Wales Council for Voluntary Action

Supporting charities, volunteers and communities

8. Managing money

8.7 VAT

Value-added tax (VAT) is not a tax on profits it is essentially a tax on transactions, (in theory) borne by the final consumer. VAT is a tax which is levied on turnover calculated on the value, actual or deemed, of the supply of goods and services known as "taxable supplies", which are supplied by the registered taxpayer.

What are taxable supplies?

Taxable supplies are supplies of all types of goods and services other than those which fall within the exemption and zero rate lists. These supplies have to be made "in the course or furtherance of business". The definition of "business" has been drawn widely in the relevant case law and can catch activities not necessarily confined to commercial or profit-making activities.

Registration

It is important for voluntary organisations to consider their VAT position and, if they believe it is either necessary or of benefit to them (or both), to register with HM Revenue and Customs (HMRC) for VAT purposes - even in advance of the anticipated income from business activities exceeding the limit. Late registration can result in penalties.

Unlike a commercial operation, which generates income through the actual provision and sale of goods or services, a charity has a complex variety of income sources.

Some of these sources such as donations, legacies and grants are freely given without the expectation of goods or services being given in return.

In VAT terms, such income is derived from non-business activities and is therefore outside the scope of VAT and would not count towards the business turnover for registration purposes.

On the other hand, the sale of goods produced by the beneficiaries of a charity or services provided to members could be construed as 'business activity' and therefore subject to VAT. 'Business' has a very wide meaning for VAT purposes. It is easier to define the activity as "business" unless it can be clearly defined as "outside the scope" of VAT.

VAT is applicable at various rates - at present there are three rates in the UK:

- standard 20%
- reduced 5%
- zero 0%

A voluntary organisation, having registered for VAT, must charge VAT on business supplies as appropriate. However, the voluntary organisation is then in a position to reclaim some or all VAT charged to it.

Minimising irrecoverable VAT

The major problem in relation to charities and VAT is irrecoverable VAT. Much of the income of the sector is either exempt from VAT or outside-the scope. This means there is no output VAT to set against input VAT on purchases. The input VAT cannot be passed on and comes to rest in the charity as an additional cost.

The main objective will be to minimise the size of the irrecoverable VAT charge, because not all the input VAT incurred by the organisation can be set against taxable outputs.

It is advisable to consult professional advisers in order to maximise recovery.

Partial exemption

Some charities have a mixture of income which renders them partially exempt (if they are registered for VAT) because of their mixtures of outputs. An organisation is partly exempt when it has a mixture of taxable and exempt business income. Normally VAT on costs cannot be recovered where it relates to exempt business income. However if this exempt related input tax is under a set limit it can still be recovered. A calculation to establish this recovery must be done for each VAT return. This is called a partial exemption calculation

VAT concessions to charities

Charities and voluntary organisations must pay VAT on goods and services, just like businesses. If they are registered for VAT, they also have to charge VAT (output tax) on goods and services that they supply to others, unless those goods and services are outside the scope of VAT, zero-rated or exempt.

However, there are three VAT concessions specifically for charities in relation to income:

- Zero-rating for the sale of goods donated to a charity
- Zero-rating for the donation of any goods for sale or export by a charity
- The possibility of exemption of all income which would otherwise be standard-rated from a fundraising event

There are, of course, other concessions which charities can take advantage of in relation to their income as included above, in particular, the exemption of education, and health and welfare, but these are not specifically aimed at charities.

Goods donated to a charity

The sale by a charity of goods donated to it is zero-rated. Without this concession, part of the proceeds of sale would go to the Treasury rather than the charity. Secondly, all VAT incurred on the costs of disposing of donated goods is fully recoverable.

Following the 1991 Budget, all charities and their trading subsidiaries can benefit from zero-rating. Any goods which are purchased as goods for resale and then sold must be standard-rated, unless they are zero-rated goods such as books.

Goods which are purchased for resale and which would be zero-rated in a normal commercial situation will remain zero-rated, for example books and pamphlets.

Zero rating on supplies to a charity

There are supplies which when bought in by a charity can be bought without VAT (Zero rated)

These are specific supplies and conditions have to be met for a charity to benefit from them.

These include:

- Talking Books for the Blind
- Advertising
- Medical Products
- Some equipment for medical or veterinary uses
- Construction services
- Professional advice should be sought on the eligibility of the Zero Rating relief in these areas before orders are placed with suppliers.

Reduced rate on supplies to a charity

- A more limited number of supplies may qualify for a reduced rate of VAT when supplied to a charity.
- The qualifying supplies are:
- Fuel & Power
- Certain Energy Saving Materials installed in a building

Goods donated by a charity

Any goods donated for sale or export by a charity are zero-rated. Although this concession appears to relate to income, its beneficial effect is on inputs. Charities are allowed to reclaim the VAT on goods to be given away abroad by them. This is achieved by allowing charities to treat this activity as a zero-rated business activity. Without this concession, the charities would not have been able to recover VAT paid when these goods were purchased.

Fundraising events

The third concession will benefit the charity in that part of the takings which would otherwise have gone to the Treasury remain with the charity, but has the disadvantage that any VAT incurred will be locked in and become a cost to the charity.

The rules are now the same as for Extra Statutory Concession C4 in relation to income tax. The tax authorities' main concerns are that those attending are aware they are at a charity event, and that the events do not compete with commercial activities. In theory, the exempt events are supposed to be "one-off", but in fact up to 15 such events at the same venue within one year can be exempt. Examples are barbecues, auctions, festivals, concerts, balls and discos.

Once the concession is available then all types of income directly connected with the event which would otherwise have been standard-rated are exempt, including

- Admission charges
- Catering
- Sales of merchandise
- Sponsorship
- Sale of advertising space.

It is important that sponsorship and advertising are directly connected with the event. The downside of this exemption is that any VAT incurred on the costs of mounting the one-off event will be irrecoverable. The availability of the exemption from VAT has no effect on the direct tax status of such events and whether, for example, the sale of entrance tickets represents trading income.

VAT and sponsorship

Sponsorship can sometimes cause VAT problems for charities. Sponsorship can be a genuine donation, a trading transaction or a mixture of the two. Clearly, if anything is supplied, or deemed to have been supplied, in return for financial support, then a taxable supply has been made for VAT purposes.

HMRC accept that a payment where only an acknowledgement has been given can be treated as a donation and therefore outside-the-scope. If a contribution is made to the charity on the condition that a company's name or trading style is advertised or promoted, then this constitutes advertising, and is a standard-rated supply by the charity.

Furthermore, if the company receives some other benefit in return, for example, tickets to a concert which is not an exempt one-off event, then this is a standard-rate supply by the charity.

Where there is an element of donation in the payment it may be possible to split the amount: put the ‘vatable’ supply through the charity's trading subsidiary, and the non-‘vatable’ element through the charity. If this is not possible it is advisable to put the complete transaction through the trading subsidiary.

VAT and trading

Trading occurs through the purchasing or selling of goods and services. Charites can only undertake trading activity if they meet certain exemptions. A distinction is made between primary and non-primary purpose trading to establish if the trading is part of the charity's primary purpose. Non-primary purpose trading is generally carried out with a sole purpose of raising money.

Charities wishing to carry out non-primary purpose trading will often need to set up a trading subsidiary. Most charity shops are not considered as trading if the charities are selling donated goods - the charity is realising the potential of the donated goods.

There is no general exemption from VAT for charities which undertake trading activities. The sale of goods by charities is subject to VAT on the same basis as would apply to commercial organisations, unless specific provisions for zero-rating or exemption apply. There are a number of such provisions applying to some charities, to charities generally, or to a class of supplier which includes some charities or charities generally.

There is a range of more detailed guidance on this potentially complex area, and you can find details of where to find that guidance in the ‘Further information’ section below.

VAT and affinity credit cards

The income from affinity credit cards has, via a non-statutory concession, become capable of being split. One part will relate to payment for services provided by the charity, such as use of logo and mailing list. The other part is a donation for which the charity provides nothing in return. The normal split would be 20% for services, 80% donation, but the split would need to be negotiated and carefully drafted in each particular case together with approval from HRMC.

Glossary of VAT Terms

Output Tax – VAT charged on Taxable Business Sales
Input Tax – VAT incurred on goods and services bought in by a VAT registered body
Recoverable Input Tax – Input Tax incurred by a VAT registered body which can be recovered

Further information

HM Revenue and Customs (HMRC)
VAT guidance for charities and not-for-profit organisations
Charity trading profits: tax obligations and reliefs
Tel: 0845 302 0203 (Charities Helpline)
www.hmrc.gov.uk

Charity Commission for England & Wales
Tel: 0845 3000 218
www.charity-commission.gov.uk

Institute of Fundraising
Trading and VAT
Fundraising and VAT
Tel: 020 7840 1000
www.institute-of-fundraising.org.uk

Charity Finance Directors' Group (CFDG)
VAT – Made Simple
The Tax Implications of Charity Trading
Tel: 0845 345 3192
http://www.cfdg.org.uk

Charity Tax Group
Tel: 020 7222 1265
www.ctrg.org.uk

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