

VAT & Charities

Update

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- Grants versus contracts
- The 'business' question (again)
- When can agreements reached with HMRC be relied upon?
- VAT accounting errors – penalties
- Making Tax Digital



Grant Funding or a contract to supply services?

- HMRC updated guidance in 2018.
- Key points – each agreement judged on own merits.
- For a transaction to be within the scope of VAT the following tests must be met:
 - There must be a supply of goods or services made in the course or furtherance of a business activity.
 - Income received must be 'consideration'.
 - Direct link between supply and payment.



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What is a grant?

- Generally accepted that funding freely given which is not paid in return for a supply of goods or services is not a supply for VAT purposes and is outside the scope of VAT.



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Indication of grant funding

- Was the funding secured following a grant application submission to a common funding organisation i.e. local authority, local/central government?.
- The recipient of the funding pursues its charitable aims and objectives.
- The funder has no expectation of a direct benefit arising.
- Good housekeeping conditions (funder does not dictate how funds spent except in that spent as intended).
- Accounting treatment – grant funding not treated as trading income in charity's accounts or trading expenditure in funders accounts.
- If funding withdrawn charity has no contractual or legal redress to have re-instated.
- 'Clawback' funder can reclaim sums not spent or if terms of funding agreement not complied with.



Indicators payment is consideration for a supply

- Did recipient of funding submit competitive tender?
- Is the funder seeking to engage a supplier to supply goods or services to it?
- Is the funder receiving goods/services in return for its payment?
- Is the funder the direct beneficiary of any supplies of goods/services?
- Funder outsources services, recipient is sub-contractor
i.e. local authority with statutory duties/obligations.



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Indicators payment is consideration for a supply (*continued*)

- Legally binding contract which is commercial in nature i.e. penalty clauses if targets not met.
- Supplies are an economic activity i.e. charity may not have profit motive but supplies made should have the potential to make a profit.
- Arms length relationship.
- There is a direct link between supplies made and income received, including third party consideration.
- Measurement i.e. service deliveries, invoices, payment made.



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Indicators payment is consideration for a supply (*continued*)

- Quality control/monitoring/targets – more than ‘good housekeeping’ ensuring supplies desired are made.
- If the supplier is not paid it has legal redress.
- Income received treated as trading income in suppliers accounts and as trading expenditure in funder accounts.



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Important cases

Year	Taxpayer	Outcome
1990	Hillingdon Legal Resource Centre	HMRC win - Grant
1996	Wolverhampton Citizen's Advice-Bureau	HMRC win - Grant
1994	Trustees of the Bowthorpe Community Trust	HMRC win - Grant
2000	Keeping Newcastle Warm	HMRC win -Consideration
2003	Edinburgh Leisure and others	HMRC loss Consideration
2006	University of Southampton	HMRC win - Grant
2007	Bath Festivals Trust	HMRC loss - Consideration
2012	Groundwork Cheshire	HMRC loss - Consideration
2012	Hope in the Community	HMRC win - Consideration
2014	South African Tourist Board	HMRC win - Grant



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The 'business' question, what is an economic activity?

- Zero-rating the construction of new charitable buildings
- Recovering VAT incurred on construction services

Key questions on business/economic activity point

- Is there a credible relationship between the level of fees/charges and the value of goods/services supplied?
- Is there a legal (contractual) and economic link between the consideration paid and the goods or services supplied?
- Does the transaction have the economic risk characteristic usually associated with a commercial business activity?
- Does the contractual position accurately reflect the economic and commercial reality of the transaction?
- The receipt of a payment by a charity does not in itself mean that a particular activity is economic in its nature.

Glasgow School of Art (First Tier Tax Tribunal)

- The charity incurred VAT on building works to Assembly Building.
- It claimed VAT of £470k on a VAT repayment return and submission of error correction notice to HMRC.
- HMRC refused to make the VAT repayment claim on the basis leasing the Assembly Building to the Student Union (SU) was not an 'economic activity'.



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Glasgow School of Art (First Tier Tax Tribunal)

- HMRC cited the following points:
 - SU paid rent of £5k per annum (+ VAT)
 - Rental equated to £0.45 per square foot. Market rates per square foot at the time were £12-£15 (office) and £7-£8 (bar restaurant) on average.
 - It would take the charity over 500 years to recover the cost of the works at the rental charged.
- The FTT found in HMRC's favour,
“Looking at the totality of the evidence, objectively considered, we find that the appellant was not engaged in an economic activity of letting when leasing the Assembly Building to the SU”.
- **HMRC win**



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Wakefield College (Court of Appeal)

- The charity appealed the Upper Tribunal decision that construction services supplied to it in the course of constructing a new building were not zero-rated.
- The issue in this case was whether subsidised fees charged to students prevents the zero-rate from applying because the subsidised income represents a business activity.

Wakefield College (Court of Appeal)

The Court of Appeal found that the supply of courses by Wakefield College to students paying subsidised fees is a business activity. The Court of Appeal provided the following reasons for its decision:

- The sole activity of the College is the provision of educational course, this is not an ancillary activity.
- The provision of courses to students paying subsidised fees is significant.
- The fees paid by subsidised students is significant in amount.
- The subsidised fees made a significant contribution to the cost of providing courses.
- The level of course fees was fixed by reference to the cost of the courses.
- The fees were not fixed by reference to the means of the student.



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Longridge on Thames (Court of Appeal)

The charity sought to obtain zero-rating on the construction of a new building. It argued that its predominant aim was not to make business supplies because:

- of its reliance on volunteers; and
- its primary (charitable) objective is to enhance children's skills around water-based sports and develop life skills.

Longridge on Thames (Court of Appeal)

HMRC refused zero-rating on the following grounds:

- £700k per annum generated from charges
- £50k per annum shop sales
- 100,000 people per year use the facility

The Court of Appeal found in HMRC's favour, overturning earlier FTT and UT decisions in favour of the charity.



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Key Point

VAT incurred by Wakefield College and Longridge on Thames is irrecoverable and 'sticking tax'. The college makes VAT exempt supplies of education and Longridge on Thames VAT exempt supplies of sporting services and, possibly, education.



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Wakefield College and Longridge on Thames (Court of Appeal)

Key point here is that VAT incurred by Wakefield College and Longridge on Thames is irrecoverable and 'sticking tax'.

Wakefield College makes VAT exempt supplies of education and Longridge on Thames makes VAT exempt supplies of sporting services and, possibly, education.



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When can agreements reached with HMRC be relied on?

The recent FTT decision in *The Serpentine Trust Ltd* (Serpentine) concerned an agreement reached between the charity and HMRC using the Alternative Dispute Resolution (ADR) process.

- Serpentine operates various supporter schemes.
- Supporter payments were treated as a donation by the charity.
- HMRC challenged this treatment.
- In 2014 the FTT found that sums received were taxable (standard rated).



When can agreements reached with HMRC be relied on?

- Charity agreed prior to FTT hearing (in April 2013) an apportionment with HMRC: Example, “I hereby agree to donate £500 to the Serpentine Trust,
 - Donation: £470
 - Benefit (including VAT) £30
 - Total £500
- Tribunal chairman in 2014 commented that the agreement reached in 2013 between HMRC and the charity was ‘wrong in law’ and ‘inconsistent with HMRC’s published position’.
- HMRC revisited the 2013 agreement and raised retrospective VAT assessments.
- HMRC also contacted other organisations it had similar apportionment agreements with.



When can agreements reached with HMRC be relied on?

The Tribunal in 2018 considered the following points:

- Does the Tribunal have the jurisdiction to rule on the issues in dispute?
- Does reference to the 'schemes' included in documents exchanged between the parties during the ADR process have the meaning relied on by Serpentine or HMRC?
- Had Serpentine and HMRC concluded a contract?
- If there was a contract, had HMRC misunderstood this?
- If there was no unilateral mistake on HMRC's part, did HMRC have the power to reach such an agreement or had HMRC acted beyond its legal powers (*ultra vires*)?



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When can agreements reached with HMRC be relied on?

- The Tribunal judge set aside HMRC's witness' oral evidence as 'unreliable'.
- FTT found that HMRC had agreed a contract but was *ultra vires* and beyond HMRC's powers, so void. HMRC's VAT assessments stood.
- Recommend that charities make use of HMRC's VAT Charities Team non-statutory clearance facility.



Penalties

Mistakes made despite taking 'reasonable care':

No penalty is due

Careless mistakes:

A penalty of 30% of the potential lost revenue may be due

Deliberate (but not concealed) inaccuracy:

The penalty percentage may be 70%

Deliberate and concealed inaccuracy:

The penalty percentage may be 100%



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Penalties

Reminder – HMRC can (and increasingly do) charge a penalty of 30% of the VAT involved for a ‘careless’ error on a VAT return or other documents i.e. error correction notices.

Example of a case Constable VAT dealt with:

- Two fully taxable businesses.
- Both businesses submit calendar quarterly VAT returns.
- On 31/03/2016 A charges B £150k + £30k VAT and raises a VAT invoice on that date.



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Penalties

- A accounts for output VAT on 03/16 VAT return.
- B reclaims input VAT on 06/16 VAT return as B had misplaced the VAT invoice and requested a duplicate from A.
- B has VAT inspection in Spring 2017 from HMRC.
- HMRC officer raises VAT assessment in respect of VAT accounting period 06/16 because input VAT claim overstated by £30k.



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Penalties - example

- HMRC officer instructs B to submit error correction notice to correct the position i.e. £30k proper to 03/16 VAT period.
- HMRC imposes 30% penalty for 'careless' error on input VAT reclaimed late (£9k penalty).
- Constable VAT managed to get the penalty withdrawn but at a cost to the client.



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Making Tax Digital

- With effect from 1 April 2019 all VAT returns starting on or after this date must be submitted to HMRC digitally by using an Application Programming Interface (API).
- Deferred by HMRC (on 18 October 2018) to 1 October 2019 for the following complex business and organizing:
 - Trusts
 - Not for profit organisations that are not set up as a company
 - VAT divisions
 - VAT groups
 - Governments departments/NHS Trusts
 - Local Authorities
 - Public Corporations
 - Traders based overseas
 - Payment on Accounts
 - Annual Accounting Scheme



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Making Tax Digital

- With effect from 1 April 2020 all businesses must digitally retain VAT accounting records. VAT law already requires that businesses keep and maintain certain records.



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