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VAT made simple for charities

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Most businesses charge VAT on all of their sales and recover VAT on just about all purchases. However, charities are different and face complicated scenarios when it comes to VAT, with only some of their income taxable. This means that only part of the VAT they incur is recoverable...

Charities must decide which, if any, of their income streams are taxable and register for VAT if that potentially-taxable income, in the previous twelve months, exceeds the VAT registration threshold—currently at £85,000.

Some types of income are outside the scope of the VAT system—also known as non-business income. Charity income streams can be either exempt from VAT or taxable:

Activities outside the scope of VAT

- Grants and donations
- Legacies
- Gains on investments
- Bank interest

Activities exempt from VAT

- Sales by charities in particular areas of education and training, health and welfare services, admission to cultural events and facilities and access to sports facilities
- Income from qualifying charity fundraising events
- Renting and selling property (unless the property is opted to tax)
- Lottery income
- Membership subscriptions of certain public interest membership bodies (professional associations, learned societies, philanthropic bodies etc.)

Taxable activities - subject to VAT

- Most sales of goods
- Consultancy services
- Management and administration services
- Royalties and other intellectual property rights
- Sales of advertising
- Most commercial sponsorship (unless for a qualifying charity fundraising event)
- Renting and selling property that is opted to tax
- Sales of electronic products and services

The standard rate of UK VAT is 20% but some sales are at 5% such as gas and electricity to domestic and non-business customers, or at 0% such as publications, children's clothes, some food & drink and sales of advertising to a charity.

Output VAT and input VAT

The VAT charged on sales is output VAT. A charity can reclaim from HMRC the VAT it incurs on purchases that it uses to make its taxable supplies. The reclaimable VAT is your 'input VAT'. The net amount is paid to HMRC or reclaimed if input VAT exceeds output VAT.

However, VAT incurred on purchases that are used wholly in making VAT-exempt supplies cannot be recovered unless it is very small, nor can VAT generally be incurred on purchases used wholly in non-business activities. However, particular types of charity can reclaim the VAT they incur in their non-business activities, for example hospices, academies and free schools, search and rescue charities and air ambulance charities.

VAT incurred on mixed-use purchases ('residual VAT'), such as organisational overheads, must be apportioned between taxable, exempt and non-business use, with only the taxable-use apportionment claimable. The aforementioned 'particular' charities, such as hospices, can also claim the non-business apportionment.



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This apportionment is usually carried out on an income basis—the taxable apportionment being (taxable income/total income) x 100%. However, it is possible to use alternative apportionment bases (e.g. staff numbers, staff cost, expenditure, floor area etc.) though any other apportionment basis may have to be agreed in writing by HMRC.

VAT returns

All VAT-registered charities must submit periodic—usually quarterly—VAT returns to HMRC. Each VAT return must state: the total amount of output VAT due for that quarter, the amount of input VAT claimed in that quarter, the net amount of VAT payable to or due from HMRC, as well as the total sales and purchases net of any VAT and figures for the total of EU purchases and sales made in that quarter. If VAT is due to HMRC it must be paid by a given due date.

For VAT periods beginning on or after 1 April 2019 (or for some charities October 2019), under HMRC's 'Making Tax Digital' (MTD) programme, VAT-registered businesses, operating at or above the VAT registration threshold, must submit VAT returns to HMRC digitally via a new online link using compliant software. Within a year any separate systems containing financial information, such as a database or ePOS system, must also be linked digitally to the accounting software.

Please take this account as a brief overview of how VAT works for UK charities. Other key areas include:

- **VAT reliefs** - charities are eligible for special VAT reliefs at a reduced or zero-rate. To comply, the charity may need to provide a certificate confirming what relief conditions are met. These include charity advertising, export of goods, construction services and property sales, medicinal products and equipment, vehicles, rescue equipment and more.
- **Cross-border transactions** - the above rules apply to UK charities transacting with UK customers and suppliers. There are separate VAT rules for international sales and purchases.
- **VAT groups** – it may be possible for two or more connected entities to form a single entity for VAT purposes—a 'VAT group'. All transactions (with a few exceptions) within the group are ignored for VAT purposes and only business transactions with entities outside the group are subject to VAT.

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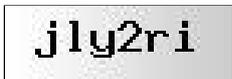
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