



Charities and VAT

Introduction

Although charities do benefit from certain exemptions under the VAT legislation, there is no general VAT free status afforded to charities. As a result, charities need to be very careful that they comply with VAT regulations and account for VAT correctly.



Should my charity be VAT registered?

If a charity is running a business activity, then the normal rules for registration that apply to any business in the UK will apply. Once income from business activities reaches the VAT registration limit (currently £70,000 in any rolling twelve month

period), then the charity must register for VAT. Late registration will result in penalties and, potentially, loss of VAT recoverable.

In assessing the VAT registration limit, any non business income, such as freely given donations, can be ignored.

Understand the VAT status of your charity's income

After identifying the charity's non business income which is outside the scope of VAT, it is then important to fully understand the VAT status of the remaining income for two reasons:-

- To ensure the correct level of VAT charged, if any, is being levied on sales/income earned.
- To determine what VAT, on costs relating to earning the income, can be reclaimed.

Business income can fall into any of the following categories for a charity which is VAT registered:

- Standard rated – income on which 17.5% VAT needs to be charged and accounted for to HM Revenue and Customs.
- Reduced rate – in very specialist areas a 5% VAT charge could apply, but this is very unusual for charities.
- Zero rate – income on which no VAT is charged, but any input VAT incurred directly relating to this income can be recovered.
- Exempt – again no VAT is charged, but no VAT can be recovered on costs relating to earning this income.

Understand the VAT status of your charity's income

For VAT registered charities, the calculation of what input VAT can be reclaimed is often the most difficult area of VAT accounting. The basic rules are as follows:-

- Costs directly relating to earning, standard rate, reduced rate or zero rated income – input VAT charged thereon is fully reclaimable.
- Costs relating to earning exempt or outside the scope income – no reclaim is available on input VAT incurred on these costs.

Many costs, however, do not fall neatly into one category or another. Typically overhead costs of operating a charity, many of which carry an input VAT additional charge, are general costs which are not specific to any income area. It is here that the partial exemption rules come into play - where a charity can reclaim a proportion of input VAT on the "pot" of non specific VAT. Normally the proportion reclaimable is calculated on a standard basis approach, whereby the reclaim is apportioned based on income earned e.g. if 50% of the charity's income is exempt or outside the scope and 50% is standard or zero rated, then 50% of the input VAT on general overhead costs can be reclaimed.

The partial exemption rules are complex and often improved recovery can be achieved by one of the following:-



- Use of the de minimis rule which can, particularly for small enterprises, add to the amount recoverable.
- Use of a non standard method agreed with HM Revenue and Customs which is more appropriate for the particular charity concerned.

These areas are worth professional review if a charity's level of non recovery is substantial.

The partial exemption rules and calculations need to be applied to each VAT return period, whether that is monthly or quarterly. Remember too, that annually a full review is required for the VAT period ending either 31st March, 30th April or 31st May and an annual adjustment is required to the amount recovered.

Property

- Many charities rent offices or other commercial premises. For an enterprise that is partially exempt and cannot recover all of its input VAT, the question of whether the property rented is opted for tax (and therefore the landlord charges input VAT on the rent and other charges relating to the property) or non opted (VAT free) is a significant one. There can be a major cost saving in finding the right commercial property which is not subject to the option to tax. Also, if you find one, make sure your lease does not permit your landlord to change his mind about option in the future and then charge you VAT on top of the rent and charges.
- In certain circumstances charities can acquire new commercial buildings on a zero rated basis because of the nature of the usage of the property, rather than being charged standard rated VAT on the building price. There are two situations where zero rating can apply:-

1. Where the building is to be used for a relevant residential purpose - examples include:

- A home or other institution providing residential accommodation for children, the elderly, the disabled etc.
- A hospice.
- Residential accommodation for students or school pupils.
- An institution which is the sole or main residence for at least 90% of its residents.



2. A building used for a relevant charitable purpose. This would cover buildings used for either or both of the following:-

- A building used by a charity for a purely non business purpose.
- A village hall or similar in providing social or recreational facilities for a local community.

Conclusion



VAT for charities is a complex area and it is vital that charities understand their VAT status and make the best possible use of the exemptions available.

If you have doubts about your charity's VAT accounting, a review by Monahans may be the answer.

For further advice and assistance

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