

VAT made simple

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Introduction

VAT is a sales tax charged by businesses on certain goods and services they provide. You have to add VAT to your customer invoices ('output VAT') and pay this VAT over to HM Revenue & Customs ('HMRC'). However, you are allowed to deduct the VAT you incur in making your VATable sales and only pay over the net amount. Deducting VAT charged by suppliers is referred to as 'recovering VAT' and the VAT incurred on business purchases is referred to as 'input VAT'.

For VAT purposes activities are divided into three broad categories:

- **Outside the scope or non-business activities** VAT does not apply to these activities. VAT is not charged, but the VAT incurred by the activity cannot be recovered.
- **Exempt activities** These activities are within the scope of VAT, but are specifically exempted. VAT is not added to any charges, but VAT incurred by the activity cannot be recovered, except in very limited circumstances. Most of the exemptions are for activities in the public interest and include services commonly provided by charities such as health, welfare, education, sport and admissions to cultural events.
- **Taxable activities** These activities are within the scope of VAT. VAT is added at the appropriate rate and VAT incurred by the activity can be recovered. The UK currently has three rates of VAT, the standard rate (20%), the reduced rate (5%) and the zero rate (0%). It is important to note that zero-rated activities are taxable, they just carry VAT at a zero rate. No VAT is added to any charges but VAT incurred by the zero-rated activity can be recovered.

1 Registering for VAT

You have to register for VAT if the turnover on taxable activities exceeds the VAT registration threshold. This threshold is increased annually in the government's budget. The VAT registration threshold from 1 April 2011 is £73,000.

You must register for VAT if either:

- At the end of any calendar month, the value of taxable supplies in the last 12 calendar months has exceeded the VAT registration threshold. You must notify HMRC within 30 days of the end of the month and will be registered from the first day of the second month.
- At any time, there are reasonable grounds for believing that the value of taxable supplies in the next 30 days alone will exceed the VAT registration threshold. You must notify HMRC within 30 days of becoming aware that the threshold will be exceeded. The registration is effective from the date you became aware.

You register by completing form VAT 1 or online. Once you are registered you must provide your customers with proper VAT invoices and complete regular VAT returns.

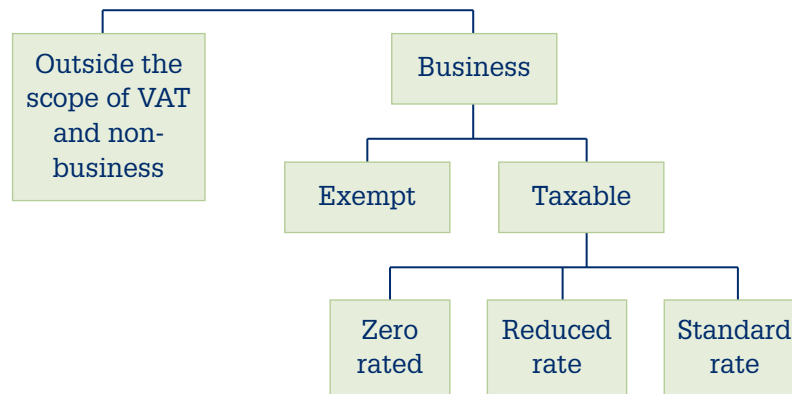
HMRC may permit an organisation to be exempted from registration if it makes mainly zero-rated supplies, so that it would normally recover VAT from HMRC rather than pay it. An organisation can also register voluntarily as long as it makes or will make some taxable supplies. It may have to provide evidence of an intention to make taxable supplies.

Pre-registration VAT

You can recover input VAT on pre-registration purchases for:

- Goods that have been purchased for taxable activities and are still 'on-hand' at the date of registration (for example as fixed assets or stock), providing they were not purchased more than four years prior to registration.
- Services supplied up to six months prior to the date of registration. The services must have been supplied for a taxable activity and not re-supplied before registration.

2 VAT categories of activity



Outside the scope and non-business activities

VAT only applies to business supplies. So, for a transaction to be subject to VAT, it must first be a 'supply' and that supply must be 'business'.

A supply is something that is provided in return for consideration. Consideration is usually monetary but can also be by way of barter. An activity is outside the scope of VAT when:

- Nothing is provided, for example, a donation is 'consideration' without anything provided in return
- There is no consideration, for example a service provided for free.

'Business' is not really defined in VAT legislation, but the intention is to distinguish between the activities of businesses, which are subject to VAT, and the private activities of individuals, which are not subject to VAT. Many activities of charities sit in the grey area between these two extremes. Case law suggests that business implies a certain degree of commercial intent and that the following factors may indicate that an activity is non-business:

- The nature of the activity is clearly charitable or social
- Fees are set to be as low as possible to maximise affordability for charitable or social reasons
- The activity possesses important features that would be very unusual in a 'commercial' environment.

Exempt activities

Exempt supplies are not subject to VAT and do not count towards the VAT registration threshold. Many activities undertaken by charities are exempt including:

- Medical care by registered health professionals such as doctors, dentists and nurses. The medical care must be provided within the terms of the registration, but can include supervised nursing care.
- Education and vocational training when provided by an 'eligible

body'. Eligible bodies including schools, colleges, universities and charities which apply any profits from the education and vocational training to the continuance or improvement of such supplies.

- Care, treatment or instruction designed to promote the physical or mental welfare of elderly, sick, distressed or disabled persons including services in registered care homes.
- Care or protection of young persons, for example services provided by a children's home, nursery, playgroup, after school club or fostering service.
- Admission charges to a museum, gallery, art exhibition, zoo or to a theatrical, musical or choreographic performance. The charity must be managed and administered (at the trustee level) on a voluntary basis by persons who have no financial interest in its activities.
- Renting out property is generally exempt, but property transactions are considered further below.
- Fundraising events (considered further below).

The above list is not exhaustive.

Zero-rated supplies

Zero-rated supplies are taxable, but the rate of VAT is 0%. This is in many ways the ideal situation if your customers are unregistered or using the supply for non-business or exempt activities. All your input VAT is recoverable, but the price to customers is not increased by VAT.

Some supplies are always zero-rated including:

- Printed books, booklets, leaflets, brochures, newspapers, journals and periodicals
- Children's clothing or footwear
- Unprepared food and animal feed, with exceptions
- Certain supplies of passenger transport.

Some supplies are zero-rated when supplied by a charity. Examples include:

- Sale of donated goods, which must be available for sale to the general public or more than one disabled person or person in receipt of specified benefits
- The export (to a country outside the EU) of goods. The export is treated as a zero-rated supply, even if the goods are given away for free, for example as aid.

Some supplies are zero-rated when supplied to a charity. Here the charity does not have to be registered for VAT to benefit from the zero-rating, but usually does have to give the supplier a certificate confirming eligibility for zero-rating. Various goods and services qualify for zero-rating, each with specific conditions attached. Examples include: advertising, collecting tins, aids for disabled people, medical goods and services, and construction of new buildings (see property

below). See VAT Notices 701/1, 701/58, 701/6 and 701/7 for more details.

Reduced rate supplies

Reduced rate supplies include:

- 'Qualifying' supplies of fuel and power. These include fuel for domestic use, use below certain de-minimis levels, use for relevant residential purposes (children's and old peoples homes, hospices etc) or use for a charity's non-business activities. If a supply is partly qualifying, then provided 60% or more of the supply is for qualifying purposes, the whole supply can be considered qualifying.
- Supply and installation of certain energy saving materials in a qualifying building. The materials are only reduced rate when supplied by an installer that also provides a supply of installation services. Purchases of materials by DIY builders are not covered.
- Renovation or alteration of certain residential premises if the premises have not been lived in for two years or more. Qualifying residential premises include single and multiple occupancy dwellings, such as bedsits, and certain relevant residential buildings such as children's homes and hospices.
- Conversion of premises into one or more single household dwellings, a multiple occupancy dwelling such as bedsits, or premises intended for use solely for a relevant residential purpose (children's homes etc).
- Goods to provide welfare advice supplied by a charity or state regulated private welfare institution, for example DVDs and information to promote awareness of the health risks of taking illegal drugs to young people. Dual purpose goods (eg t-shirts printed with welfare advice messages) are not covered.
- Contraceptives and certain smoking cessation products.
- Supply and installation of certain mobility aids when installed in domestic accommodation occupied by a person aged 60 or over. The reduced rate does not apply to installations in residential care homes and similar.

Standard-rated supplies

Business supplies that are not exempt and do not qualify for zero or reduced rating are standard-rated. Standard-rated, reduced rate and zero-rated supplies together comprise the taxable supplies. If the total (VAT exclusive) turnover from taxable supplies exceeds the VAT registration threshold you must register for VAT.

3 Recovering VAT

A VAT registered business can recover the VAT it incurs on purchases that are used in making taxable supplies. It recovers this 'input VAT' by deducting it from the VAT it charges to customers ('output VAT') and paying over the balance to HMRC. If recoverable input VAT exceeds output VAT it receives a repayment from HMRC.

To recover input VAT you must be VAT registered. (note: there are certain special VAT refund schemes for national museums and galleries, listed places of worship and memorials but these work by giving a grant to cover the VAT and are not VAT recovery in the usual sense).

Where an organisation has a mix of non-business, exempt or taxable activities it cannot usually recover the VAT incurred by the non-business or exempt activities.

Calculating the recoverable VAT

For businesses with a mix of taxable and exempt or non-business activities, calculating the VAT on purchases that can be recovered is a two step process.

Step 1 – direct attribution The VAT on purchases must first be directly attributed to the VAT types of activity (taxable, exempt, non-business) as far as possible. The VAT on a purchase is directly attributable to a type of activity if the purchase is entirely used in that type of activity. For example if you hire a piece of equipment for an exempt activity, the VAT charged on the equipment hire is directly attributable to exempt activities.

Step 2 – apportionment Some purchases may be used across different types of activity. Here any VAT on the purchase cannot be directly attributed to one type of activity and is referred to as **residual VAT**. Typically the VAT on overheads such as fuel, telephone bills and central function costs is residual. The residual VAT must be apportioned to the different types of activity (taxable, exempt and non-business) on a 'fair and reasonable' basis.

VAT incurred by non-business activities

VAT that is directly attributed (step 1) and apportioned (step 2) to non-business activities is irrecoverable.

VAT incurred by business activities

The VAT that is directly attributed (step 1) and apportioned (step 2) to business activities (taxable and exempt) is referred to as **input VAT**:

- The input VAT attributed and apportioned to taxable activities is recoverable
- The input VAT attributed and apportioned to exempt activities is referred to as **exempt input VAT**. Exempt input VAT is irrecoverable unless it meets the **de minimis test**. If exempt input VAT is de minimis it can be recovered.

The de-minimis test

The de-minimis test changed with effect from 1 April 2010:

- For VAT periods commencing before 1 April 2010, exempt input VAT is de-minimis if it is not more than £1,875 in a VAT quarter and not more than 50% of total input VAT
- For VAT periods commencing on or after 1 April 2010 exempt input VAT is de-minimis if any of the following three tests is met:
 - 1 Total input VAT is no more than £1,875 in a VAT quarter and the turnover on exempt activities is no more than 50% of the turnover on all business activities
 - 2 Total input VAT less input VAT directly attributable to taxable activities is no more than £1,875 in a VAT quarter and the turnover on exempt activities is no more than 50% of the turnover on all business activities
 - 3 Exempt input VAT is not more than £1,875 in a VAT quarter and not more than 50% of total input VAT.

Example

Local Advice Organisation ('LAO') has £20,000 income and incurs £1,000 VAT on purchases in the VAT quarter commencing 1 April 2011. The splits of income and VAT are shown in rows a) and b) below. LAO uses the levels of income to apportion residual VAT.

	<i>Non-business activities</i>	<i>Business activities</i>		<i>Residual activities</i>	<i>Totals</i>
		<i>Exempt activities</i>	<i>Taxable activities</i>		
a) Income in VAT quarter	£10,000	£4,000	£6,000		£20,000
Percentage of total income	50%	20%	30%		100%
b) Step 1: directly attribute VAT on purchases as far as possible. Any remaining VAT is residual VAT	£500	£200	£100	£200	£1,000
Step 2: apportion residual VAT between non-business, exempt and taxable	50% x £200 = £100	20% x £200 = £40	30% x £200 = £60	(£200)	
c) VAT directly attributed and apportioned to activities	£600	£240	£160	–	£1,000

LAO meets the first two of the de-minimis tests for the VAT quarter as:

- Test 1: total input VAT (£400 = £240 + £160) is less than £1,875 and exempt income (£4,000) is less than 50% of total business income (£10,000 = £4,000 + £6,000)
- Test 2: Total input VAT less input VAT directly attributable to taxable activities (£300 = £400 – £100) is less than £1,875 and exempt income (£4,000) is less than 50% of total business income (£10,000 = £4,000 + £6,000)

Test 3 fails as exempt input VAT (£240) is less than £1,875 but is not less than 50% of total input VAT (£400). However, as at least one of the other tests is met this does not matter and LAO is de-minimis for the VAT quarter.

Note: in practice it would not be necessary to apply all three tests – as soon as a test is met you are de-minimis for that period.

LAO can therefore recover all £400 input VAT incurred in the VAT quarter. The VAT attributed and apportioned to non-business activities (£600) is irrecoverable.

Apportioning residual VAT

The apportionment of residual VAT between taxable, exempt and non-business activities must normally be carried out in the following order.

a The business / non-business method

If you have no non-business activities then all residual VAT goes into step (b).

If you have non-business activities the residual VAT must first be apportioned between business and non-business activities. There is no prescribed apportionment method, but it must be fair and reasonable and reflect the extent to which the residual purchases are used by business and non-business activities. The residual VAT apportioned to non-business activities cannot be recovered. The residual VAT apportioned to business activities goes forward into step (b).

b The partial exemption method

If you have no exempt activities, then all residual VAT apportioned to business activities (from step (a)) is recoverable.

If you have exempt activities, the residual VAT (including the residual VAT from step (a)) must be apportioned between exempt and taxable activities. You must use the 'standard partial exemption method' unless this does not produce a fair and reasonable result or you may obtain permission from HMRC to use a 'special partial exemption method'. The standard method uses the VAT exclusive turnover on exempt and taxable activities as the basis of apportionment. Special methods are commonly based on the number or cost of staff working in the different types of activity, floor area or expenditure.

Combined methods

From 1 January 2011 a business can apply to HMRC for a combined method - that is a method that apportions residual VAT between taxable activities and exempt / non-business activities in one go. The main advantages of a combined method are that it is simpler and the business does not need to distinguish between exempt and non-business activities. The main disadvantage is that the de-minimis test is not available if a combined method is used.

Annual adjustment

You have to apportion residual VAT each quarter, then again annually using whole year figures. This is the 'annual adjustment' which allows for changes and seasonal variations in activity. Any resulting adjustment can be made in either the last VAT return of the current VAT year or the first VAT return of the following year.

For the annual adjustment the £1,875 quarterly limit for the purposes of the de-minimis test is replaced with a £7,500 annualised limit.

Use of provisional recovery rates

From 1 April 2009 businesses can use, for the apportionment between taxable and exempt activities in step (b) above, the partial exemption recovery rate determined in the previous year's annual adjustment. This saves having to calculate the levels of taxable and exempt activity

anew each quarter. At the end of the year actual (annual) levels of taxable and exempt activity must be used to determine the true recovery rate for the year. This rate can then be used on a provisional basis during the following year.

Annual de-minimis test

From 1 April 2010, a business can assume, for the purposes of its quarterly VAT calculations, it is de-minimis if it was de-minimis in the previous year's annual adjustment. This is then corrected at the annual adjustment by applying the above de-minimis tests, using an annualised £7,500 limit.

The Children's Society case

Before this case it was generally assumed that VAT incurred in generating voluntary donations was attributable to a non-business activity of generating donations and so irrecoverable. Examples include the costs of campaigns to generate committed givers, legacy generation and the costs of generating core grant funding. However the 2006 High Court case Church of England Children's Society has changed this view. The court held that VAT recovery on the costs of generating voluntary donations depends on how those donations are used:

- If the donations are wholly used to subsidise taxable activities – the VAT is recoverable
- If the donations are wholly used to subsidise exempt activities – the VAT is irrecoverable unless exempt activity is overall de-minimis
- If the donations are wholly used to support non-business activities – the VAT is irrecoverable
- If the donations are used to subsidise a mix of types of activity or to fund overhead costs – the VAT is residual.

HMRC have also accepted (November 2009) that VAT incurred on investment management fees may also attract the 'Children's Society treatment' – that is one must look through the investment activity to see how the investment income and gains are used. However if the income or gains are from restricted or endowment funds the look through must be to the permitted activities.

Practicalities

If you have a mix of taxable, exempt and non-business activities your accounting systems will need to be able to identify purchase directly attributable to each type and residual purchases. The usual approach in a computerised accounting system is to set up separate VAT codes for purchases attributable to taxable, exempt, non-business and residual activities.

4 Fundraising events

All sorts of fundraising events organised by charities qualify for exemption from VAT (and income or corporation tax) providing the fundraising purpose is clearly advertised as such. The exemption covers admission charges, sponsorship for the event, the sale of goods, food and drink at the event and advertising in brochures.

The exemption also covers events organised by a wholly owned subsidiary of a charity provided the subsidiary has agreed in writing to transfer its profits from whatever source to a charity; or the subsidiary's profits from whatever source are otherwise payable to a charity.

You can hold up to 15 events of the same kind in the same location in one year. If you go over the limit, none of the events qualify. However, small scale fundraising events, where the gross takings do not exceed £1,000 per week, do not count towards the 15 limit. This means VAT exemption applies to any number of small scale events.

Overseas challenge events are not usually covered by the exemption for fundraising events. If an event includes a package of both travel and accommodation or bought-in accommodation or more than two nights' accommodation from a charity's own resources (for example in a building owned by the charity) then the event does not qualify as a fundraising event. Most challenge events must instead be dealt with under the special 'Tour Operators' Margin Scheme' (see VAT Notice 709/5).

Problems can also arise with events organised by for-profit companies such as the London Marathon. They do not qualify as VAT exempt fundraising events so fees for places in the event are standard-rated. This means that where charities charge registration fees or require participants to raise a minimum amount of sponsorship for such events, any such charges by the charity are standard-rated. HMRC do, however, accept that where participants pledge to raise a specific amount this is not binding and so can be treated as an outside the scope donation. It is however usually beneficial to charge participants a small mandatory registration fee as this will ensure the event is a taxable activity for the charity and any VAT incurred in purchasing places and assisting participants is recoverable.

5 Membership subscriptions

The VAT status of a charity's membership subscription depends on what, if anything, is supplied in return for the subscription. This can be a problematic area for a membership charity. The package of membership benefits often changes over time and even when a charity has an agreement with HMRC as to the VAT status of its subscriptions, this can quickly become out of date.

Where nothing is supplied in return for the subscription, so the subscription is effectively a donation to the charity, it is likely to be regarded as outside the scope of VAT. Nominal benefits such as the right to vote at an AGM and receive the annual report are unlikely to affect this. There is a specific exemption for subscriptions charged by non-profit making professional associations, learned societies, trade associations, trade unions and organisations whose aims are in the public domain and are of a political, religious, patriotic, philosophical, philanthropic or civic nature.

Where neither of these situations applies and a charity provides its members with a package of benefits, it is allowed to apportion the subscription between the benefits provided. So, for example, if a charity provides its members with standard-rated and exempt benefits, the subscription can be apportioned between standard-rated and exempt. The subscription is assumed to include any VAT due on the standard-rated benefits. The apportionment should generally be undertaken using information about the cost of the benefits. It is sometimes possible to agree with HMRC that part of a membership subscription is consideration for the benefits provided, with the remainder being a donation. In all cases it is recommended you agree the apportionment in advance with HMRC.

6 Property

The VAT rules for property transactions are especially complex. Property here comprises land, buildings and civil engineering works. Property transactions include purchasing, selling, renting, constructing, extending and renovating property. Given the amounts involved, charities are advised to take professional advice before entering into substantial property transactions.

Qualifying use

Special VAT rules apply where a charity's use (or intended use) of property is:

- For a '**relevant charitable purpose**'. This means use for a charity's non-business activities or use by a charity as a village hall or similarly in providing social or recreational activities for a local community.
- For a '**relevant residential purpose**'. This means use as a children's home, a care home, a hospice, residential accommodation for students or members of the armed forces, a monastery, nunnery or similar and an institution which is the main residence of 90% or more of its residents. However use as a hospital, prison, hotel or similar is excluded. In some situations, use as a hostel is considered to be similar to use as a hotel.

Recovering VAT on property transactions

Where a charity incurs VAT in a property transaction, the charity's ability to recover that VAT depends on how the property will be used by the charity:

- If the property will be used for wholly taxable activities, the VAT can be recovered
- If the property will be used for wholly exempt or non-business activities, the VAT cannot be recovered.
- If the property will be used for a mix of taxable, exempt and non-business activities, the VAT must be apportioned and only part can be recovered. There are special rules setting out how the apportionments must be carried out. Where property is used for a mix of taxable and exempt or non-business activities and VAT bearing transaction costs exceed £250,000, the 'capital goods scheme' must usually be applied to determine how much VAT can be recovered.

Buying, selling and renting property

By default the sale or renting of property is VAT exempt. However there are several key exceptions:

- A property owner can 'opt to tax' the property. This means that

supplies of the property by that person then become standard-rated. If a landlord has opted to tax a building and rents it out, the landlord adds VAT to the rental charges. However, the option to tax can be 'dis-applied' when the property is to be used for a relevant residential purpose or a relevant charitable purpose other than as an office for general administration. This means the supply remains VAT exempt. Disapplying an option to tax can help a charity reduce its irrecoverable VAT. However the charity must inform the landlord, before the transaction takes place, that it will be disapplying the option to tax. This will often be a disincentive to the landlord as it will make it partially exempt. To deal with this many commercial leases contain clauses that allow the landlord to increase the rent in the event of a disapplication, so the advantage to be gained from disapplying a landlord's option to tax may be minimal.

- The sale by a property developer of the freehold or a long lease (21 years or more in England and Wales, 20 years or more in Scotland) in a new building is zero-rated if the purchaser will use the building for a relevant charitable or relevant residential purpose. This applies even if the purchaser is not VAT registered. Before the transaction takes place the purchaser must give the developer a certificate confirming the intended use.
- The first sale of the freehold or a long lease in a substantially reconstructed protected building is zero-rated if the purchaser will use the building for a relevant charitable or relevant residential purpose. Protected buildings include listed buildings.
- The freehold sale of a new or uncompleted commercial building or civil engineering work is standard-rated. A building is new within three years of completion and commercial means the building is not intended for use for a relevant residential or relevant charitable purpose or designed as a dwelling. It does not matter who the vendor is or if the freehold has been sold previously.
- The rent of hotel accommodation, holiday accommodation, parking and sporting facilities are all standard-rated by default though there are some important exceptions.

Constructing, renovating and extending property

Where a charity purchases services from builders, architects etc in order to construct, renovate or extend property, those services are normally standard-rated and the charity can recover that VAT according to its intended use of the property, as explained above. However there are a few special rules:

- If a charity contracts for the construction of a new building and it intends to use that building for relevant charitable or relevant residential purposes, it can zero-rate most of the construction costs. The charity must provide the main contractor with a certificate confirming the intended use. Costs that cannot be zero-rated include

professional fees (architects, surveyors, engineers etc) and certain materials and fittings such as carpets.

- If a charity constructs an annexe that it intends to use for a relevant charitable purpose, it can zero-rate most of the construction costs as for a new building. To qualify as a zero-rated annexe it must have minimal physical integration with the existing building, it must be capable of functioning independently from the existing building and it must have its own main entrance.
- If a charity substantially reconstructs a protected building and intends to use that building for a relevant charitable or relevant residential purpose after reconstruction, it can zero-rate the reconstruction costs though professional fees, carpets etc are excluded from zero-rating as above.
- If a registered housing association converts a non-residential building into dwellings or into a building intended for relevant residential use, it can zero-rate the conversion costs though, as above, professional fees, carpets etc are excluded from zero-rating.

Disabled access works

Charities can zero-rate certain works they carry out to facilitate use of a building by disabled persons. The charity does not have to be VAT registered to qualify and it does not have to give the contractor a certificate of eligibility though many suppliers will request a zero-rating declaration to confirm eligibility. Qualifying works include:

- The construction of ramps, including raising floor levels, reducing the angle of a slope, creating a slope, demolition and clearance, connecting services and making good.
- The widening of existing doorways and passages (but not the creation of new doorways and passageways). Can include external paths and gates in some situations.
- The creation, extension or adaptation of washrooms and lavatories. Covers materials, equipment, installation, repairs and maintenance, demolition and clearance, connecting services and making good.
- The creation, extension or adaptation of washrooms, lavatories and bathrooms in residential accommodation or a day-care centre where at least 20% of the individuals using the centre are disabled persons. Covers associated goods, installation, maintenance and repair.
- Lifts. The purpose of the lift must be to facilitate the movement of disabled persons between floors. The lift must be in either a permanent or temporary residence of one or more disabled persons, or a day-care centre where one or more disabled persons receive care. Covers installation, repair and maintenance and associated goods (such as the lift and lifting gear).

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International VAT

Special VAT rules apply to cross-border supplies. The rules depend on:

- Whether it is a supply of goods or a supply of services
- The VAT status of the customer (for goods whether or not they are VAT registered in their own country and for services whether or not they have any business activities)
- The location of the supplier and customer. A distinction is made between customers and suppliers located inside the EU and customers and suppliers located outside the EU.

Supplies of goods

A UK VAT registered business supplying goods to a foreign customer must:

- a** Charge UK VAT if the customer is in another EU state but not locally VAT registered (eg a private individual or a charity with no taxable activities). If the supplier is responsible for delivery and total sales of goods to unregistered customers in another EU state exceed that state's 'distance selling threshold', the supplier must register for VAT in that state. The rate of UK VAT is the same as would apply if the customer were in the UK, so, for example, a supply of books or children's clothing would be zero-rated.
- b** Treat the supply as UK zero-rated if the customer is in another EU state and VAT registered in that state. The customer must provide their VAT number to the supplier and the supplier must check that it is a valid VAT number (for example by ringing the HMRC national advice service). The customer must account for output VAT to their local tax authorities on the supply at local VAT rates.
- c** Treat the supply as zero-rated if the customer is outside the EU.

In situations (b) and (c) the supplier must ensure the goods physically leave the UK within certain time limits (usually 3 months) and must retain adequate proof of this. If these conditions are not met, the supplier must charge or account for UK VAT as in situation (a).

A UK VAT registered business purchasing goods from a foreign supplier must:

- a** Pay VAT (at UK rates) on the import of goods from a supplier based outside the EU. This VAT must normally be paid before the goods can clear customs. This 'import VAT' can be recovered by the UK business as input VAT to the extent the goods are used for taxable activities.
- b** Account to HMRC for output VAT at UK rates if the supplier is in another EU state and has zero-rated their supply (as in (b) above). This output VAT is recoverable as input VAT to the extent the goods are used for taxable activities.

This is only a brief outline of the rules. For more information, see VAT Notice 703 for supplies of goods to customers outside the EU, VAT Notice 702 for imports of goods from non-EU suppliers and VAT Notice 725 for supplies of goods to customers in other EU states. See section 9 below for how to access the VAT notices on the HMRC website.

Supplies of services

The VAT rules for cross border supplies of services underwent substantial changes on 1 January 2010. From this date the rules are as follows.

For most supplies of service ('general rule services'):

- a** If a UK VAT registered business purchases services from a foreign business, the UK business must account to HMRC for output VAT (at UK rates). This output VAT is recoverable as input VAT to the extent the services are used for a taxable activity.
- b** If a UK VAT registered business supplies services to a foreign customer that has no business activities ('B2C', eg a private individual), UK VAT must be charged by the supplier at UK rates.
- c** If a UK VAT registered business supplies services to a foreign customer that has some business activities ('B2B'), the UK business must in effect zero-rate its supply. If the customer is in the EU, the customer must then account for output VAT to their local tax authorities on the supply at local VAT rates (the mirror of situation (f) above). For customers outside the EU the position depends on the local tax rules. Many countries around the world operate VAT type taxes.

Exceptions to the above rules for supplies of services include where the services are VAT exempt, where the services relate to land, where the services involve physical performance (eg: plays and conferences), and, for supplies to non-business customers (B2C), supplies of intellectual property rights, advertising services and services of consultants.

The above is just a brief summary of the VAT rules for cross border supplies of services. You should refer to VAT Notice 741A before deciding on the VAT status of a cross-border supply of services.

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Conclusion

VAT is a complex tax, especially for charities as they often have activities in all categories of VAT – taxable, exempt and non-business. If you are currently unregistered for VAT, you will need to monitor the turnover from potentially taxable activities to ensure that you do register at the right time if you do go over the threshold.

It may be possible to arrange your affairs to plan for VAT to a certain extent. You will certainly need to consider VAT even if you are unregistered. For example, when budgeting, your costs have to include VAT where it applies. You may also have to consider a new activity for its VAT consequences and new premises should always trigger a review of your VAT position.

All charities can benefit from the many special zero-rating concessions for charities when purchasing goods and services. Check that all relevant staff in the charity know about the concessions and how to get them when placing orders.

VAT registered charities cannot usually recover all the VAT they incur on purchases and must attribute and apportion this VAT. It worth considering the best method for your charity and, if necessary, agreeing this with HMRC. You then need to keep this under review as your activities may change and affect the VAT position.

Legally, a charity is responsible for managing its tax affairs in the same way as any other person or entity, so ignorance of the law is no excuse if you get it wrong. And, as it is difficult to put things right for VAT after the event, it is better to ensure that you think about it at the planning stage.

Further information

HMRC website www.hmrc.gov.uk

This is a vast and sometimes confusing website. One way to navigate it is, from the homepage, click the Library button in the quick links section at the left. From the Library section you can find the following links:

- **Publications:** click here to drill down to the Public Notices and Information Sheets: most of the VAT rules are covered in the VAT Public Notices. VAT Notice 701/1 is specifically for charities and is a good starting point for anyone new to charity VAT.
- **Revenue & Customs Briefs:** these announce new developments and changes in HMRC policy, often following court cases. They can also be accessed from the Publications button in the Library
- **What's New:** a daily listing of new developments and changes to the HMRC website. Click the What's New button at the right of the Library page

HMRC charity enquiries 08453 02 02 03.

This is a dedicated help line for charities on all aspects of tax. You are given a menu of options – select VAT reliefs for charities for advice on all aspects of charity VAT.

Charity written enquiries

More complex VAT queries and requests for rulings should be made in writing to: HMRC Charities, St John's House, Merton Road, Bootle, Merseyside L69 9BB.

National Advisory Service 0845 010 9000

This is a more general VAT advice line for all UK businesses. The address for writing is: HMRC National Advice Service, Written Enquiries Section, Southend on Sea, Alexander House, Victoria Avenue, Southend, Essex SS99 1BD. Written enquiries from charities are usually referred to the specialist charities unit in Bootle and it is usually fastest for charities to write directly to Bootle.

A practical guide to VAT for charities

Kate Sayer and Alastair Hardman

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CFDG (Charity Finance Directors' Group) is the professional body for finance directors within the sector, and has nearly 1,600 members. CFDG provides assistance to charities on a range of issues, such as accounting, taxation, audit and other finance-related functions. CFDG's mission is to deliver services that are valued by members and enable those with financial responsibility in the charity sector to develop and adopt best practice.

For more information go to www.cfdg.org.uk



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made simple guides

Made Simple guides are aimed at finance professionals and other managers working in charities. They cover technical areas such as tax and VAT treatments as well as information management areas and aim to provide practical guidance to busy managers and trustees in charities.

The content of guides is correct at the time of going to print, but inevitably legal changes, case law and new financial reporting standards will change. You are therefore advised to check any particular actions you plan to take with the appropriate authority before committing yourself. No responsibility is accepted by the authors for reliance placed on the content of this guide.

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