Challenges for charities: some common questions

Indirect Tax



22 June 2023

We provide answers to some common VAT questions asked by charity trustees.

Key Points

What is the issue?

Charities benefit from certain concessions in the legislation but do not get special treatment. For example, they will not pay VAT on their advertising expenses and only 5% VAT on fuel costs for their premises.

What does it mean for me?

If a charity is not registered for VAT, it is important to regularly check that taxable sales are less than £85,000 on a rolling 12-month basis. Trustees must be clear about which sources of income qualify as exempt or outside the scope of VAT and

are therefore excluded from the calculations.

What can I take away?

Input tax can only be claimed if an expense directly relates to VATable supplies. It might be worthwhile reviewing the methods adopted by your charity clients to exclude VAT incurred on costs relevant to both non-business and exempt activities to ensure that the calculations are fair and accurate.

Our charity is not registered for VAT but the total income is close to the annual £85,000 threshold. Do charities get special treatment with this threshold?

As far as VAT is concerned, charities do not get special treatment but they can benefit from certain concessions in the legislation. However, when it comes to registering for VAT, a charity or not-for-profit entity must follow the same rules as a commercial business; i.e. it must register once its taxable sales have exceeded £85,000 in any rolling 12-month period or will exceed £85,000 in the next 30 days.

Your main challenge is to analyse all sources of income and identify those that are not ‘taxable’; i.e. the income is either exempt from or outside the scope of VAT. These sources of income are ignored as far as the threshold is concerned.

For example, donations, legacies and most grant income are outside the scope of VAT. Income from fundraising events is exempt. However, you must include sales of donated goods – such as from a high street shop – because they are zero-rated.

You say that a charity can ignore most grant income from the registration test. Are there some grants that must be included in the calculations because they are subject to VAT?

There are some grants where a charity is being paid for supplying goods or services as a condition of getting the grant. If these supplies are taxable, they must be included.

For example, I encountered a situation several years ago where a charity received a grant from a local council but a condition of the funding was that the charity's staff had to unlock and lock the public toilets next to its premises each day. This payment relates to a supply of VATable services.

A useful strategy is to check grant and funding agreements to see if there are references to performance indicators, targets, service agreements, and so on.

If a charity is registered for VAT and charges VAT on its grants because they are taxable, does that mean it can claim more input tax on its expenses?

Yes. There was a well-publicised tribunal case many years ago – *Bath Festivals Trust* [2008] UKVAT 20840 – which related to a charity that organised an annual music festival on behalf of the local council. The charity received grants from the council for its work promoting the event and charged VAT.

This was an unusual situation because HMRC claimed that the income should be outside the scope of VAT rather than standard rated – it usually challenges the reverse outcome! The reason was because the charity claimed input tax on its costs and overheads on the basis that they related to taxable sales. However, the charity won the case; the grant income was subject to VAT.

As a separate issue, VAT charged to local authorities is not usually a problem because they can reclaim it from HMRC with a 'section 33' claim. The legislation in Value Added Tax Act (VATA) 1994 s 33 gives local authorities the right to recover VAT on expenses that relate to their non-business activities.

Our charity is registered for VAT and has organised a fundraising dinner, with ticket sales exceeding £10,000. Are these sales subject to VAT?

This question is very topical because a recent case has been heard in the First-tier Tribunal about whether fees charged by the Yorkshire Agricultural Society for admission to its annual Great Yorkshire Show qualified as exempt income from a

fundraising event (*Yorkshire Agricultural Society v HMRC* [2023] UKFTT 389).

To qualify as a fundraiser, an event must meet three conditions, as specified in VATA 1994 Sch 9 Group 5 Item 1:

- It must be organised by a charity or not-for-profit organisation for a charitable purpose.
- Its primary purpose must be to raise money.
- It must be promoted as being primarily for raising funds.

HMRC argued that the 'primary purpose' of the Great Yorkshire Show was 'to promote farming in the community' and not to raise money. However, the judge decided that the wording of the legislation referred to 'whose primary purpose' and therefore accepted that '***a*** primary purpose' had to be the raising of funds rather than '***the*** primary purpose.'

There was a secondary issue: HMRC did not like the reference to the publicity material as an event which will 'raise funds' as opposed to being a 'fundraising event.' This might seem over fussy but charities must ensure that all three conditions are fully met to prevent a later challenge from HMRC. If they are not met, the £10,000 income from ticket sales will be taxable.

Can a charity that is registered for VAT fully claim input tax on all its expenses?

Unfortunately not. A charity can only claim input tax if an expense has a 'direct and immediate' link to a taxable supply; i.e. a supply where it charges either 0%, 5% or 20% VAT. As an opening challenge, a charity must do a business/non-business split of its expenses; i.e. exclude VAT on all costs that relate to non-business or charitable activities. In most cases, this will be straightforward but there will be some expenses, such as telephone bills, where there will be a dual purpose and the VAT must be apportioned. The calculation method must be fair and reasonable; no specific method is prescribed in law.

Once a charity has identified the 'business VAT' on its expenses, can it be fully claimed on a VAT return as input tax?

Many charities have exempt income, such as the fundraising events mentioned above. They must therefore carry out a separate input tax split between exempt input tax (not claimable) and taxable input tax (claimable). A charity must use the standard method of calculation for partial exemption purposes to calculate how much input tax can be claimed. Alternatively, it could apply to HMRC to request a special method if the standard method produces an unfair result (see HMRC Notice 706 s 4).

Our charity has some activities where we charge a token fee for our services, which in most cases does not cover our costs. Will these activities be classed as business or non-business?

HMRC changed its policy last year about the approach that a charity or similar entity should adopt to determine if an activity is classed as business and therefore the income is subject to VAT. HMRC issued Revenue and Customs Brief 10 (2022) after considering the binding views of judges in two well-publicised tribunal cases:

- *Wakefield College* [2018] EWCA Civ 952; and
- *Longridge on the Thames* [2016] EWCA Civ 930.

There has been no change in the law. Instead, the Brief explains how HMRC will now approach the question of whether an activity or supply is business or otherwise. See ***Business or non-business: Two new tests.***

Business or non-business: Two new tests

Test 1: Does the activity result in goods or services being supplied for a consideration (i.e. a 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’, 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 updated to give further guidance on the revised policy (see VBNB30200 to VBNB30400).

What are the special VAT concessions for charities that you mentioned earlier?

To give a practical example, charities are not charged VAT on supplies of advertising. They must give the supplier proof of their charitable status and the supplier will then zero-rate their services (see VATA 1994 Sch 8 Group 15 Item 8).

Another important concession is that a landlord who has opted to tax their building will not charge VAT on rent to a charity if it only uses a building for its charitable activities, other than as an office. If a building is partly used for charitable activities and partly for business purposes – which are carried out in clearly defined areas – the landlord should apportion the VAT. See ***Animal Charity: VAT on property rent***.

Animal Charity: VAT on property rent

Animal Charity rents a building for £30,000 per quarter excluding VAT. The landlord has made an option to tax election on the building so wants to add £6,000 VAT to each
invoice. The charity uses the building as follows:

- The ground floor is used as a shop to raise funds by selling donated goods.
- The first floor is used to give care and treatment to stray cats and dogs.
- The second floor is used for head office type functions of the charity; e.g. accounting, human resources, property management.
- The first-floor rent will be exempt from VAT, despite the option to tax election.

An easy calculation would be for the landlord to charge VAT on two-thirds of the total rent – based on a simple square footage split of two floors being taxable and one being exempt; i.e. £30,000 plus VAT of £4,000 (see HMRC Notice 742A para 3.5).

Note: There is no official form to complete to benefit from this concession but the landlord should be advised of the usage split in writing, with the letter signed by a senior member of the charity; e.g. a trustee.

What about VAT on the fuel bills for charity premises?

Supplies of gas and electricity to a charity for non-business purposes are subject to 5% VAT when charged by the fuel supplier. If a building is partly used for charitable purposes and partly for business purposes – such as the building used by Animal Charity – the following outcome is relevant:

- The charity must certify to the fuel supplier the proportion of the building that qualifies for the reduced VAT charge; i.e. based on its non-business use.
- If the qualifying part of the building exceeds 60% of the total building use, the entire supply of fuel and power will be subject to 5% VAT. (See HMRC Notice 701/19 s 3.)

Are there any final tips you can give?

Some of the concessions that are available to charities do not apply to their trading subsidiaries, however, even if these subsidiaries are wholly owned by the charity and gift their trading surplus to the charity.

For example, the zero-rating concession for advertising expenses is not available to a subsidiary but there is no problem with the exemption for fundraising events.

Finally, a charity can register for VAT on a voluntary basis if the mix of income means it will save VAT by reclaiming input tax; e.g. if there are many zero-rated sales. However, the additional compliance costs – such as the need to complete

digital accounting records and send returns electronically to HMRC – must be fully considered.

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