

VAT Charities and Not For Profit Bodies - A General Guide

CHARITIES AND VAT

Since the introduction of VAT, the law has provided a range of special reliefs which cover many supplies to and by charities. Zero-rating applies to some supplies to charities and there are some exemptions, zero-rating and other concessions for business supplies by charities. However, there is no general relief from VAT for goods supplied to charities and in general the normal VAT rules apply to business supplies made by charities.

Under charity law, charities can carry out '*primary purpose trading*', ie trading activities in the course of carrying out their primary purpose.

But charities may also wish to carry out '*non-primary purpose trading*' as a way of raising money (eg a charity whose primary purpose is providing education may sell Christmas cards and gifts through a catalogue). Charity law does not permit charities to carry out non-primary purpose trading in their own right on a substantial basis. In order to carry out non-primary purpose trading on a significant scale, charities have to establish subsidiary trading companies. These are trading companies controlled by one or more charities but are not themselves charities. Although profits of these subsidiaries can be passed to the charity free of corporation tax, they are not charities and most of the VAT reliefs available to charities are not available to subsidiary trading companies.

Where a charity and its trading subsidiaries are VAT-registered it may be possible, under certain conditions, for them to register as a VAT group.

Business activities. It is important not to confuse the term 'trading' as frequently used by a charity to describe its non-charitable commercial fund-raising activities (usually carried out by a trading subsidiary) with 'business' as used for VAT purposes. Although trading activities will invariably be business activities, 'business' for VAT purposes can have a much wider application and include some or all of the charity's primary or charitable activities.

REGISTRATION AND BASIC PRINCIPLES

Registration. Any business (including a charity or its trading subsidiary) that makes taxable supplies in excess of the VAT registration threshold must register for VAT. Taxable supplies are business transactions that are liable to VAT at the standard rate, reduced rate or zero rate.

If a charity's income from taxable supplies is below the VAT registration threshold it can voluntarily register for VAT but a charity that makes no taxable supplies (either because it has no business activities or because its supplies or income are exempt from VAT) cannot register.

Charging VAT. Where a VAT-registered charity makes supplies of goods and services in the course of its business activities, the VAT liability of those supplies is, in general, determined in the normal way

as for any other business. Even if VAT-registered, a charity should not charge VAT on any non-business supplies or income.

Reclaiming VAT. The first stage in determining the amount of VAT which a VAT-registered charity can reclaim is to eliminate all the VAT incurred that relates to its non-business activities. It cannot reclaim any VAT it is charged on purchases that *directly* relate to non-business activities. It will also not be able to reclaim a proportion of the VAT on its general expenses (eg telephone and electricity) that relate to those non-business activities.

Once this has been done, the remaining VAT relating to the charity's business activities is input tax.

- It can reclaim all the input tax it has been charged on purchases which *directly* relate to standard-rated, reduced-rated or zero-rated goods or services it supplies.
- It cannot reclaim any of the input tax it has been charged on purchases that relate *directly* to exempt supplies.

It also cannot claim a proportion of input tax on general expenses (after adjustment for non-business activities) that relates to exempt activities unless this amount, together with the input tax relating directly to exempt supplies, is below a de minimis limit.

BUSINESS AND NON-BUSINESS ACTIVITIES

An organisation such as a charity that is run on a non-profit-making basis may still be regarded as carrying on a business activity for VAT purposes. This is unaffected by the fact that the activity is performed for the benefit of the community. It is therefore important for a charity to determine whether any particular activity is a 'business' or a 'non-business' activity. This applies both when considering registration (if there is no business activity a charity cannot be registered and therefore cannot recover any input tax) and after registration.

If registered, a charity must account for VAT on taxable supplies it makes by way of business. Income from any non-business activities is not subject to VAT and affects the amount of VAT reclaimable as input tax.

'Business' has a wide meaning for VAT purposes based upon *Directive 2006/112/EC* (which uses the term 'economic activity' rather than 'business'), UK VAT legislation and decisions by the Courts and VAT Tribunals.

An activity may still be business if the amount charged does no more than cover the cost to the charity of making the supply or where the charge made is less than cost. If the charity makes no charge at all the activity is unlikely to be considered business.

An area of particular difficulty for charities when considering whether their activities are in the course of business is receipt of grant funding.

VAT Capital Goods Scheme (CGS)

In respect of property the CGS applies to capital expenditure on land and buildings, civil engineering works and refurbishment acquired or carried out after 31 March 1990. The CGS applies to businesses which do not make exclusively taxable supplies. The scheme recognises that such items of capital expenditure may be used by a business over a number of years and that there may be variation over those years in the extent to which the items are used to make the taxable supplies. It provides a mechanism whereby the initial input tax claimed may be adjusted over a period of 10 years.

If the capital item is used wholly in making taxable supplies input tax is recoverable in full. If the capital item is used wholly in making exempt supplies, none of the input tax is recoverable. If the capital item is used for making taxable and exempt supplies, a proportion of the input tax may be claimed under the partial exemption rules. Where, subsequently, in the adjustment period for that item (10 years for land and property) there is a change in the extent of taxable use, an input tax adjustment has to be made to take account of this. If taxable use increases, a further amount of input tax may be claimed and, if it decreases, some of the input tax already claimed must be repaid.

The scheme applies to the acquisition of land and property on which VAT is charged, and the value of that property is £250,000 or more. Adjustments under the CGS are carried out on an annual basis.

Specific records must be maintained and retained in order to demonstrate to H M Revenue & Customs that the CGS has been applied correctly.