



CHARITIES AND VAT GRANT OR CONTRACT FOR SERVICES

Charities rely on funding to carry out their charitable activities. The VAT treatment of funds received by charities depends entirely on the terms under which funding is received. Funds can be received as a grant or as consideration for services.

Grants vs contracts

- A grant received by a charity is no different from any other donation. It is given freely with no strings attached. The donor may impose some conditions in terms of “good housekeeping” as to the way the money is spent but, as long as there is no benefit derived to the donor, the grant is treated as being outside the scope of VAT. The direct result of this is that the charity will not be allowed to recover any Input VAT on any cost incurred in connection with any activities associated with the grant.
- A contract for services on the other hand is a legal agreement to provide goods and/or services for consideration. This is a transaction by way of business and therefore any income derived from services performed in the UK under the contract will be subject to VAT unless they are specifically exempt from VAT.

VAT issues and consequences

The distinction between the two methods of funding is not always clear.

A charity receiving a grant has to make an objective decision as to how it treats this funding. The accounting treatment of funds received and any VAT implications will depend as to whether this is a grant or a contract for services. The charity receiving the funding will need to consider:

- whether it is required by law to register for VAT.
- whether voluntary registration is possible and beneficial.
- how much VAT can be claimed back as Input VAT.

Should HMRC challenge the VAT treatment of monies received they will argue sometimes that the grant is outside the scope of VAT in order to deny the recovery of Input VAT, but at other times they will insist that any services rendered by the charity as a result of the funding are taxable supplies and therefore subject to VAT.

Every contract has to be judged on its own merits. As more and more accountability is demanded from public bodies, agreements for funding are becoming increasingly complex and advice from an appropriate professional is in most cases absolutely necessary.

A wrong decision can have serious consequences for a charity. As things stand at the moment, the VAT treatment of a source of income may be challenged by HMRC on a VAT visit three or four years after the event. Correcting VAT errors can be a costly affair for any business.

HMRC will ask for the VAT due, be it Output VAT not charged on services rendered or Input VAT wrongly claimed on expenses relating to income which is thought to be outside the scope of VAT. In addition to the VAT and interest due there are also heavy penalties on assessment. These vary from 10% of the VAT due for a careless mistake to 100% if HMRC decide that VAT was under-stated or over-claimed as a result of deliberate action or concealment.

Of course, by the time these assessments are raised the money would most likely have been spent and the charity will be faced with financial hardship. This is why it is advisable to have a clause in all agreements of funding stipulating that any fees agreed are exclusive of VAT.

Contrary to popular belief, HMRC are not soft on charities. One is dealing with Civil Servants who are sent out to collect as much tax as possible by applying the rules according to the rule book.

This is the reason why so many cases end up in the courts. Usually it is the charity that takes HMRC to court asking for VAT assessments to be cancelled.

What to watch out for when reviewing a funding agreement:

- Who instigated the arrangement? Did the funder come to the charity asking how much will it cost to carry out certain tasks or did the charity go to the funder asking for help in carrying out its charitable objectives?
- Is the funded activity one that usually the recipients have to pay in order to receive it?
- Is there “consideration” involved in the charity undertaking these tasks?
- Will the charity have carried out these services even without the grant?
- Will the charity perform these services after the funding ceases?
- Was the donor required to perform the tasks that the agreement requires the charity to perform?
- Does the donor receive any benefit from the funding?
- Does a third party benefit from the services provided and is there a direct link between the donor and the person benefiting under the contract?
- What happens to any excess or unused funds?
- Can the donor sue for damages for non-performance?
- Are there any conditions in the agreement that go beyond the “good housekeeping” requirements?
- Are there any terms in the contract that would make a contract for services? Terms such as “performance targets” or “damages for non-performance”?

Landmark cases

There have been some important court cases, which are worth looking at when deciding if any charity funding is subject to VAT.

- The Wolverhampton Citizen's Advice Bureau treated a grant from the Council as subject to VAT and claimed Input VAT against their Output VAT. They based that on the fact that the Council specified the hours they had to open to the public and the level of services to be provided. The Tribunal decided that this was not a contract for services because the Council did not derive any benefit from it. As for the conditions imposed by the Council these were held to be purely "good housekeeping".
- The Bowthorpe Community Trust is another similar case where the Council was funding work experience for handicapped and disabled students. Although the Council was receiving priority for cases referred to the Charity by the social services, it was held that the Council derived no benefit, and therefore the Trust could not claim Input VAT.
- The Hillingdon Legal Resort Centre received a grant from the local authority to run a citizens' advice centre. It was a condition of the grant that detailed reports and formal accounts be submitted to the council. The Tribunal ruled that this was a grant and the conditions involved were good housekeeping and did not change the grant into a contract for services especially since the council did not derive any benefit.
- The Bath Festival Trust was another case in which the Charity received grants from the Council to organise music festivals previously arranged by the Council. The Tribunal held that these were taxable supplies and that the Charity correctly treated them as standard-rated supply of services and therefore reclaimed input tax on its related expenses. HMRC were arguing that because the Charity's predecessor (the Bath Festival Society) was receiving funds from the Council to promote music festivals, which were treated as grants, the funding of the new Trust must also be treated as a grant not subject to VAT.
- Exactly the same result was achieved in the Woking Museum case where the Tribunal held that the Charity was taking over an important part of the Council's strategy relating to cultural matters.

The issues raised in these notes are complex and open to interpretation. Whilst every care has been taken in the preparation of these notes, no liability can be accepted by Chariot House Limited, its partners and staff for reliance on them for acting or refraining from acting. Always seek professional advice. E&O. E.