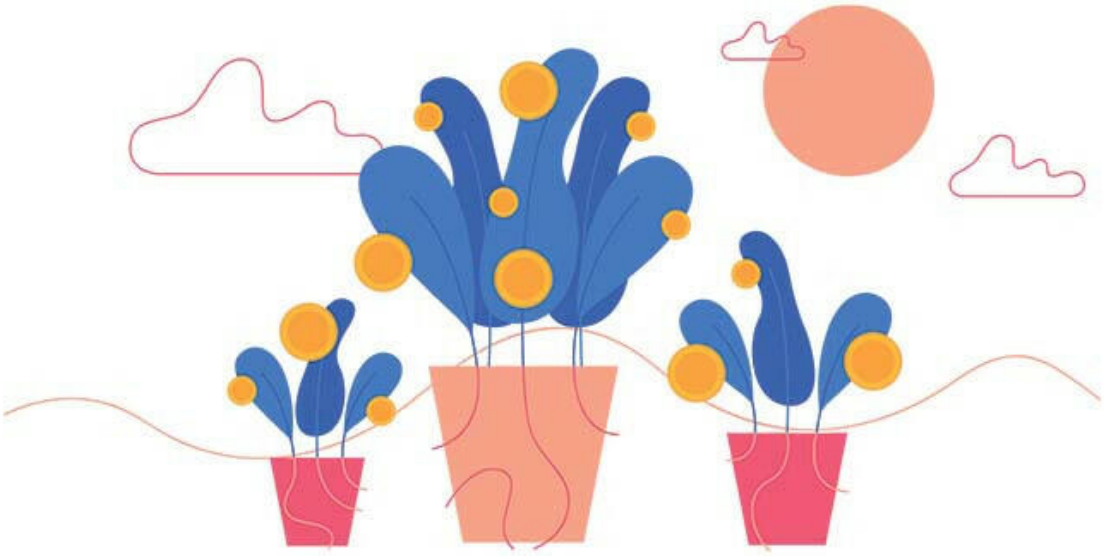
Is activity deemed to be business or non-business for the purposes of VAT?

Indirect Tax



22 August 2022

HMRC changes have impacted the way in which an activity is deemed to be business or non-business for the purposes of VAT. We ask what this will mean in practice.

Key Points

What is the issue?

HMRC has changed the way it interprets the law about whether an activity carried out by an organisation is deemed to be business or non-business. Revenue and Customs Brief 10 (2022) has replaced the six questions known as the ‘Lord Fisher tests’ with two completely new tests. You need to consider the new tests with immediate effect.

What does it mean for me?

There is no output tax to pay on income received from non-business activities and the income is also ignored as far as the VAT registration test is concerned. But input tax cannot be claimed on costs that directly relate to a non-business activity and an apportionment is necessary if costs are partly relevant to business and partly to non-business activities.

What can I take away?

The new rules are particularly important to consider if you act for any charities or not-for-profit making organisations. There could be sources of income that are now subject to VAT with the new rules or vice versa. You need to consider each activity in isolation to determine its VAT treatment.

HMRC recently issued Revenue and Customs Brief 10 (2022) (see bit.ly/3BJGVvr), explaining its new interpretation of the legislation about whether an activity is classed as business or non-business for VAT purposes. It is a good time to address some practical questions about the revised procedures.

Why is the business or non-business issue so important?

If a source of income relates to a business supply, it will be subject to VAT in most cases. If it is non-business, it will be outside the scope of VAT, which means that there is no output tax to pay. And, equally importantly, non-business income is ignored as far as the annual £85,000 VAT registration sales threshold is concerned. A business or charity with only non-business income will never register for VAT.

You mention charities: presumably this issue is more relevant for charities and not-for-profit organisations than for a commercial business?

Definitely. HMRC's Revenue and Customs Brief 10 (2022) highlights the following entities that might be affected by the new rules:

- charities;
- not-for-profit making organisations;
- a business operating nursery and creche facilities;

- a business that receives grants or subsidies; and
- an organisation or business carrying out non-business activities.

However, just because an activity or source of income does not make a profit or surplus – and is not intended to do so – this does not mean that it is automatically classed as a non-business activity. There have been many cases where HMRC, supported by the tribunals, have ruled that breakeven or loss-making activities are subject to VAT. That will continue to be the case.

What is the reason for HMRC moving the goalposts by issuing the recent Brief?

For over 30 years, HMRC has placed a lot of emphasis on what are known as the 'Lord Fisher tests' to determine whether supplies are business or otherwise. These tests consider six different questions and – by and large – have given clear guidance as to whether an activity is classed as being relevant to a business. They are not conclusive and very few scenarios will pass or fail all six tests. The questions were formulated by the judge in *Lord Fisher* [1981] STC 238, a high profile tribunal case about whether money collected by Lord Fisher from friends and relatives to take part in shooting events on his estate were subject to VAT.

However, times change, and HMRC's recent Brief takes account of two cases heard in the higher courts in recent years where the business/non-business issue was relevant:

- *Wakefield College* [2018] BVC 22; and
- *Longridge on the Thames* [2016] BVC 33.

What has changed? Are the Lord Fisher tests no longer relevant?

The Brief has replaced the six Lord Fisher tests with two completely new tests – see ***Business or non-business: two new tests***. The first challenge is to consider Test 1: if the answer to this question is 'no', then an activity qualifies as non-business and no VAT issues are relevant. You don't need to consider Test 2. With Test 1, there needs to be a legal relationship between a seller and buyer; for example, if a street busker receives payment from passers-by for entertaining them on his guitar, his income is not subject to VAT because there is no legal agreement in place with the

passers-by. The receipts will fail Test 1 and are therefore regarded as non-business as far as VAT is concerned.

It is also important to recognise that there is no such thing as a business or non-business organisation with these rules. You need to consider each activity carried out in isolation. For example, an animal charity that sells donated goods from a shop on the ground floor and treats sick animals free of charge on the first floor of the same premises is carrying out both business and non-business activities.

Regarding the Lord Fisher tests, I quote directly from HMRC's Brief: 'Businesses can no longer rely on the old "business test" to decide whether an activity is business or not, but it can be used as a set of tools designed to help identify those factors which should be considered.'

Business of non-business: two new tests

Test 1: Does the activity result in goods or services being supplied for a consideration? (Consideration means payment.) A legal relationship must exist between the buyer and seller.

Test 2: Is the remuneration earned from the activity obtained for the purpose of receiving income?

If the answer to Test 1 is 'no', then the activity or income is non-business and there is no need to consider Test 2.

HMRC's VAT Business/Non-Business Manual has been fully updated from 1 June 2022 to give further guidance on the new policy (see VBNB30200 to VBNB30400).

Can you give an example of an activity that will possibly have a different VAT outcome with the new rules compared to the Lord Fisher tests?

Sticking with the animal charity scenario, some pet charities take in stray animals from the streets – mainly cats and dogs – and then re-home them when they are restored to full health. The charity will sometimes make a charge to the new owner but what is the motive for the charge?

If the charge is being made to help pay for some of the overheads of the charity – or to raise funds for other projects – then it will be business related income. But if the charge is being made because the charity's trustees think that a charge is to ensure the new owner has a genuine commitment to caring for the animal, this is a non-income motive – a 'no' answer to Test 2.

A key issue, I guess, is how much is being charged for a supply of goods or services?

That question will be relevant in many situations. To quote from HMRC's updated VAT Business/Non-Business Manual VBNB30300: 'An activity that is intended to bring in £10 per week is much less likely to be for the purpose of generating income than one intended to bring in £10,000 per week.'

A local charity where I live charges £2 for a very impressive quarterly magazine about its activities. It is very glossy and clearly costs a lot more than £2 per copy to publish. They told me that the purpose of making this token charge is to stop people taking away three or four free copies at a time; i.e. the 'purpose' of the charge is not linked to raising income but a way of controlling the circulation of the magazine.

What about claiming input tax?

Input tax cannot be claimed on any expenses that directly relate to non-business activities. If an expense is partly relevant to business and non-business activities – such as the premises rent for the animal charity I mentioned earlier – input tax can be apportioned in any way that gives a fair and reasonable outcome.

Don't forget that the business/non-business apportionment of input tax is completely different to the input tax apportionment that is needed for a business that is partially exempt, where the method of apportionment between taxable and exempt supplies is prescribed in law.

How should advisers deal with these new rules?

I feel very positive about the new Brief and, as a big fan of tax simplification, I am pleased that we have gone from six tests down to two.

There will still be some grey areas – and inevitable tribunal hearings – but the fact that HMRC has based its revised policy on two high-profile binding tribunal cases should keep those appeals to a minimum.

I have highlighted some final tips to help advisers.

Key issues to consider about business or non-business situations

- The scale and regularity of a payment is relevant. To quote from HMRC's manual: 'If the consideration is much lower than the value of the supply, that might show that the activity is not for the purpose of obtaining income.'
- Some charges are made for a token amount in order to create a binding contract between a buyer and a seller; e.g. a peppercorn rent. These payments will not be subject to VAT because they do not tick the box for Test 2.
- If a payment for goods or services is very low compared to the going rate in the commercial market, this could indicate it is a non-business source of income.
- A common question is whether a source of income might not be subject to VAT if it is classed as a hobby rather than a business; e.g. selling small items on the internet. Each situation should be considered on its merits but to quote from HMRC's manual VBNB30300: 'A business activity is less likely to be done for pleasure as would a hobby or pastime.'
- Don't forget that charities are subject to the same VAT rules as other organisations. They get certain concessions in the legislation but not special treatment.
- A one-off sale can still be classed as business – for example, if you buy a plot of land in order to build a house and sell at a profit, this will be a business activity even though you will only make one sale at the end of the project.