

VAT opportunities and obligations for charities and not for profit organisations

There have been a number of changes in VAT law over the past few months, in particular the important changes which took effect from 1st January 2010, and several important VAT cases have also called into question HM Revenue & Customs' (HMRC) traditional treatment of certain items.

This leaflet deals with some of the key opportunities and reminds you of new reporting obligations. In some cases, HMRC has yet to issue revised guidance but you should consider whether you wish to make a claim and, if so, when. If you have the opportunity to make a claim the sooner you do it, the greater the amount you are likely to recover. So act quickly and seek help where necessary.

Opportunities

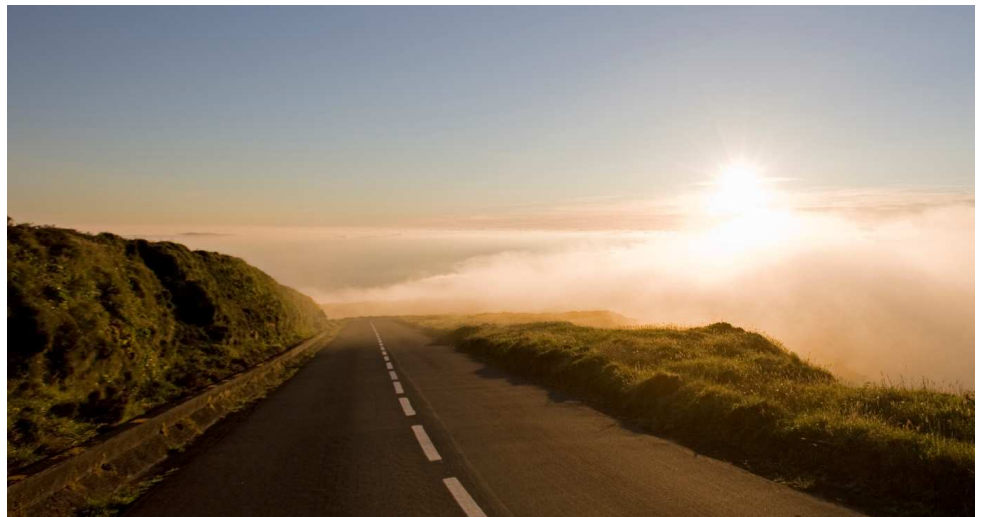
- Pay-per-click advertisements
- Business/non-business supplies
- Shared services exemption
- Increase in VAT rate
- VAT recovery on postal charges
- Listed places of worship grant scheme

Obligations

- The "VAT Package"
- Filing EU sales lists
- Withdrawal of charity buildings concession

Pay-per-click charity advertisements

PPC is used by organisations on search engines such as Google to encourage searchers to click on the organisation's link in priority to any other links on the results page following a search.



The organisation pays the search engine provider an agreed amount each time their website is accessed through the sponsored link.

Supplies of advertisements for charities together with their design and production costs, are generally zero rated for VAT.

Until now HMRC has taken the view that a PPC-sponsored link placed on a third party's website is not an advertisement itself but simply a means of access to the charity's website. Following representations from charities that zero-rating should apply to PPC charity advertisements, HMRC has reviewed its approach and concluded that PPC-sponsored links appearing on search engine websites are advertisements for the purpose of Item 8 and 8A, and qualify for zero-rating when supplied to a charity. It follows that the supply of copyright and design services associated with such sponsored links fall within the zero-rating.

However, HMRC still maintains that services supplied by copywriters and designers for the purpose of search engine optimisation do not qualify for relief as these services entail the optimisation of the charity's own website, and so are specifically excluded from the zero rating provisions.

Making claims or adjustments

Businesses that have accounted for and paid VAT on supplies of charity advertisements that are now considered to be zero-rated may submit claims for overpaid tax. These will be subject to a transitional four year limitation period and 'unjust enrichment' provisions. Guidance on how to make claims is available on HMRC website in VAT Notice 700/45 'How to correct VAT errors or make adjustments or claims'. You can find further detailed guidance on charity advertising on HMRC website in VAT Notice 701/58 'Charity advertising and goods connected with collecting donations'.

Business/non-business supplies

A recent Tribunal case looked at whether supplies which were for no consideration could be treated as business activities. A professional body provided free membership to students prior to qualification as an incentive to encourage them to remain members after qualification.

HMRC believed that where a subscription membership was offered to members for no consideration it should be treated as outside the course of its business activities which would therefore result in restriction of input tax. However, the taxpayer argued that the free membership offered to students was effectively a promotional incentive that fell wholly within their normal business activities.

The Tribunal concluded that there was no business/non-business apportionment required with the result that the whole of the appellant's input tax should be recovered. They also concluded that there was no provision or case law authority that actually deems the provision of services for no consideration to be a non-business activity.

Shared services exemption

Many charities and similar organisations whose principal activities are exempt from or outside the scope of VAT suffer significant amounts of irrecoverable VAT on the cost of buying in outsourced services from commercial providers.

European VAT legislation provides an exemption for certain services provided within cost sharing groups whose members carry out exempt or non-business activities. This kind of cost-sharing between charities would give efficiencies and economies of scale in pursuing common charitable objectives in the field concerned, which is very much in line with Government policy. However, such arrangements are not common in practice, partly because of the additional VAT cost of buying in the services compared to providing them "in house".

Although the relevant article in the European VAT Directive is a mandatory provision which most of the 27 Member States have adopted, it has not been implemented in UK VAT law. As a mandatory exemption, HMRC would have to allow its application by a taxpayer able to demonstrate that its conditions had been met under the Community law principle of direct effect. So far, they say, no such case has been presented to them.

However, it was announced in the emergency budget on 22 June 2010 that HMRC would open a consultation on the shared services exemption. No date has yet been announced but we will provide further information as soon as this is available.

If you are involved in shared services agreements or believe these might be beneficial for your charity, we would encourage you to respond to the consultation when it is published.

Increase in VAT rate

It seems counter-intuitive to include this in the section headed "opportunities", but we felt it was appropriate to mention a few items which may help to mitigate the impact of the increase in VAT to 20% with effect from 4 January 2011:

- Bring forward major expenditure if your cash flow allows this.
- Ask suppliers to invoice before 31 December 2010 in respect of goods and services supplied before that date. (NB. Beware the anti-forestalling legislation which prevents goods and services supplied after 4 January 2011 from being charged at the current rate).
- Consider the impact of existing grants/contract income receivable which may cover periods after the rate change.

Ensure your systems are geared up to account for output tax at the correct rate from 4 January 2011.

VAT recovery on postal charges

In the UK, supplies by the post office have been treated as VAT exempt, which means there is no VAT to recover on postal costs as none is charged. A recent EU VAT case involved TNT UK and took the view that the VAT exemptions given to Royal Mail provide it with an unfair competitive advantage.

TNT UK lost its case but the ECJ took the opportunity to clarify the extent of Royal Mail's exemption. The court confirmed that the VAT exemption is restricted to the national operator providing universal postal services at standard charges. However, where prices are individually negotiated, postal and delivery services are subject to VAT.

Most businesses have a postal tariff rate that is a penny or two less than the national rate. In many people's view this means it qualifies as individually negotiated and should therefore be standard rated for VAT rather than exempt.

It remains to be seen whether HMRC's view of the scope of the exemption is fully in line with that of the EU, but HMRC appears to be willing to consider retrospective claims.

What action should you take?

Charities that are VAT registered may be able to reclaim VAT on individually negotiated postal contracts as these will now be deemed to include VAT at the standard rate. The amount you can claim will depend on your charity's normal partial exemption and business/non-business recovery position.

There is a rolling four-year cap on claims. This means that you should consider submitting claims as soon as possible. Evidence of what you spent and that your rates were less than the national rate for a stamp should enable you to consider a claim.

Listed places of worship grant scheme

Charities that own and/or manage listed places of worship have benefited from a grant scheme that refunds the VAT on repairs to the fabric of their buildings. This scheme was due to end in March 2011 but we have just learned that as a result of extensive lobbying prior to the comprehensive spending review, it has been extended for a further four years. The scope of eligible expenditure has however been reduced to exclude professional fees and repairs to organs, bells, pews and similar fixtures with effect from January 2011. Any expenditure incurred before this date on such items must be claimed by the end of December 2010 to be eligible for a VAT grant. The scheme will operate with a fixed annual budget of £12 million and it is likely therefore that claims will come under greater scrutiny than before.

The “VAT package”

Virtually all organisations that purchase or provide intra-EU services have been affected by the biggest change to the VAT system since the early 1990s. This has been termed the VAT package. Compliance obligations are radically different, requiring changes in the way businesses account for VAT on certain sales and purchases, combined with new EU sales list (ESL) reporting requirements.

Here is a reminder of the new basic rule for services applicable from 1 January 2010:

- The supply of services by a relevant business person within the EU is now deemed to take place where the customer belongs rather than where the supplier belongs.
- Services supplied to business customers in other EU countries will therefore normally be zero rated provided you obtain the customer's VAT registration number and state it on your invoices to them.
- Most services received from suppliers in other EU countries are now subject to the reverse charge. Therefore output VAT needs to be accounted for in the UK by the recipients of such services, and input VAT will be recoverable depending on your normal partial exemption or business/non-business recovery rates.

The definition of “relevant business person” is broad and extends to organisations that are not necessarily in business but are registered for VAT, such as certain services provided to or by charities. However the provisions are complex and you should obtain specialist advice where necessary.

Filing EU sales lists

Part of the VAT package is the requirement to submit EU sales (ESLs) in respect of services supplied to customers and clients in other EU states. The requirement already covered goods but it now covers goods and services. Many organisations are now submitting ESLs for the first time.

This is a statistical document on which you must show all the supplies made to each of your EU customers. It also provides a way for the customer's tax authorities to check that the VAT due on the reverse-charged service has been accounted for. EU sales lists can be downloaded from HMRC's website or can be completed online.

- ESLs for services normally cover calendar quarters, so some businesses may prefer to request that their quarterly VAT returns are aligned with their calendar ESL quarters.
- You have 14 days to submit paper ESLs and 21 days for those submitted electronically.
- You will need all your customers' EU VAT numbers in order to complete an ESL, so it is advisable that you request EU VAT numbers from all your EU customers as soon as possible. HMRC's website contains information on checking their validity.

Withdrawal of charity buildings concession

The charitable building Concession was withdrawn on 1 July 2010. Under this Concession, HMRC had permitted zero-rating where a building was used 90% or more for a relevant charitable use.

HMRC has now accepted that the term 'solely', as used in the phrase 'solely for a relevant residential or relevant charitable purpose', can incorporate an appropriate de minimis margin and that this statutory condition is only satisfied if the relevant use of the building by the charity is 95% or more. In the light of this change of view, the Concession is no longer considered to be necessary and has therefore been withdrawn, as charities can now rely on the revised interpretation of the statutory provision. Any charity wishing to make use of the Concession must have issued the necessary certificate before 1 July 2010; and by 1 January 2011, either the building must have been constructed to a point above foundation level or the charity must be in occupation of the building, if it is being acquired or leased.

HMRC have confirmed that any method can be used to measure qualifying use of a charitable or residential use building, provided that it is fair. They have produced a new guidance setting out some methodologies for calculating qualifying use.

The demise of Lennartz

Historically VAT registered charities have been able to claim input VAT in full on the acquisition of certain new assets and account for output VAT on the non-business use of those assets over a ten year period.

HMRC announced a change of policy from 22 January 2010 advising that this method will no longer apply to assets used for a mixture of business and non-business purposes. This followed an ECJ case which held that Lennartz can only apply to assets used for private purposes or exceptionally for other uses which are wholly outside the taxpayer's normal activities.

Therefore, charities which applied Lennartz to assets used as part of their normal day-to-day activities, which are correctly defined as non-business for VAT purposes, were not entitled to do so. HMRC will allow existing Lennartz adjustments to run their course or charities can unravel the Lennartz arrangements and make a one-off adjustment for input tax and output tax as necessary. It may be beneficial to do this in view of the prospective increase in VAT to 20% which will mean that a greater amount of output VAT will be paid compared with the original input tax claimed, particularly if any of this was at the temporary lower rate of 15%.

Charities with a binding commitment to, for example, a building project on the understanding that Lennartz would be available, will need to contact HMRC to discuss their options.

How we can help

Our VAT team provides a comprehensive service advising on all aspects of VAT, whether compliance or advisory in nature. We review your organisation and identify potential opportunities, and can review structures or recommendations from other advisers to give you comfort. To discuss anything contained in this leaflet or other possible claims or advice, contact:

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