship - where the company receives a benefit, such as free advertising, as opposed to a corporate donation which is freely given and attracts no benefit
- Use of a charity's logo (cause-related marketing) – where a company pays a licence fee to use the charity logo on its products for marketing purposes (including affinity credit cards)
- Charity treks or challenge events – where participants pay a minimum sponsorship amount to take part in a trek or challenge event
- Selling bought-in goods, merchandise and Christmas cards
- Selling advertising space
- Barter arrangements – where goods or services are donated by a company in return for advertising or promotion. For example, a company prints the charity's newsletter for free in return for advertising space in the newsletter

Examples:

(1) A charity holds a weekly car boot sale at the local village hall. It raises around £300 per week. The proceeds are less than £1,000 per week, therefore it is a small scale fundraising event and is exempt.

(2) A charity holds a national golf day which involves golf days being held at 30 golf clubs across the country each raising £5,000 for the charity. Although there are 30 events, they are held in different locations. Therefore this qualifies as exempt as less than 15 events in a single location.

(3) A charity holds a regular fortnightly gala dinner at its headquarters. Tickets cost £25 and at least 50 people attend each dinner. There are more than 15 of the same type of event in the same location per annum, therefore this is not covered by the fundraising exemption.

(4) A wildlife charity raises funds by charging outdoor clothing companies to advertise on its website. The advertising generates £60,000 per year. This is not a fundraising event, it is a commercial transaction and is therefore standard rated.

Membership Subscriptions and VAT

Membership schemes vary tremendously and the VAT treatment depends on how the scheme is set up and what the member gets in return for their subscription. There are 3 broad types of membership:

- Membership of trade unions, professional bodies, or religious, political and philosophic societies where the benefits to members are minimal and refer to the objects of the organisation
- Membership to a charity or non-profit organisation where the member receives nothing in return and is effectively making a regular donation to the organisation
- Membership to an organisation where more substantial benefits are received in return for the subscription such as publications, free admission (to museums, galleries, wildlife reserves, zoos, performances, sports facilities, etc)

Subscriptions to trade unions and professional bodies are exempt from VAT.

Subscriptions that are effectively just donations, are treated as donations which are outside the scope of VAT (non-business).

Subscriptions where substantial benefits are received are treated as standard-rated, unless a special apportionment method is agreed with HMRC, or unless another exemption applies (e.g. the cultural exemption for cultural, heritage or wildlife charities).

Apportionment methods for subscriptions involve placing a value on the benefits received by members and treating this part of the subscription as taxable. The balance will be treated as a donation and will therefore be outside the scope of VAT.

Example

ABC is a charity promoting classical music. Annual membership of ABC costs £30. Members receive 4 CDs per year. Each CD is valued at £5. The apportionment is calculated as follows:

Value of CDs = $4 \times £5 = £20$

Balance (treated as a donation) = £10

Total = £30

Consequently, £20 of the subscription would be treated as standard rated and £10 would be outside the scope of VAT.

ABC would have to agree this apportionment method with HMRC before adopting it.

Saving VAT

There are a number of items that can be supplied to charities at the zero rate of VAT. These special concessions are very useful to charities. For charities that are not VAT registered, it simply means the items are cheaper. For charities that are VAT registered it is immediate VAT relief (no need to reclaim on the quarterly return) and it does not affect the VAT recovery rate. In order to claim the zero-rate relief, the charity needs to provide the supplier with a declaration. A template for the declaration is provided in the HMRC Notice 701/58 available from the HMRC website.

The following is a list of all the goods and services covered by the zero rating relief. Bear in mind, in some cases the relief is only available under certain circumstances.

- Advertising
- Aids for disabled people
- Ambulances
- Collecting tins and badges
- Construction of new buildings
- Disabled access
- Emergency alarm systems
- Hearing aids
- Lifeboats
- Medical equipment
- Medicines
- Motability scheme
- Printed matter
- Rescue equipment
- Talking books for the blind
- Vehicles adapted for wheelchair users
- Vehicles used for disabled or terminally ill
- Visual aids for the partially sighted

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