

VAT

made simple



Sayer Vincent LLP

**Chartered accountants
and statutory auditors**

Invicta House

108–114 Golden Lane

London EC1Y 0TL

Offices in London, Bristol and Birmingham

020 7841 6360

svinfo@sayervincent.co.uk

www.sayervincent.co.uk

 [@sayervincent](https://twitter.com/sayervincent)



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Introduction	4
Registering for VAT	5
VAT categories of activity	8
Recovering VAT	12
Membership subscriptions	17
Property	18
Making tax digital for VAT	21
Further information	23

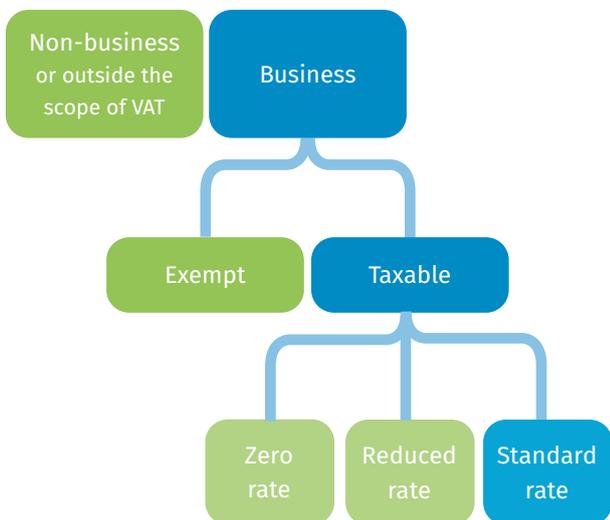
Introduction

This guide is aimed at UK charities. Its purpose is to outline the UK VAT rules as they apply to UK charities and not for profit organisations.

VAT is a type of sales tax charged by VAT registered businesses on certain goods and services they sell (*taxable supplies*). The business must add VAT to its customer invoices, as a percentage of the net selling price, charge it to the customer, collect this VAT from the customer and pay this VAT over to HM Revenue & Customs (HMRC). This VAT is referred to as *output VAT* or *output tax*.

The business can deduct from the output VAT due to HMRC, the VAT it incurs on purchases that are used or to be used to make its taxable supplies. Deducting VAT charged by suppliers is referred to as *deducting VAT* or *recovering VAT* and the VAT incurred on purchases is referred to as *purchase VAT*.

VAT types of activity



For VAT purposes activities are divided into the following categories:

- **Non-business activities(outside the scope of VAT)** Output VAT is not charged on non-business income, but the purchase VAT incurred by non-business activities cannot (usually) be recovered.
- **Business activities (within the scope of VAT)** The VAT rules apply to these activities though some activities are exempt from VAT (**VAT exempt**) and only the remainder are subject to VAT (**taxable activities**).
- **Exempt activities** these activities are within the scope of VAT, but are specifically exempted. Output VAT is not added to any invoices, but purchase VAT incurred by the activity cannot be recovered, except in very limited circumstances (see the section *VAT recovery* below). Many of the VAT exemptions are for activities in the public interest and commonly undertaken by charities, such as the provision of medical care, welfare services, education, sports facilities and admissions to cultural events.
- **Taxable activities** These activities are subject to VAT. Output VAT is added at the appropriate rate to sales invoices and purchase 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.

Registering for VAT

You must register for VAT if taxable income exceeds the VAT registration threshold. Taxable income includes standard-rated, reduced rate and zero-rated income, but excludes VAT exempt and non-business income. With effect from 1 April 2017 the VAT registration threshold is £85,000.

You must register for VAT if you meet either the ***past turnover test*** or the ***future turnover test***.

Past turnover test At the end of any calendar month, taxable income 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.

Future turnover test At any time, there are reasonable grounds for believing that the taxable income 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.

Exception and exemption from VAT registration

You can be excepted from VAT registration if you meet the past turnover test, do not meet the future turnover test, and HMRC is satisfied your taxable turnover in the next 12 months will not exceed the VAT deregistration threshold. This is, with effect from 1 April 2017, £83,000.

HMRC may also permit an organisation to be exempted from VAT registration if it makes mainly zero-rated supplies, so that it would normally recover VAT from HMRC rather than pay it.

Voluntary registration

A business can also register voluntarily as long as it makes or will make some taxable supplies. The business must provide HMRC with evidence of an intention to make taxable supplies.

Registration process

Most businesses can now register for VAT online, though businesses seeking exception from registration must write to HMRC. Once a business is registered for VAT, it must provide its customers with VAT invoices and submit regular VAT returns to HMRC, usually quarterly.

Group registration

In some situations several distinct entities can register for VAT as a single entity. This is referred to as a 'VAT group'. The VAT group members must nominate a representative member who acts for the group in relation to VAT.

The advantages of group registration include:

- transactions between entities within the group are (usually) ignored for VAT purposes; there is only one VAT return to complete, and, for a charity with a trading subsidiary, group registration with the trading subsidiary may improve VAT recovery if the trading subsidiary's activities are largely taxable.

Disadvantages include:

- members are jointly and severally liable for VAT debts; and in some situations, it is necessary for a charity subsidiary to remain outside any VAT group in order to supply it with zero-rated or reduced rate services, for example where a charity uses a *design and build* subsidiary to carry out a construction project (see **Property** below).

Bodies corporate can form a VAT group if:

- each is established or has a fixed establishment in the UK; one controls the others or they are under common control;
- they satisfy various anti-avoidance conditions set out in section 3 of VAT Notice 700/2. Bodies corporate include companies limited by share capital, companies limited by guarantee, CIOs, SCIOs and companies established by Act of Parliament or Royal Charter, but exclude charitable trusts.

An individual in business or a partnership can also join a VAT group if they control the bodies corporate and are established or have a fixed establishment in the UK.

The UK VAT return

By default a UK VAT return must be submitted to HMRC quarterly, though businesses may request or be required to submit monthly VAT returns. The VAT return has 9 boxes for completion:

Box 1 total output VAT due (including output VAT due under a reverse charge) and from 1 January 2021, import VAT due under postponed accounting.

Box 2 Total acquisition VAT due. Acquisition VAT is a special type of VAT due on certain purchases of goods within the EU. With effect from 1 January 2021 acquisition VAT only applies to some businesses in Northern Ireland.

Box 3 the total of boxes 1 and 2.

Box 4 total purchase VAT to be claimed. See the section Recovering VAT below for how to establish this figure.

Box 5: Box 3 minus box 4.

Box 6 Net value of business income, including taxable sales, exempt sales and reverse charge purchases (as the latter are deemed to be supplied by a UK customer to themselves).

Box 7 net value of business purchases including purchases subject to a reverse charge.

Box 8 value of sales of goods to EU businesses – from 1 January 2021 this box is only relevant for businesses in Northern Ireland.

Box 9 value of purchases of goods from EU businesses – from 1 January 2021 this box is only relevant for businesses in Northern Ireland.

Pre-registration VAT

You can recover purchase VAT on purchases made before the date of VAT registration for:

- Goods that have been purchased for taxable activities and are still on-hand at the date of registration (for example, as stock or tangible fixed assets), 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.
- Certain capital items: VAT recovery on some capital purchases, such as the purchase, refurbishment or construction of a building, is adjusted for a period of 10 years after initial purchase under the *Capital Goods Scheme*. It may be possible to reclaim some of the preregistration VAT incurred on a capital item under the Capital Goods Scheme.

Reverse-charge purchases

Some purchases of services from non-UK suppliers are subject to a special VAT regime, known as a *reverse charge*. This can apply to UK charities, typically for purchases of online or mobile services such as database access, access to online networks, use of software and social media, ticketing services,

downloads of digital data and automated online services.

Ordinarily it is for the supplier to charge UK output VAT to its customers, collect this VAT and pay it to HMRC. However where a supplier of services is located outside the UK this can be problematic for HMRC, so under the reverse charge procedure, a UK business customer is deemed to make the supply of services to themselves in the UK. In effect, the VAT system pretends the UK customer sold the services to itself in the UK. This deemed sale is then potentially subject to UK output VAT under the UK's VAT rules.

If it is subject to VAT, then if the UK customer is registered for VAT, it must charge itself UK output VAT on the deemed sale, at the appropriate UK rate of VAT and pay this VAT to HMRC as output VAT.

This output VAT is also the UK customer's purchase VAT, and recoverable in accordance with the UK VAT recovery rules.

If the UK customer is not registered for VAT in the UK, this deemed supply counts towards the customer's UK VAT registration threshold if, and only if, it is a *B2B-general-rule service*.

B2B means *business to business* and as such excludes purchases by charities that have no business activities but includes purchases by charities with some business activities.

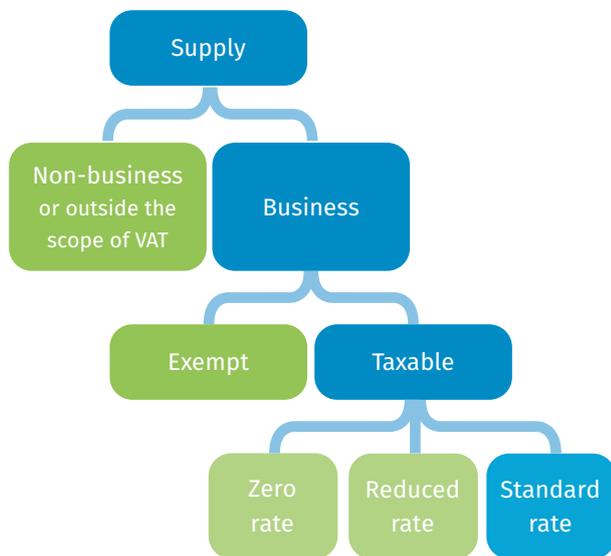
B2B-general-rule services include:

- supplies of intellectual property rights
- advertising services (if not zero-rated)
- consultancy, advice and professional services
- data processing and the provision of information
- banking
- insurance and financial services
- supplies of staff
- supplies of electronically-supplied services, telecommunication and broadcasting services.

For more on the cross-border-VAT rules, see the Sayer Vincent guide [International aspects of VAT made simple](#).

VAT categories of activity

Outside the scope and non-business activities



For a transaction to be subject to VAT, it must meet both of the following conditions:

- **It must be a *supply*.** It must be a supply of goods or services for consideration, and.
- **It must be a *business supply*.** The supply of goods or services for consideration must be in the course or furtherance of a business activity of the supplier.

A supply is an exchange transaction in which goods or services are provided in return for consideration. Consideration is usually monetary but can also be by way of barter, provided the barter transaction is capable of valuation. Consideration does not have to be paid by the beneficiary of the supply, it can be paid by a third party, for example, a local authority paying for a care contract.

A transaction is not a supply if:

- A payment is made but nothing is provided in return. For example, an unfettered or *pure* donation is a payment but without any goods or services provided or expected in return.
- There is no consideration and goods or services are provided for free
- There is a token or symbolic consideration, for example a lease of premises for a peppercorn
- Goods or services are provided but any consideration is voluntary. For example, a street musician soliciting donations from passers-by
- There is no direct link between the services and consideration

Business activities include:

- Any activity of producers, traders or persons supplying services, including mining and agricultural activities and activities of the professions.
- The exploitation of tangible or intangible property for the purposes of obtaining income therefrom on a continuing basis.

UK courts and tribunals have devised a set of six *business* tests in order to determine if an activity is business or non-business. The tests asked if the activity is:

- 1 a serious undertaking earnestly pursued
- 2 pursued with reasonable continuity
- 3 substantial in amount
- 4 conducted on sound and recognised business principles
- 5 predominantly concerned with making supplies for consideration and
- 6 consists of supplies commonly made by those who seek to make a profit from them

Exempt activities

VAT exempt supplies are business and within the scope of VAT, however no output VAT is charged and they do not count towards the VAT registration threshold. Many activities undertaken by charities are VAT exempt including:

- **The provision of medical care in hospitals and medical centres.** This includes the provision of medical care in hospices
- **Supplies of education by an *eligible body*** Eligible bodies include recognised schools, colleges and universities. They also include non-profit making bodies (such as charities) which provide education on a ring-fenced basis. This means that the education is either provided on an overall loss making or break even basis, or if there is a surplus, it is re-invested in the continuation or improvement of the educational supplies.
- **Supplies of welfare services by a charity** These are services which are directly connected with:
 - the provision of care, treatment or instruction designed to promote the physical or mental welfare of elderly, sick, distressed or disabled persons. For example, the provision of care in a care home. The exemption includes ancillary accommodation, catering and other services
 - the care or protection of young persons. For example, services provided by a children's home, nursery, playgroup, after school club or fostering service
 - the provision of spiritual welfare by a religious institution as part of a course of instruction or a retreat, but excluding courses or retreats designed primarily to provide recreation or a holiday.
- **Admission charges to a museum, gallery, art exhibition, zoo or to a theatrical, musical or choreographic performance** The body making the admission charges must be a public body or a non-profit making body that is managed and administered on an essentially voluntary basis by persons with no financial interest in its activities and which ring fences any profit from the cultural admissions to the continuance or improvement of the cultural facilities
- **Supplies of services by cost-sharing groups.** Organisations that carry out non-business and/or exempt activities can join together to create an independent entity (a **cost sharing group** or CSG) which provides its members with VAT exempt supplies of services. The services can potentially be of any nature but the exemption excludes supplies of goods
- **Renting out and selling property** is generally exempt, but with many exceptions. Property transactions are considered in the section **Property** below.
- **Supplies in connection with qualifying charity fundraising events** (considered further below).

The above list is not exhaustive, but highlights activities commonly undertaken by charities.

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 purchase VAT is recoverable, but the price to customers is not increased by VAT.

General zero-rated supplies

Some supplies are always zero-rated including:

- **Sales of printed books, booklets, leaflets, brochures, newspapers, journals and periodicals.** With effect from 1 May 2020, the supply of electronic books, booklets, leaflets, brochures, newspapers, journals and periodicals is zero-rated but excluding e-publication that are wholly or predominantly devoted to advertising, or to audio or video content.
- **Children's clothing or footwear.** Very broadly, under 14 year old's sizes are seen as being children's clothing (see the *size charts* in *VAT Notice 714 section 2*).
- **Food and drink** most sales of food and drinks for human consumption are zero-rated, however there are exclusions for certain types of product such as potato crisps, most forms of confectionery, chocolate biscuits, soft and alcoholic drinks and bottled water. The zero-rating also excludes supplies in the course of catering. Supplies in the course of catering include supplies of prepared food or drink for consumption on the premises on which supplied (for example, meals and drinks in a restaurant or café) and supplies of hot food or drinks for consumption anywhere (for example, hot takeaway food or drink).
- **Supplies of passenger transport** in vehicles designed or adapted to carry not less than ten passengers.

Supplies by charities

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

- **Sale of donated goods.** The goods must be donated for sale or hire and 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 UK) of any goods.** The export is treated as a zero-rated supply, even if the goods are given away for free, for example, as aid.

Supplies to charities

Some supplies are zero-rated when supplied to a charity. Here the charity does not have to be registered for VAT to benefit from zero rating, but may be asked or required to give the supplier a certificate confirming eligibility for zero rating. Various goods and services qualify for zero rating, each with specific conditions attached. These include:

- **Advertising services.** The supply to a charity of advertising services in third party media is zero-rated, however this excludes where the recipients of the adverts are selected by or on behalf of the charity. In Revenue & Customs Brief 13/20 HMRC accepted that most forms of web advertising are zero-rated when the recipients are selected on the basis of sharing broad behavioural, demographic or location characteristics. However adverts sent to email addresses, social media accounts and subscription website accounts are excluded as are natural hits – paying to be ranked in a search engine, as this is not seen as advertising
- **Goods for collecting donations.** Zero rating applies to collecting buckets, lapel stickers, pre-printed appeal letters, collecting envelopes and various others, see VAT Notice 701/58 section 5
- **Aids for disabled persons.** These include (subject to conditions and exceptions) medical or surgical appliances, adjustable beds, chair lifts and stair lifts and goods

that are designed solely for use by a disabled person, see VAT Notice 701/7

- **Construction of some types of building.**

The construction of certain types of building is zero-rated, these are: relevant charitable-purpose buildings (RCP), relevant residential-purpose buildings (RRP) and dwellings (see *Property* below).

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 in certain types of residential property such as children's and old people's homes, and 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.

- **The supply and installation of certain energy saving materials in a qualifying building.** Qualifying buildings include dwellings and residential accommodation. 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.

- **Supplies of welfare advice or information**

by a charity or state regulated private welfare institution. The advice or information must directly relate to either:

- the physical or mental welfare of elderly, sick, distressed or disabled persons; or
- the care or protection of children and young persons.

However, advice or information relating to a particular individual is excluded as are

dual-purpose goods (e.g. t-shirts printed with welfare advice messages) and supplies of educational services.

- **Temporary COVID-19 pandemic measures.**

With effect for supplies made from 15 July 2020 to 31 March 2021, the following supplies in the tourism and hospitality sectors are reduced rate:

- Supplies of a right of admission to shows, theatres, circuses, fairs, amusement parks, concerts, museums, zoos, cinemas, and exhibitions and similar cultural events and facilities but excluding VAT-exempt cultural admissions
- Supplies of hotel accommodation and holiday accommodation

Standard-rated supplies

Business supplies that are not exempt and do not qualify for zero or reduced rating are standard-rated. Common standard-rated supplies by charities include:

- management charges from a charity to its trading subsidiary (if not in a VAT group)
- royalties
- fees for consultancy services
- charges for digital services, such as access to databases and digital information, though the supply of certain electronic publications is zero-rated with effect from 1 May 2020 (see *Zero-rated supplies*).

Taxable supplies

Standard-rated, reduced-rate and zero-rated supplies together comprise taxable supplies. If the total (VAT exclusive) turnover from taxable supplies exceeds the VAT registration threshold you must register for VAT.

Recovering VAT

To recover input VAT you must be VAT registered. There are certain VAT refund schemes for particular types of charity including: museums and galleries; listed places of worship; academy and free schools; hospices; and search and rescue charities but these schemes refund irrecoverable VAT and are not VAT recovery in the usual sense.

Where a VAT registered entity has a mix of non-business, exempt and taxable activities it cannot usually recover the VAT incurred in the non-business or exempt activities.

Calculating recoverable VAT

For charities with a mix of taxable, exempt and/or non-business activities, calculating the VAT on purchases that can be recovered is usually 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. In effect the purchase VAT is, if possible, assigned to one of three pots, a **taxable pot**, an **exempt pot** and a **non-business pot**. The VAT on a purchase is directly attributable to a type of activity (or goes into a pot) if the purchase is wholly used or for use wholly in that type of activity. For example, if you hire a piece of equipment solely for use in a VAT-exempt activity, any VAT charged on the equipment hire is directly attributable to the exempt activity and goes into the VAT exempt pot.

Step 2 – apportionment

The VAT on purchases used or to be used across different VAT types of activities is referred to as **residual VAT**. In the pot analogy, any purchase VAT that cannot be directly assigned to one of the three pots

goes into a fourth **residual pot**. Typically, VAT on support and governance costs is residual VAT, for example VAT incurred on overheads and central function or head office costs.

Residual VAT must be apportioned to the different types of activity (taxable, exempt and non-business). In the pot analogy, the VAT in the residual pot must be shared out between the taxable, exempt and non-business pots.

The way in which the VAT in the residual pot is shared out is referred to as **the VAT recovery method**. VAT recovery methods are discussed further below.

Then:

- the VAT in the taxable pot can be claimed in full
- the VAT in the exempt pot is irrecoverable, unless exempt activity is *de-minimis* (see below), in which case it can be claimed in full
- the VAT in the non-business pot is irrecoverable, unless the charity qualifies for one of the special VAT refund schemes (academy and free schools, hospices, search and rescue charities etc.) in which case it may be eligible for refund under the rules of the scheme concerned.

Methods

There are rules as to how the apportionment in Step 2 must be carried out:

- If there are non-business activities, the residual VAT must first be apportioned between business and non-business activities, this is referred to as the **business/non-business apportionment or method**. In the pot analogy, some of the VAT in the residual pot is removed and put into the non-business pot. This

apportionment need only be on a fair and reasonable basis and does not have to be formally agreed with HMRC, though it may be possible to do so.

- If there are VAT exempt activities, the remaining residual VAT must be apportioned between taxable and exempt activities. This is referred to as the **partial exemption apportionment or method**. In the pot analogy, the VAT remaining in the residual pot is shared between the taxable and exempt pots. This apportionment must be undertaken on an income/turnover basis (the **standard partial exemption method**) though it may be possible to use an alternative **partial exemption special method** (PESM), though with effect from 1 April 2005 all new or revised partial exemption special methods have had to be agreed with HMRC in writing.

It is also possible to agree a **combined method** with HMRC, which combines the two apportionments into one.

Under a combined method there is no need to distinguish between VAT exempt and non-business activities. In the pot analogy, there is a need only for three pots, a **taxable pot**, a **non-taxable pot** and a **residual pot**. However under a combined method there is no de-minimis allowance for small scale VAT exempt activities.

Sectorised methods

It may be possible to use several residual pots and apportion each pot using a distinct apportionment method. This is known as a **sectorised method** under which the residual VAT incurred in specific sectors is assigned to its own sector specific residual pot and apportioned under sector specific rules.

The de-minimis test

The VAT in the exempt pot after steps 1 and 2 above is *de-minimis* if one or more of the following three tests is met:

- 1 Total input VAT (VAT in the taxable and exempt pots) is no more than £1,875 in a VAT quarter and VAT exempt income is no more than 50% of all business income.
- 2 Total input VAT (VAT in the taxable and exempt pots after steps 1 and 2) less input VAT directly attributable to taxable activities (VAT in the taxable pot after step 1 only) 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 (VAT in the exempt pot after steps 1 and 2) is no more than £1,875 in a VAT quarter and not more than 50% of total input VAT (VAT in the taxable and exempt pot after steps 1 and 2).

Annual adjustment

For partial exemption purposes, you are required to apportion residual VAT each quarter, then again annually using whole year figures. This is the **annual adjustment**. It allows for changes in activities such as seasonal variations and infrequent payments. 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.

Accounting systems

If you have a mix of taxable, exempt and non-business activities, your accounting systems will have to be able to identify purchases directly attributable to each type and residual purchases. Options include:

- VAT codes Many accounting systems have special VAT codes (also called 'tax codes,' 'T-codes' etc.) for transactions which can be set up to distinguish between the various pots
- VAT control accounts If the accounting systems allow multiple VAT control accounts, separate VAT control accounts could be set up for each pot
- Nominal / departmental / cost centre / purchase ledger allocations Another option might be to link nominal codes, departments, cost centres, suppliers, customers, products etc. to the VAT pots with VAT incurred by that code/ department/ cost centre/supplier/product etc. assigned to the specified pot

Typically at the end of each VAT reporting period (quarterly or monthly) figures for the VAT in each pot are extracted from the accounting system with the method calculations applied to the results using a template spreadsheet. Any irrecoverable VAT is then removed from the VAT control account(s) by a journal entry.

Charity fundraising events

Supplies of all types of goods or services in connection with a qualifying charity fundraising event are VAT exempt, unless also zero-rated (for example the sale of event programmes), in which case zero rating takes priority. Exemption covers supplies at the event, for example admission or catering, and supplies in connection with the event, such as sponsorship of the event and advertising in a programme. HMRC accept that events can include online events.

To be a qualifying fundraising event the event must meet all of the following conditions:

- 1 The event must be organised by a charity, a wholly owned subsidiary of a charity whose profits from the event are payable to a charity, or a combination of these.
- 2 Its primary purpose must be the raising of money.
- 3 It must be promoted as being primarily for the raising of money.
- 4 There must not be more than 15 events of the same kind in the same location in the body's financial year. However kinds of events whose aggregate gross takings at any location do not exceed £1,000 per week can be ignored when assessing the 15 limit. For remote events carried out via a charity's website, HMRC see the location as being the website.
- 5 It must not include provision of:
 - a package of both travel and accommodation; or
 - bought-in accommodation; or
 - more than two nights' accommodation from a charity's own resources.
- 6 VAT exemption must not be likely to create distortions of competition such as to place a commercial enterprise carried on by a taxable person at a disadvantage.

- 7 Problems can arise with events organised by for-profit companies such as the London Marathon. They do not qualify as VAT exempt charity 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 VAT standard-rated. HMRC do, however, accept that where participants pledge to raise a specific amount this is not binding on the participant and so can be treated as a donation, which is outside the scope of VAT (VAT Notice 701/1 section 5.9.3). It may, however, be beneficial to charge participants a small mandatory registration fee in order to make the event a taxable activity for the charity and any VAT incurred in the event recoverable.

Challenge events

Where a fundraising event involves a package of travel and accommodation it may be excluded from the VAT exemption for charity fundraising events by rule 5 above. In such a situation the VAT position then depends on how the event is organised:

- If there are no mandatory payments to be made by participants (deposits, registration fees, mandatory amounts to be raised etc.) then the event is a non-business activity (provision of services for free).
- If the charity (or its trading subsidiary) acts as disclosed agent for a tour operator who organises the event and takes the associated risks and responsibilities, then the charity (or its trading subsidiary) is seen as making a supply of agency services to the tour operator. The fee for

the agency services is the charity's (or trading subsidiary's) margin, which is total mandatory payments required from participants before departure less total fees payable to the tour operator.

- If a charity (or its trading subsidiary) organises the event itself, purchasing travel, accommodation, guides etc. then the *Tour Operator's Margin Scheme* (TOMS) is likely to apply. The charity's (or trading subsidiary's) taxable income is its margin which is (with effect from 1 January 2021) VAT zero-rated if the event takes place outside the UK and VAT standard-rated if the event takes place in the UK.

Membership subscriptions

The VAT status of members' subscriptions can be a problematic area for membership charities. The VAT status of the subscription depends on what, if anything, is provided in return. The package of membership benefits may change over time and even when a charity has an agreement with HMRC on the VAT status of its subscriptions, this can become out of date if the package of member benefits changes.

- Where nothing is supplied in return for the subscription, it is effectively a donation to the charity, and so outside the scope of VAT.
- There is a VAT exemption for the membership subscriptions of certain non-profit public-interest membership bodies such as professional associations, learned societies, trade associations, trade unions and membership bodies of a political, religious, patriotic, philosophical, philanthropic or civic nature. For the subscription to qualify for exemption, the benefits should relate only to the aims of the organisation and be available on payment only of the subscription.
- HMRC extra statutory concession 3.35 ('ESC 3.35') permits all non-profit making membership bodies, where members have constitutional rights and responsibilities, to apportion their subscriptions between the benefits provided. The subscription fee is assumed to include any VAT due on the standard-rated benefits (VAT Notice 48 section 3.35).

HMRC also accepts that a subscription can be treated as outside the scope of VAT provided either:

- all the substantive benefits provided are available to non-members at no charge

- or more cheaply than the subscription. Nominal benefits such as membership badges, flags or stickers, and listing of names in a programme or on a theatre seat or entrance can be ignored, or
- some or all of the substantive benefits are exclusive to members and you are able to demonstrate that the amount paid is higher than the amount that the subscriber would normally have to pay for similar goods or services (VAT Notice 701/5 section 5.3)

Property

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

Qualifying property

Special VAT rules apply to three key types of building:

- 1 Relevant charitable purpose buildings (RCP).** An RCP building (or part of a building) is a building or part that is intended for use solely for a charity's non-business activities or for use as a village hall or similarly in providing social or recreational facilities for a local community. A de-minimis level of up to 5% non-qualifying use can be ignored. Typically village hall type buildings include church halls, community centres, scout and guide huts and other publicly available multi-use premises.
- 2 Relevant residential purpose buildings (RRP).** This means a building or a part of a building that is intended for use solely as a children's home, a care home for persons in need of care, a residential 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 hospitals, prisons, hotels and some hostels for homeless persons are excluded. A de-minimis level of up to 5% non-qualifying use can be ignored.
- 3 Dwellings.** A dwelling is a building or a part of a building that consists of self-

contained living accommodation; there must be no direct internal access to any other dwelling (unless via an emergency-only door); the separate use or disposal of the dwelling must not be prohibited by the terms of any covenant, statutory planning consent or similar; and if any works involved require statutory planning consent, it has been granted and the works have been carried out in accordance with that consent.

Recovering VAT on property transactions

Where a VAT-registered charity incurs VAT on 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:

- wholly for taxable activities, the VAT can be recovered in full
- wholly for VAT exempt or non-business activities, the VAT cannot be recovered (unless exempt input VAT is de-minimis).
- for a mix of taxable, exempt and non-business activities, the VAT must be apportioned and only part can be recovered.

Capital Goods Scheme

Where land is purchased or where a building is purchased, constructed, extended or refurbished and then used for a mix of taxable and exempt or non-business activities, then if the VAT bearing capital cost exceed £250,000, the Capital Goods Scheme must be used to determine how much VAT can be recovered.

The Capital Goods Scheme adjusts the initial VAT recovery on the purchases involved over a total of 10 years depending on the use of the property. For further information see VAT notice 706/2.

Buying, selling and renting property

By default the sale or renting of property is VAT exempt. However, there are many exceptions, including:

Option to tax

A person with an interest in a property can *opt to tax* the property. This means that supplies of that property by that person then become, by default, standard-rated. However, the option to tax can be dis-applied when the property is a dwelling or is to be used for qualifying purposes, which include use as a RRP building or as an RCP building (other than as an office for general administration). Disapplication means the supplier's option to tax has no effect

New buildings

The first 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 RCP or RRP building or dwelling is zero-rated. Before the transaction takes place a purchaser of a RCP or RRP building should give the developer a zero-rating certificate confirming the intended use. The freehold sale of a new or unfinished 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 and is not designed as one or more dwellings.

Special types of property

The renting of hotel accommodation, holiday accommodation, parking facilities and sports facilities are all VAT standard-rated by default though there are exceptions. See also *Reduced rate supplies* above for the temporary COVID-19 pandemic reduced rating relief for the tourism and hospitality sectors.

Goods storage facilities

The renting of property for the storage of goods (e.g. renting of a warehouse) is standard-rated. However, this excludes renting to a charity for its non-business activities and renting to a tenant who sublets the premises to a third party who uses the property for the storage of goods.

Transfer of a business as a going concern

The sale of a building with a sitting tenant may qualify as a *transfer of a business as a going concern* (TOGC) as the sale of a property rental business. This can include where the property is only partially let. If a sale is treated as a TOGC, the sale is treated as outside the scope of VAT.

Constructing, renovating and extending property

Where a charity purchases services from builders, architects, surveyors, project managers etc. in order to construct, renovate or extend property, those services are normally standard-rated and VAT recovery depends on the intended use of the property, as explained above. However, there are a few special VAT reliefs that may apply.

Constructing RCP or RRP buildings or dwellings

If a charity contracts for the construction of a new RCP or RRP building or dwelling, it can zero-rate most of the construction costs. For RCP and RRP buildings 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.

Constructing RCP annexes

If a charity constructs an RCP annexe, it can zero-rate most of the construction costs as

for a new building. To qualify as a zero-rated annexe, it must be intended for use solely for a relevant charitable purpose, it must have minimal physical integration with the existing building(s), it must be capable of functioning independently from the existing building(s), and the existing building(s) and annexe must each have their own main entrance.

Residential conversions

If a registered housing association converts a non-residential building into a residential building (dwellings or an RRP building), it can zero-rate the conversion costs though professional fees, carpets etc. are excluded from zero-rating.

Certain other conversions of non-residential property to residential qualify for reduced rating, these are:

- a changed number of dwellings conversion, where the number of dwellings in a building changes but remains at least one
- a house in multiple occupation conversion, where a building is converted into one or more houses in multiple occupation
- a special residential conversion, where a non-RRP building is converted into an RRP building.

See VAT Notice 708 section 7

Residential renovations and alterations

The renovation or alteration of empty residential property may qualify for reduced-rating. The property must not have been lived in for at least 2 years. This relief potentially applies to empty dwellings and RRP buildings. See VAT Notice 708 section 8

Access works for disabled persons

Charities can zero-rate certain works they carry out to facilitate use of a building by disabled persons (including persons who are

chronically sick). 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 suppliers may request or require a zero-rating declaration to confirm customer 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, 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 and installation.
- 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).

Making tax digital for VAT

With effect from 2019, most VAT registered businesses with taxable turnover in excess of the VAT registration threshold have been required to adhere to *Making Tax Digital for VAT* or *MTD for VAT* regime. They must record all VAT transactions in a prescribed digital format and must use *functional compatible software* to digitally compile and submit the VAT returns to HMRC via a specially designed Applications Programming Interface (API).

HMRC do not provide any functional compatible software so it must be acquired or created. However, HMRC does provide a list of commercial functional compatible software products (see **Further Information** below).

The functional compatible software can be a single product or several linked products that collectively perform the required tasks. The functional compatible software must store the VAT transaction data in a compatible digital format and then, at the end of each VAT reporting period, extract the information required for the UK VAT return from that data and then submit that data to HMRC, via the MTD for VAT API.

Functional compatible software products

In practice most of the standard UK accounting software packages have been made MTD for VAT compatible, though problems may include:

- **Upgrades** you may have to upgrade the accounting system to the latest version and keep it up to date.
- **Legacy or non-UK products** that will not be made MTD for VAT compatible. Options include:
 - switch to a compatible product or

- link the legacy or non-UK product to functional compatible software via *bridging software*.
- **Linked systems** where VAT transaction records are stored across several different products, for example a leisure trust with a main accounts system and a custom bookings system, or a fundraising charity with a main accounts system and a donation management system, the systems must be linked digitally. Options include: importing data into functional compatible software or bridging the specialist products to a main MTD for compatible accounts system. The HMRC list of commercial functional compatible software products includes bridging products.

Soft landing period

Up to the start of the first VAT reporting period beginning on or after 1 April 2021, information can be transferred between platforms manually, however from this point it must be transferred entirely digitally.

Businesses can apply to HMRC for a digital-linking extension if they are having problems with digital linking, though they must apply in advance of the above deadline.

VAT adjustments

It is permissible to carry out VAT adjustments such as business/non-business and partial exemption apportionments, output VAT apportionments, capital goods scheme adjustments and error corrections manually (typically in a spreadsheet) and then to post the resulting VAT adjustment(s) to the functional compatible software as one or more journals or other VAT adjustment. In effect the VAT adjustments become a part of the VAT transaction record stored in the functional compatible software.

Batching

It is also permissible to batch several transactions and record as one in the functional compatible software, including:

- supplies and purchases made via agents
- employee or volunteer's expenses
- invoices on a supplier statement
- petty cash purchases, subject to a per item cap of £50 and per claim cap of £500
- sales and purchases at a volunteer run charity fundraising event

Extension of MTD for VAT

With effect from April 2022 MTD for VAT will be made compulsory for all VAT registered businesses.

The MTD approach to record keeping and reporting will also be extended to some Income Tax reporting requirements with effect from 6 April 2023 and potentially to Corporation Tax from 1 April 2026.

Further information

Other Sayer Vincent Made Simple Guides

- *Charity shops*
- *VAT for hospices*
- *Tax for arts organisations*
- *Tax for charity fundraisers*
- *International aspects of VAT*
- *Collaborative working*
- *Mergers*
- *Subsidiaries*
- *Tax effective giving*
- *Employee and volunteer taxation*
- *Gift Aid*
- *Grants and contracts*

See www.sayervincent.co.uk/resources/made-simple-guides

Key HMRC VAT notices

VAT principles

Introduction to VAT

www.gov.uk/guidance/vat-guide-notice-700

How VAT affects charities

www.gov.uk/guidance/how-vat-affects-charities-notice-7011

VAT recovery

Partial exemption

www.gov.uk/guidance/partial-exemption-vat-notice-706

Capital Goods Scheme

www.gov.uk/guidance/capital-goods-scheme-notice-7062

Zero-rating reliefs

Charity advertising

www.gov.uk/guidance/vat-when-you-supply-services-or-goods-to-charities-notice-70158

VAT reliefs for disabled persons

www.gov.uk/guidance/reliefs-from-vat-for-disabled-and-older-people-notice-7017

VAT exemptions

Care and welfare services

www.gov.uk/guidance/welfare-services-and-goods-notice-7012

Education

www.gov.uk/guidance/vat-on-education-and-vocational-training-notice-70130

Fundraising events

www.gov.uk/government/publications/charity-fundraising-events-exemptions/fundraising-events-exemption-for-charities-and-other-qualifying-bodies

Cultural admissions

www.gov.uk/guidance/admission-charges-to-cultural-events-and-vat-notice-70147

Property

Buildings and construction

www.gov.uk/guidance/buildings-and-construction-vat-notice-708

Land and property

www.gov.uk/guidance/vat-on-land-and-property-notice-742

Membership subscriptions

Clubs and associations

www.gov.uk/guidance/clubs-and-associations-vat-responsibilities-notice-7015

MTD for VAT

MTD for VAT

www.gov.uk/government/publications/vat-notice-70022-making-tax-digital-for-vat

List of MTD for VAT compatible software www.gov.uk/guidance/find-software-thats-compatible-with-making-tax-digital-for-vat

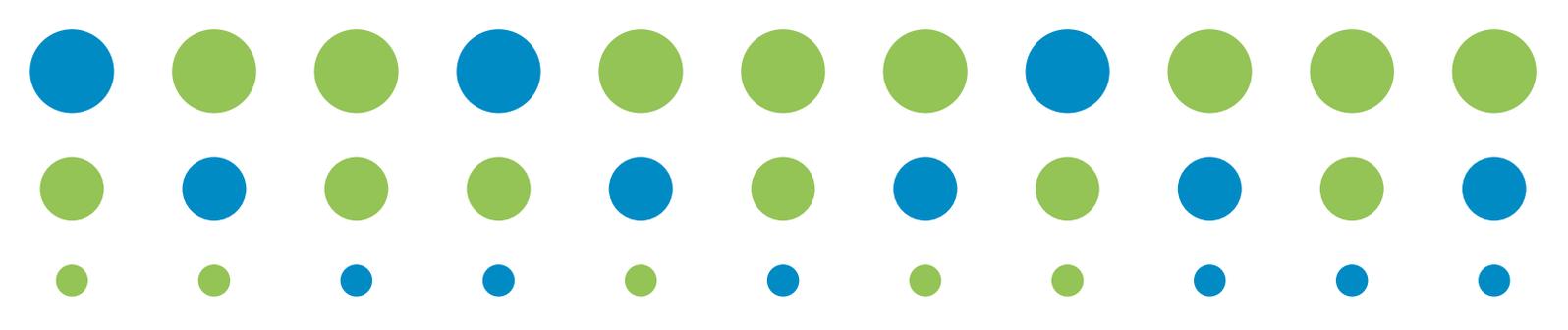
Literature

The Complete Charity VAT Handbook

Alastair Hardman and Kate Sayer

Published by the Directory of Social Change

www.dsc.org.uk/publication/complete-charity-vat-handbook



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.



Made to measure

Sayer Vincent is a firm of chartered accountants working solely with charities and social enterprises. Through tailored audit and advice services, we provide trustees and managers with the assurance that their charity is managing its resources effectively.

As well as being commercial accountants, Sayer Vincent people have an in-depth knowledge of the governance and management of charities and social enterprises. We can advise on a range of business activities to achieve the best financial outcomes, keeping in mind the context of your organisation's objectives.

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For more information, go to www.sayervincent.co.uk



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