

# YOUTH INVESTMENT FUND

An overview of VAT for charity and community capital projects

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# Webinar Agenda

- Basic principles
- Case Study – Midminster Youth CIO
- Construction
- The Business model
- Topics for future webinars or small groups
- Questions



## Poll 1 - Knowledge of VAT

- Significant VAT knowledge including in the sector
- Good general VAT knowledge but less so in community sector / capital projects
- Limited VAT knowledge or mainly in the business sector
- Little or no VAT knowledge in the charity /not for profit sector
- Little or no VAT knowledge at all



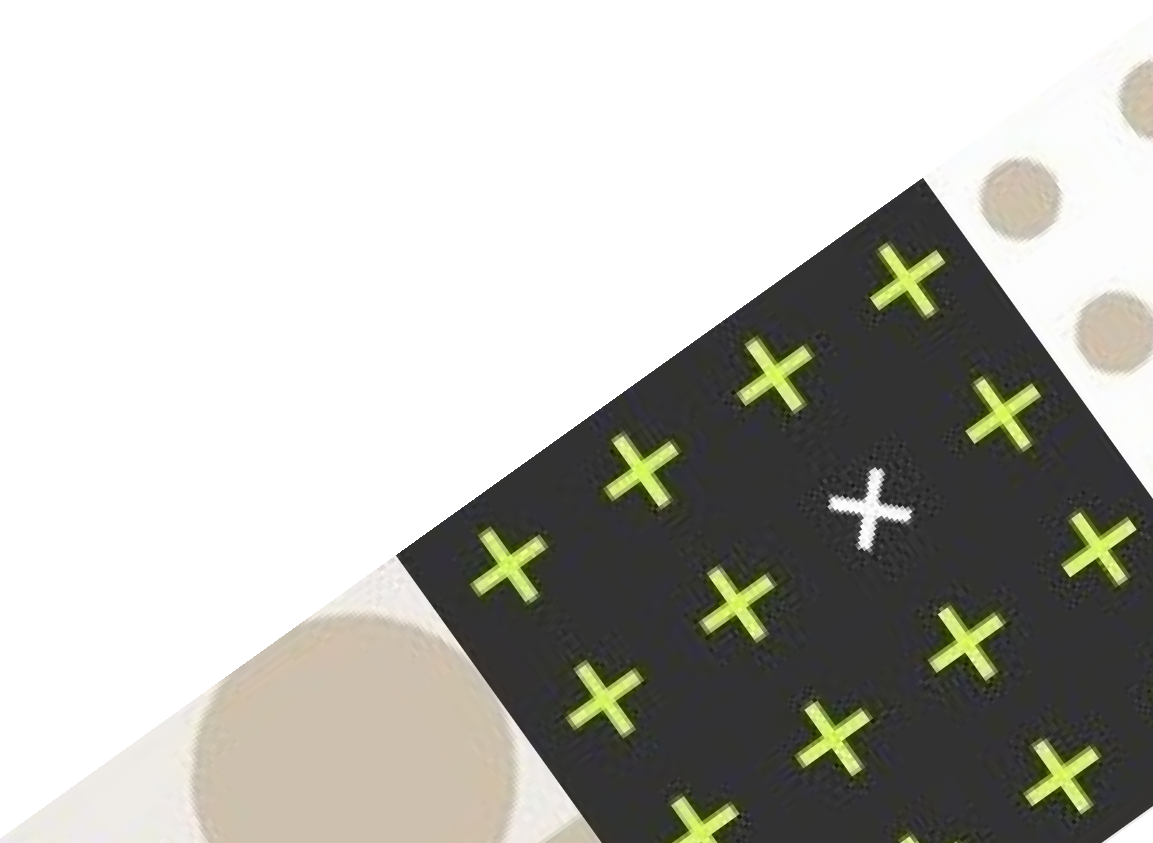
# VAT - Basic Example

**VAT is a tax on consumers**

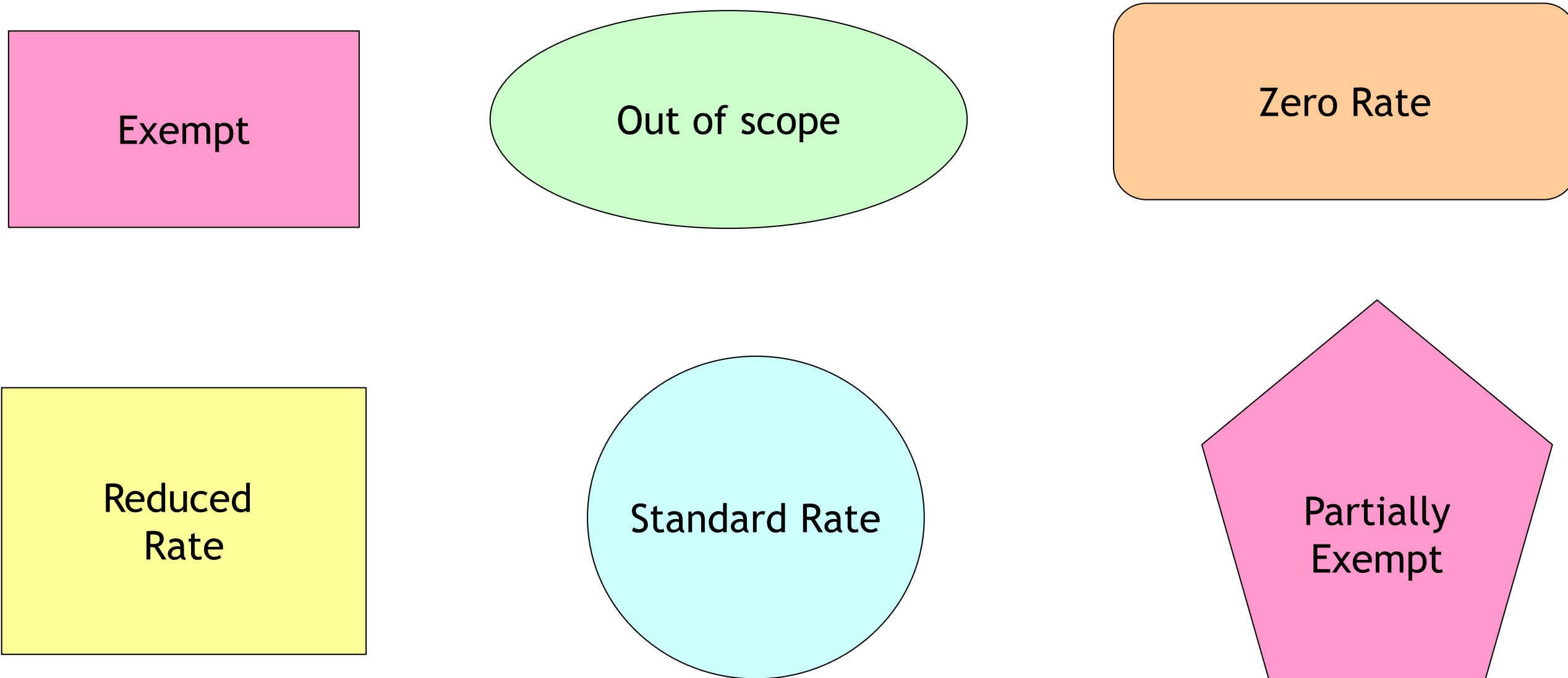
## **Example**

- A business purchases stock for £10,000 plus VAT of £2,000 (20%)
- It sells the items for £18,000 plus VAT of £3,600 (20%)
- It has collected £3,600 in VAT but paid out £2,000 in VAT
- The difference of £1,600 is then payable to HMRC

**However VAT is often not as simple as that, especially for the community and charity sector**



# How Does VAT Apply?



# How Does VAT Apply?



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# Organisational Activities

## Business

## Non-business (out of scope)

### Vatable (Threshold £85k)

### Exempt

- Grant funded projects and activities
- Donations

Zero rate 0%	Reduced Rate 5%	Standard rate 20%
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- take away food (cold)
- publications
- public transport

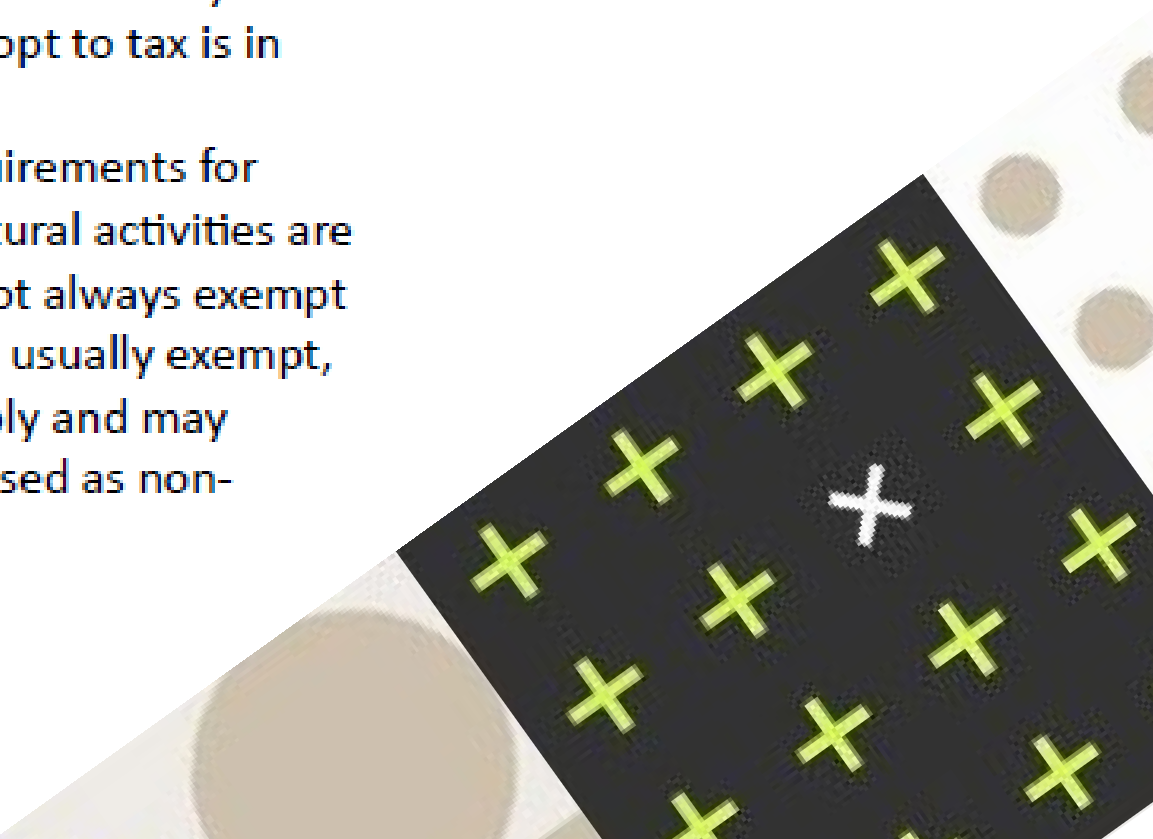
- Domestic energy and for some charities
- Energy efficiency

- Café sales
- Service contracts
- Consultancy
- Car parking charges

- Office rent and room hire (unless opt to tax)
- Welfare contracts
- Education by an eligible body
- Cultural exemption by an eligible body

**Notes**  
-Rent and room hire normally exempt unless an opt to tax is in place  
-Eligible body requirements for education and cultural activities are complex so may not always exempt  
-Welfare contracts usually exempt, but conditions apply and may sometimes be classed as non-business

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## Poll 2 - Type of YIF project

- Element of new build
- Mainly a refurbishment
- Revenue only project





# Webinar Case Study

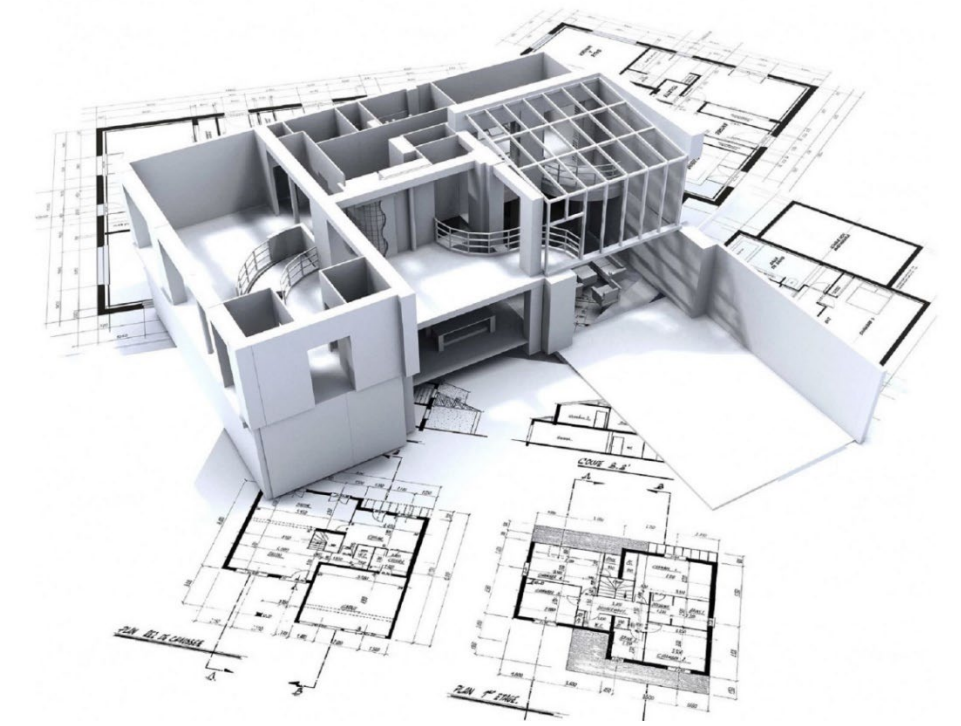
- Midminster Youth was established in 2013 and is a charity (CIO).
- Its regular annual income is £100,000 and has recently been awarded a grant of £1.1m to build a new extension to the small youth community centre. The project has been costed at £1m plus VAT of £200k
- The charity has a 35-year peppercorn lease with the council who support the project and for which planning consent has been received.



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# Webinar Case Study

- At a recent meeting of trustees, the treasurer (who runs her own business) suggested that the charity should register for VAT and then it would be able to claim back the £200k of VAT
- Another trustee said that as a charity, they had heard that the building costs could be zero rated, so no VAT would be incurred in the first place
- It was agreed that these should be investigated further as it could save a lot of money and avoid a potential funding gap, as the grant was only for £1.1m



# Case Study

## Midminster Youth CIO – Capital Cost

		£
Construction costs		840,000
Fees		<u>160,000</u>
Net		1,000,000
VAT	20%	<u>200,000</u>
Total		<u><u>1,200,000</u></u>

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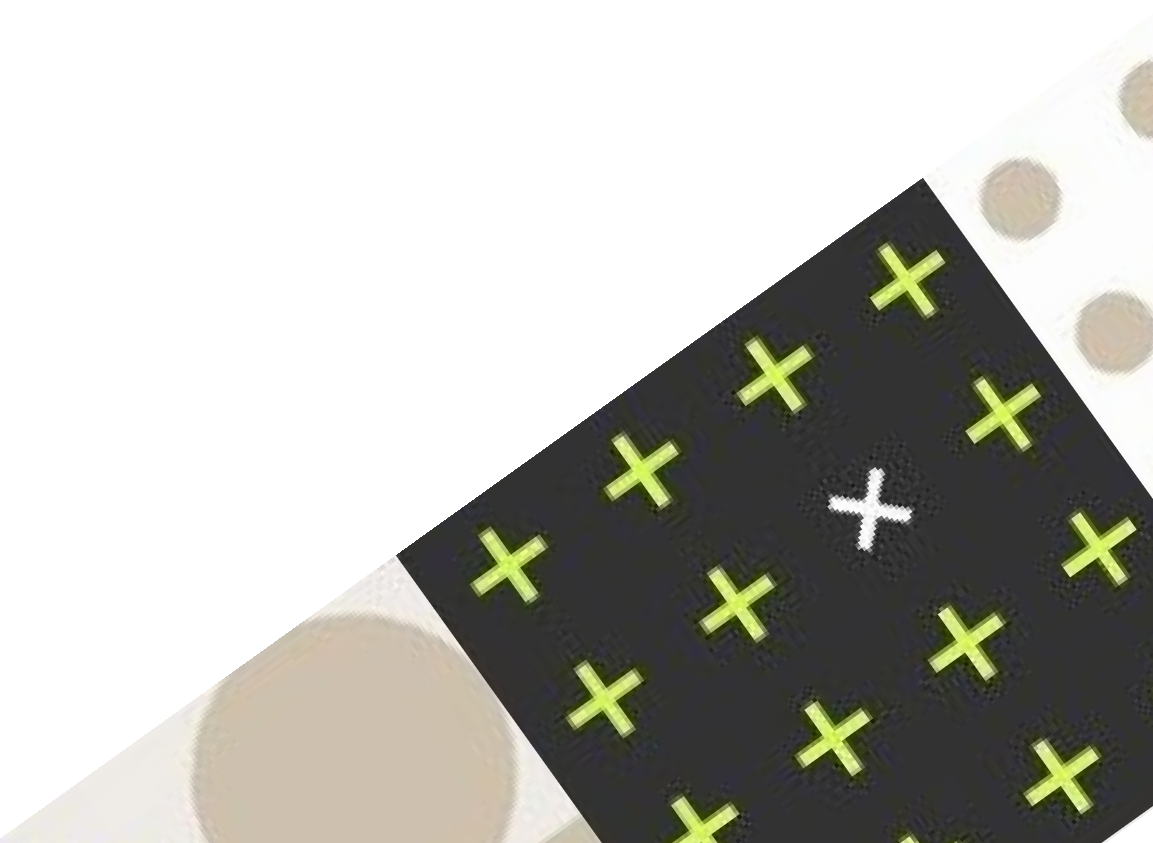
# Case Study

## Midminster Youth CIO – Capital Cost

	£
Construction costs	840,000
Fees	160,000
Net	<hr/> 1,000,000
VAT	20% 200,000
Total	<hr/> <hr/> <u>1,200,000</u>

### Possibilities to consider:

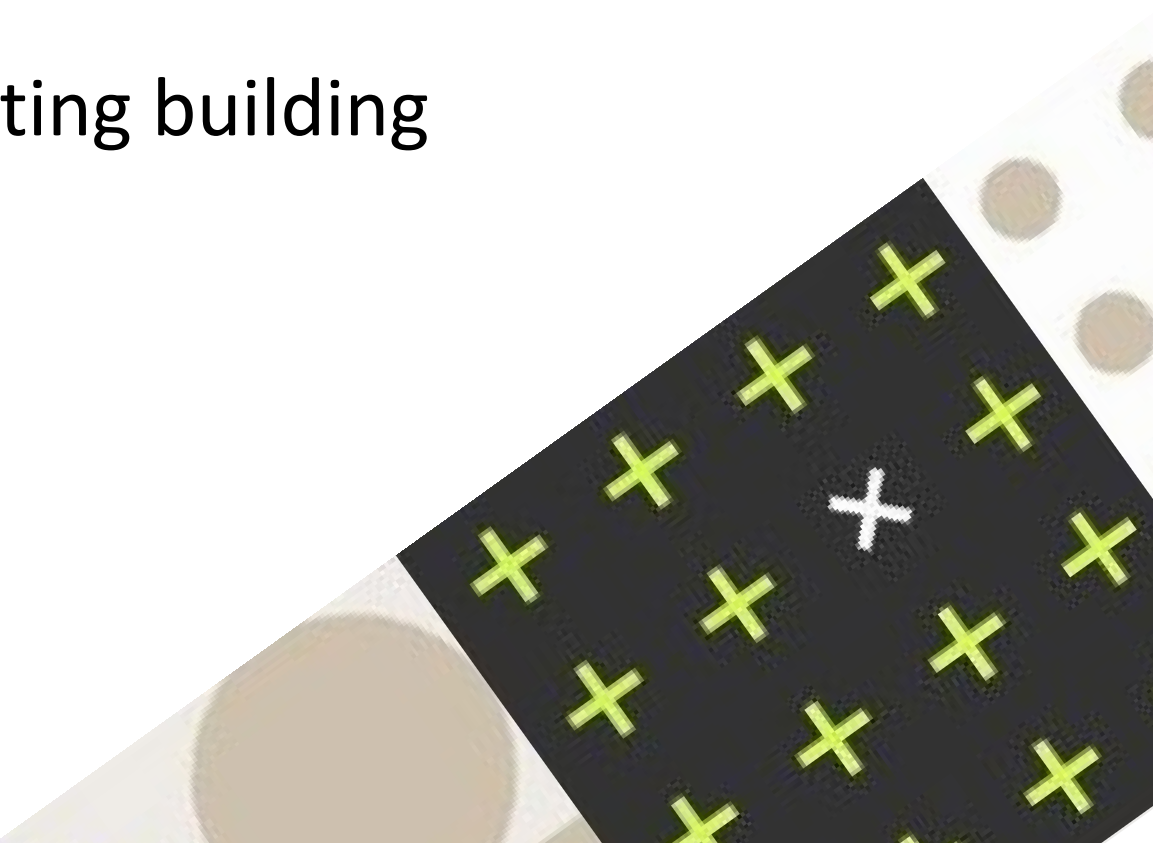
- Do the construction costs qualify for zero rating?
- If not, can the VAT be claimed back?



# Construction Work

Construction work is by default standard-rated however it can be zero-rated where:

- The services supplied are construction of a new building designed as a dwelling or solely for a **relevant charitable purpose** (RCP)
- Zero-rating includes construction work up to the point of completion and building materials supplied and incorporated by the person constructing
- Construction services that cannot be zero-rated and therefore standard-rated are:
  - The separate supply of architectural, surveying, consultancy or supervisory services
  - The hire of goods on their own without an operator
  - The conversion, reconstruction, **refurbishment** or alteration of an existing building



# Relevant Charitable purpose (RCP)

It means use by a charity in either or both of the following ways:

- otherwise than in the course or furtherance of business (in practice this excludes many community organisations)
- as a village hall or similarly in providing social or recreational facilities for a local community

A building falls within this category when there's both a:

- high degree of local community involvement in the building's operation and activities
- wide variety of activities carried on in the building, the majority of which are for social or recreational purposes (including sporting)

A certificate must be issued by the charity to the building contractor. This must be before the supply is made and the covers supply of construction services.



# Relevant Charitable purpose (RCP)

Examples of a “village hall” or similar (but will depend on business model)	Examples that do not qualify
Scout or guide huts	Community swimming pools
Sports pavilions	Community theatres
Church halls	Membership clubs
Community centres	Community Amateur Sports Clubs (CASC)
Community sports centres	



# Buildings – What counts as new

For work to be zero-rated for VAT, it must qualify as a genuinely new and either

- a self-contained house or flat that will be used solely for a ‘relevant residential purpose or
- that it will be used solely for a ‘relevant charitable purpose’ (for non-business use) or as a village hall

Self-contained means:

- that there are not any internal doors or connections to other houses or flats, it can be used independently of any other property, including businesses
- it can be sold on its own
- it has proper planning permission
- any existing buildings on the site have been demolished completely to ground level (unless you’re extending an existing building to create a new house or flat)





# Buildings – Annexes

The construction of a building intended for use solely for a relevant charitable purpose is zero-rated, with additions to an existing building normally being standard-rated. But the addition (or where only part of the addition is being used solely for a relevant charitable purpose, that part) can be zero-rated when all the following conditions are met:

- An ‘annexe’ is **constructed**, rather than an ‘extension’ or ‘enlargement’
- The annexe (or a part of it) is intended for use solely for a ‘**relevant charitable purpose**’
- The annexe is **capable of functioning independently** from the existing building
- The annexe and the existing building each has its **own independent main access**
- The demolition and reconstruction of an annexe to an existing building can be zero-rated subject to the conditions being met.



# Case Study

## Midminster Youth CIO – Capital Cost

Construction costs  
Fees  
Net  
VAT  
Total

20%

£
840,000
160,000
<hr/>
1,000,000
200,000
<hr/>
<u>1,200,000</u>

New building separate to existing building, but building will be partly used for business purposes so in this example it does not qualify for zero rating

VAT related to the fees are not zero rated even if construction qualifies

Some of this may be reclaimable but will depend upon the business model and VAT registration

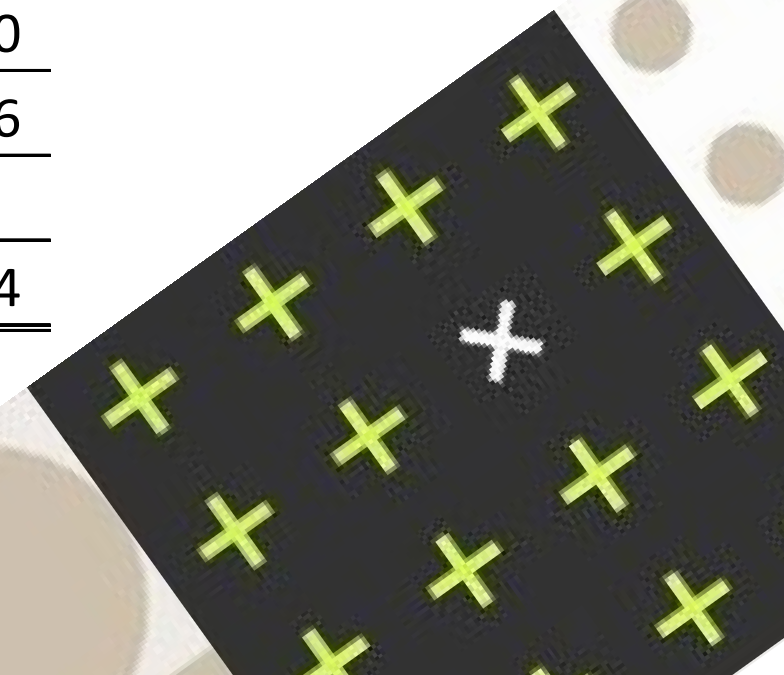


# Case Study

## Midminster Youth CIO – 5 Year Business Plan

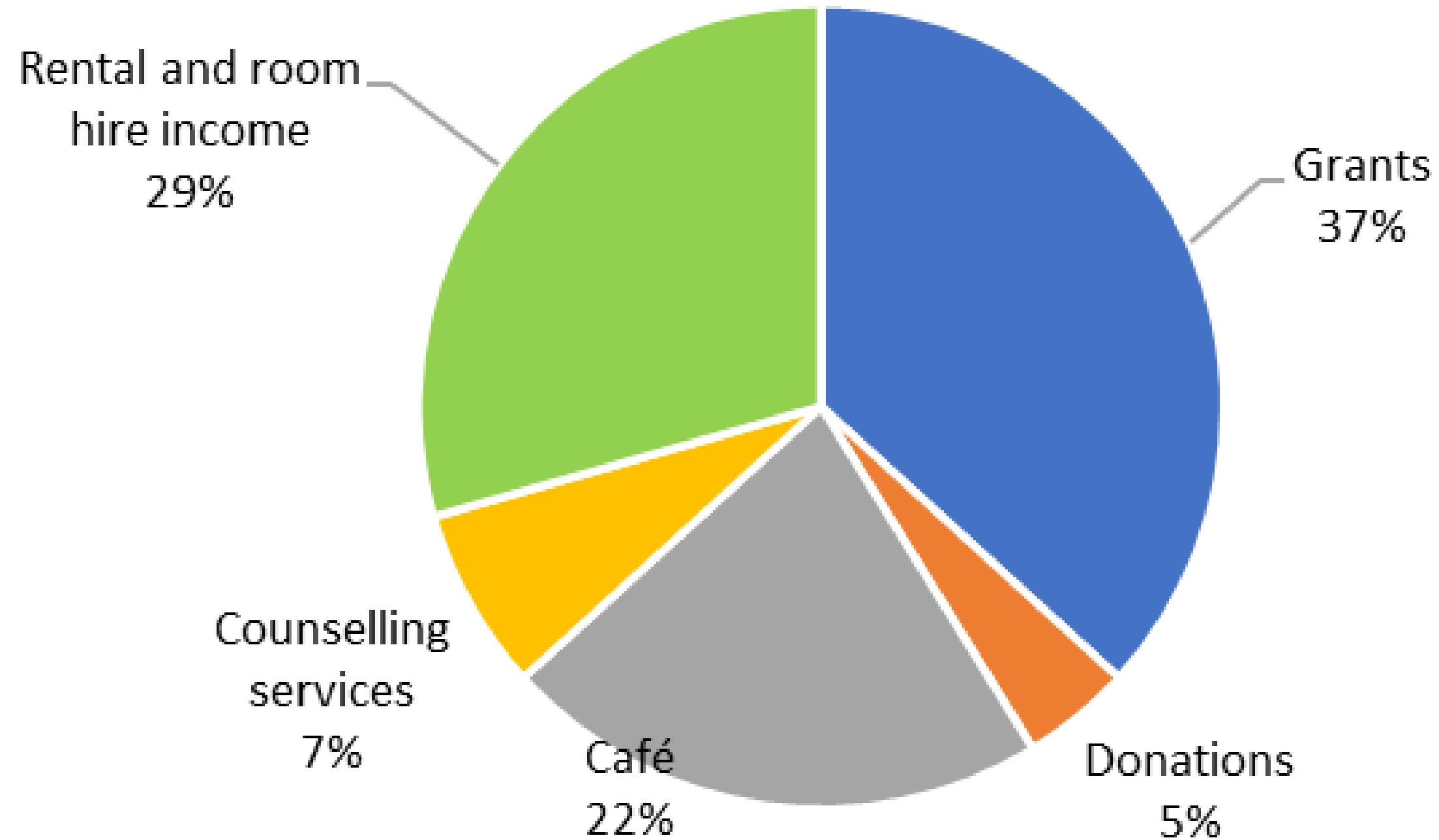
	Year 1	Year 2	Year 3	Year 4	Year 5
	£	£	£	£	£
<b>INCOME</b>					
Grants	100,000	100,000	100,000	100,000	100,000
Donations	12,000	13,000	13,000	13,000	13,000
Café	60,000	66,000	75,000	82,500	90,750
Counselling services	20,000	22,000	25,000	25,000	30,000
Rental and room hire income	80,000	80,000	82,000	85,000	90,000
	<u>272,000</u>	<u>281,000</u>	<u>295,000</u>	<u>305,500</u>	<u>323,750</u>
<b>EXPENDITURE</b>					
Café	18,000	19,800	22,500	24,750	27,225
Staff	140,000	147,000	154,350	162,068	170,171
Counselling	14,000	15,400	17,500	17,500	21,000
Building and overheads	35,000	35,000	35,000	35,000	35,000
	<u>207,000</u>	<u>217,200</u>	<u>229,350</u>	<u>239,318</u>	<u>253,396</u>
Net surplus	<u>65,000</u>	<u>63,800</u>	<u>65,650</u>	<u>66,183</u>	<u>70,354</u>

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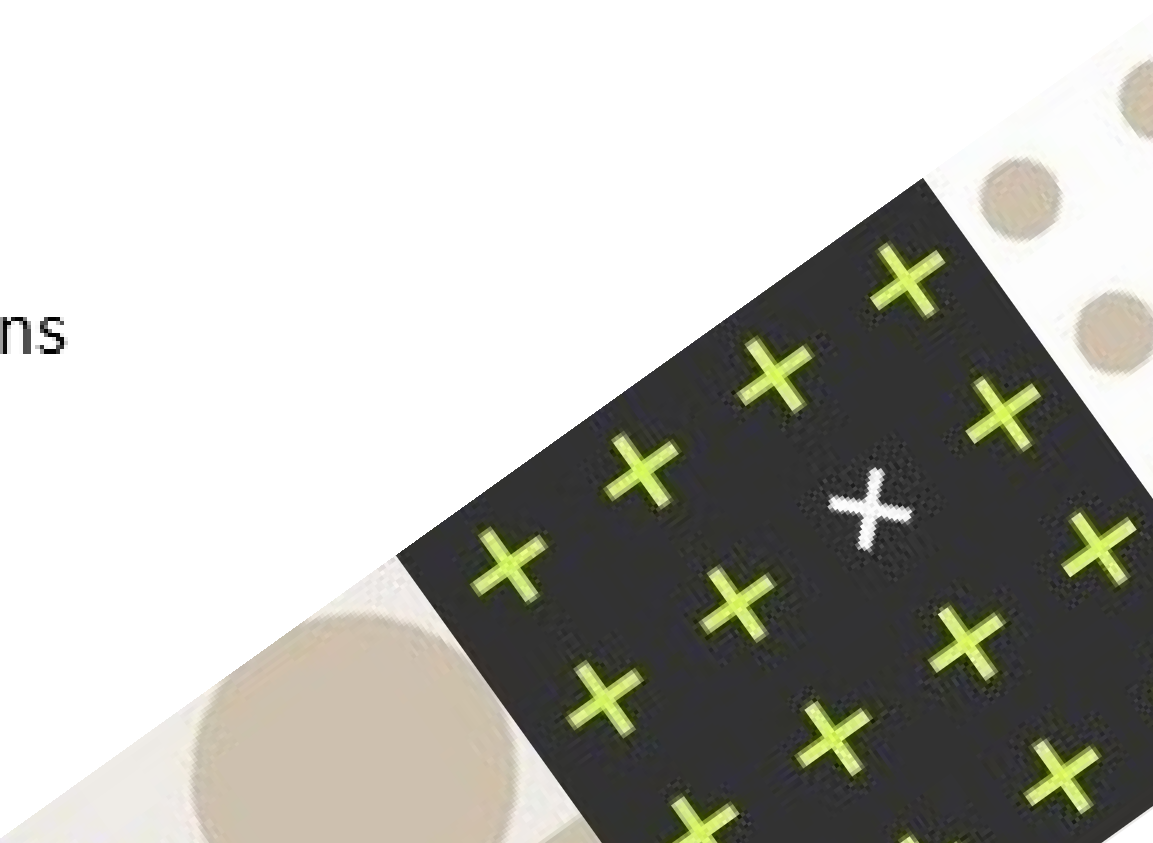


# Case Study

## Midminster Youth CIO – Year 1 Income

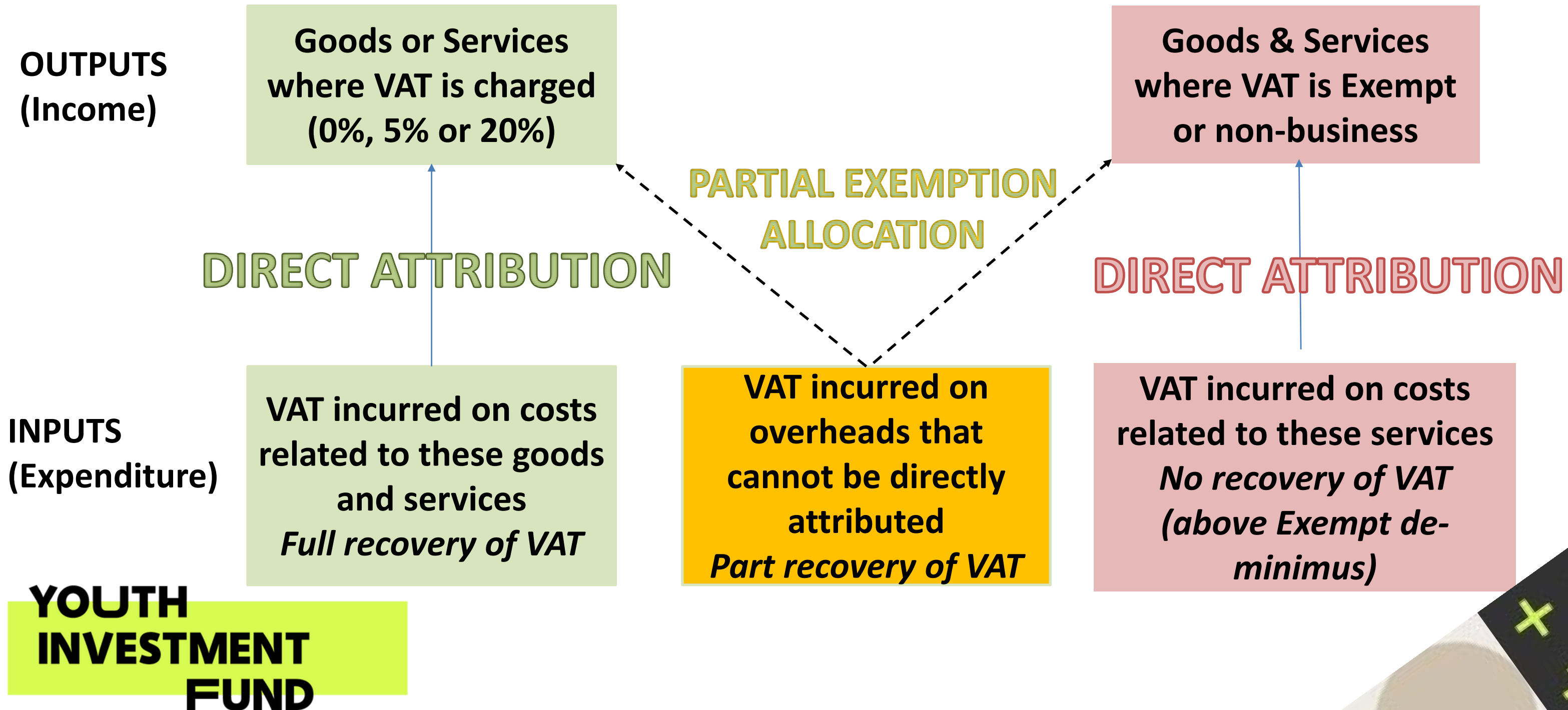


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# Direct Attribution and Partial Exemption

VAT recovery is related to the direct attribution of VAT on inputs to the organisation's outputs:



# Apportionment Methods

STEP 1



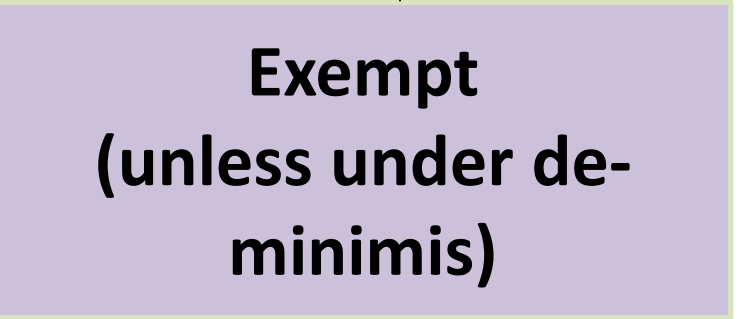
- Business to Non-Business**  
Fair and reasonable  
(examples)
- Income
  - Floor space
  - Time spent by employees
  - Free services /admissions



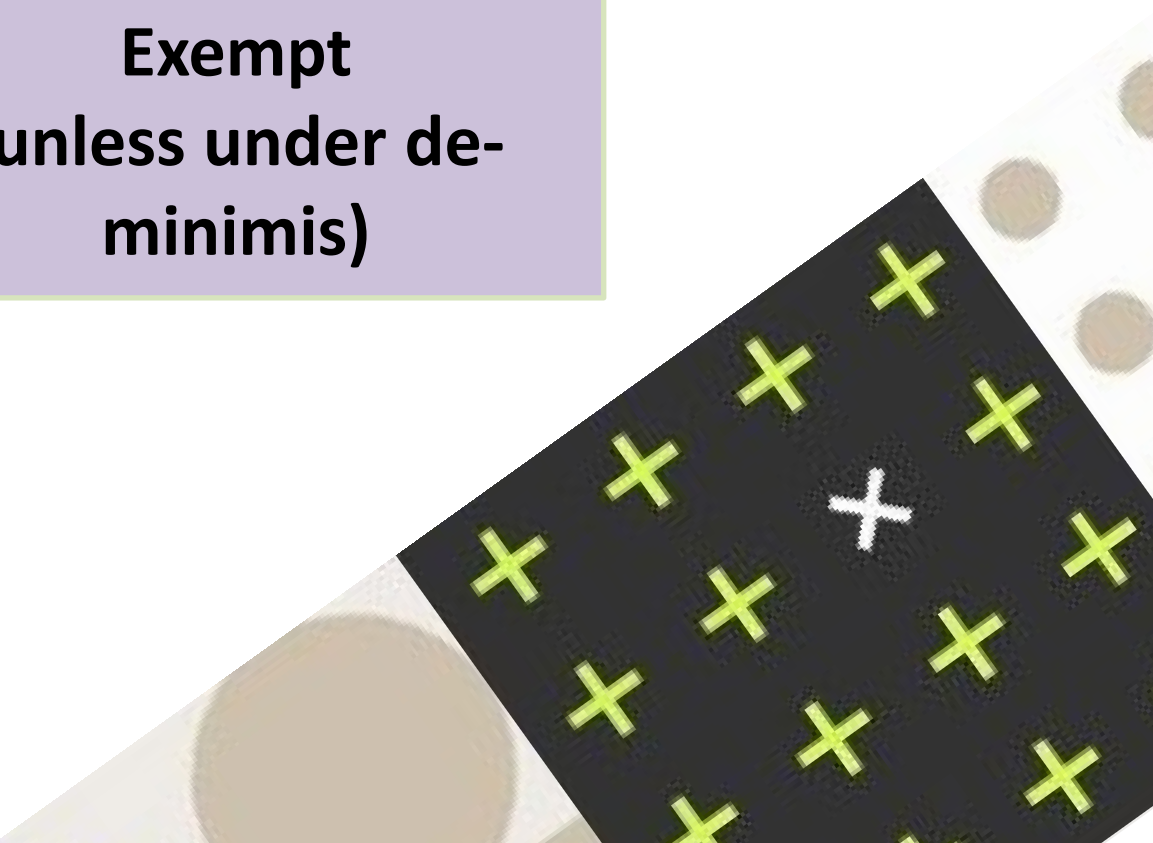
STEP 2



- Partial Exemption Methods**  
(examples)
- Income (standard method)
  - output values
  - numbers of transactions
  - staff time or numbers
  - floor area
  - costs allocations
  - management accounts



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# Buildings – Opt to tax

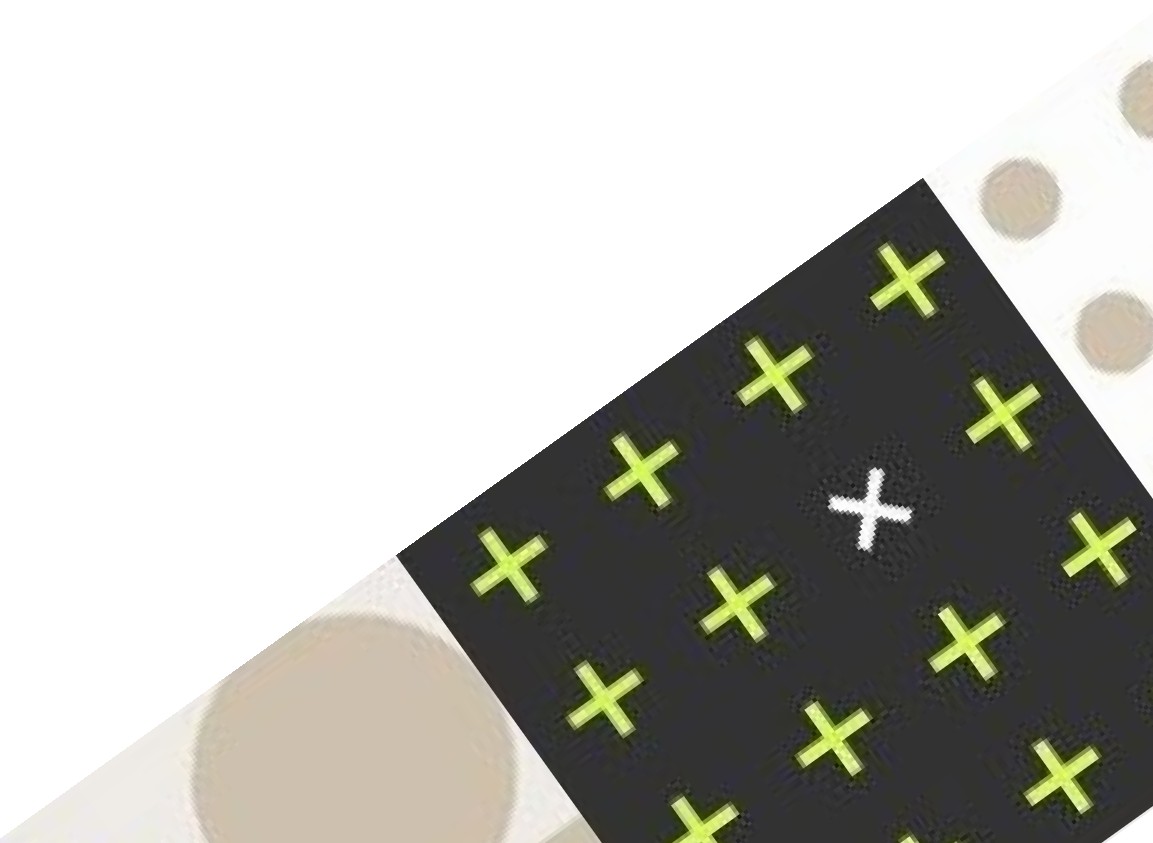
- Can elect to make a building taxable (“Opt to Tax”) which can improve VAT recovery on capital and operational costs BUT does mean that VAT is chargeable on rent and room hire which could increase costs to users or the need to reduce prices.
- Opt to tax needs negotiation/agreement with HMRC and specialist advice is strongly advised.
- The calculations may need to be reviewed each year under the Capital Goods Scheme.
- An opt to tax applies for 20 years unless the building is sold (in which case VAT applies to the sale).
- Cashflow implications and those on the business model must be understood as simplistic assumptions can prove costly.



# Buildings

## Supplies unaffected by an option to tax

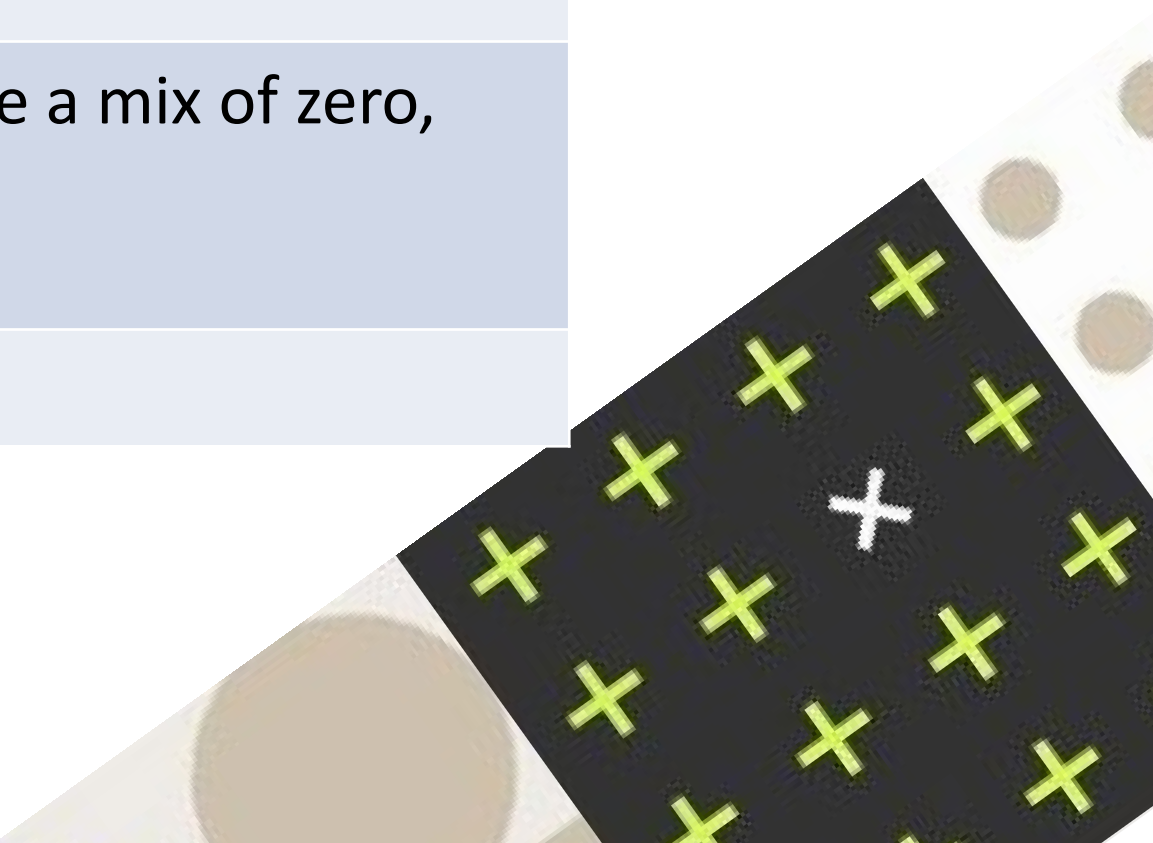
- Dwellings
- Residential use (RRP)
- Charitable use (RCP)
- Residential caravans / houseboats
- Housing associations
- DIY builders





# Examples of VAT Treatment (1)

Income	VAT Treatment
Restricted grants	Out of scope (unless subsidy of a business service)
Unrestricted charitable grants	Out of scope where genuinely a grant
Donations	Out of scope
Community café	Subject to VAT, usually at the standard rate, although occasionally zero rate may apply on cold takeaway items
Consultancy services	Standard rate VAT
Rental and room hire income	Exempt (unless an opt to tax is in force)
Community/charity shop	Will depend upon what is sold, but may be a mix of zero, reduced or standard rate Donated goods – Zero rate
Fundraising event	Exempt (max 10 per year)



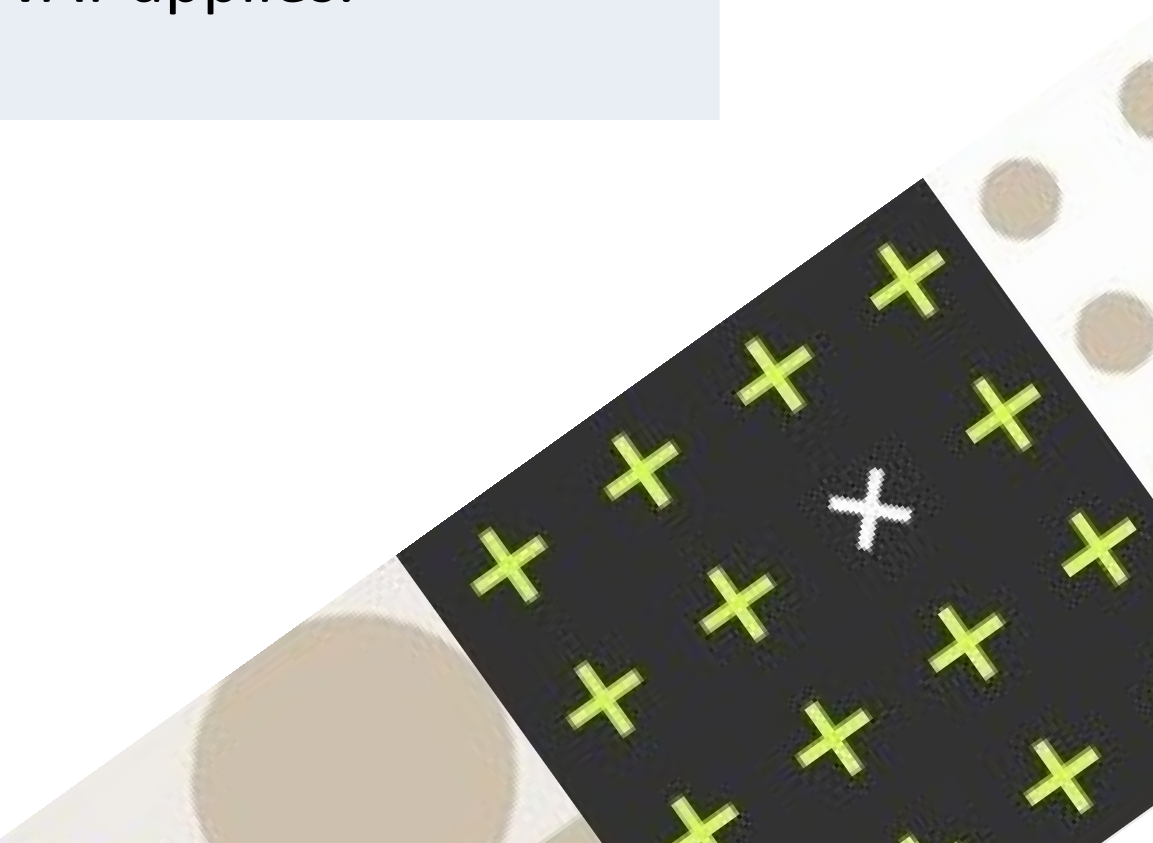
# Examples of VAT Treatment (2)

Income	VAT Treatment
Sponsorship	Standard rate VAT
Contracts for service delivery	Standard rate VAT unless the services are covered by an exemption
Welfare services	Exempt or out of scope (if provided significantly below cost for the latter). Payroll services not considered welfare (see separate slide)
Sports	Generally Standard rate but can be exempt for eligible bodies (eg for gym membership)
Education and vocational training services	Exempt where provided by an eligible body like a charity, school, college or university) and where surpluses are ringfenced and used only for education
Cultural events	Exempt (Cultural exemption) for admission charges for eligible cultural bodies (including voluntary boards) to certain cultural events such as visits to museums, art exhibitions, and performances



# Examples of VAT Treatment (3)

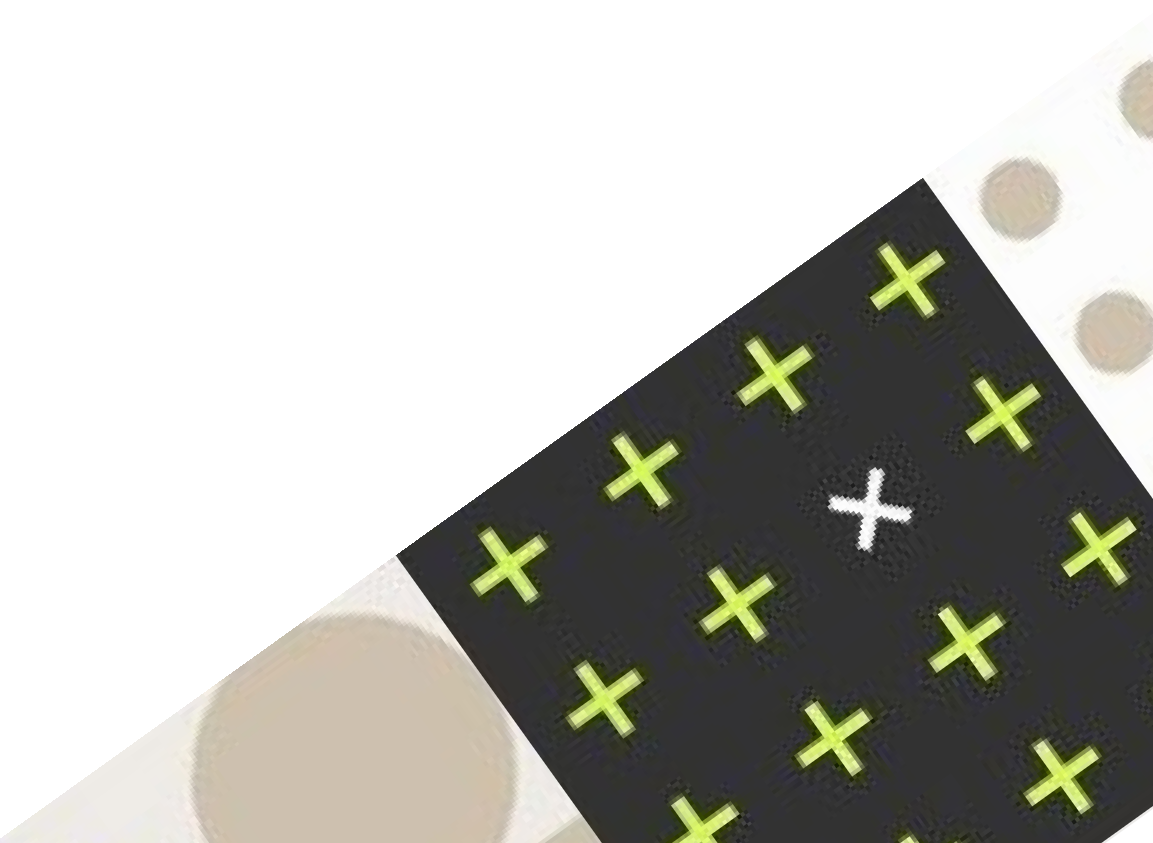
Income	VAT Treatment
Membership	Depends upon member benefits. If membership just confers voting rights and an email newsletter, then likely to be Exempt. Exemptions also apply to educational and professional bodies. Otherwise, membership fees would usually be subject to Standard rate VAT or may be split between the value of benefits.
Friends and patrons	Where a donation has little in return then it will be out of scope/non business but if benefits are provided these need to be calculate at their value and Standard rate VAT applies.



# Grants and Contracts - Overview

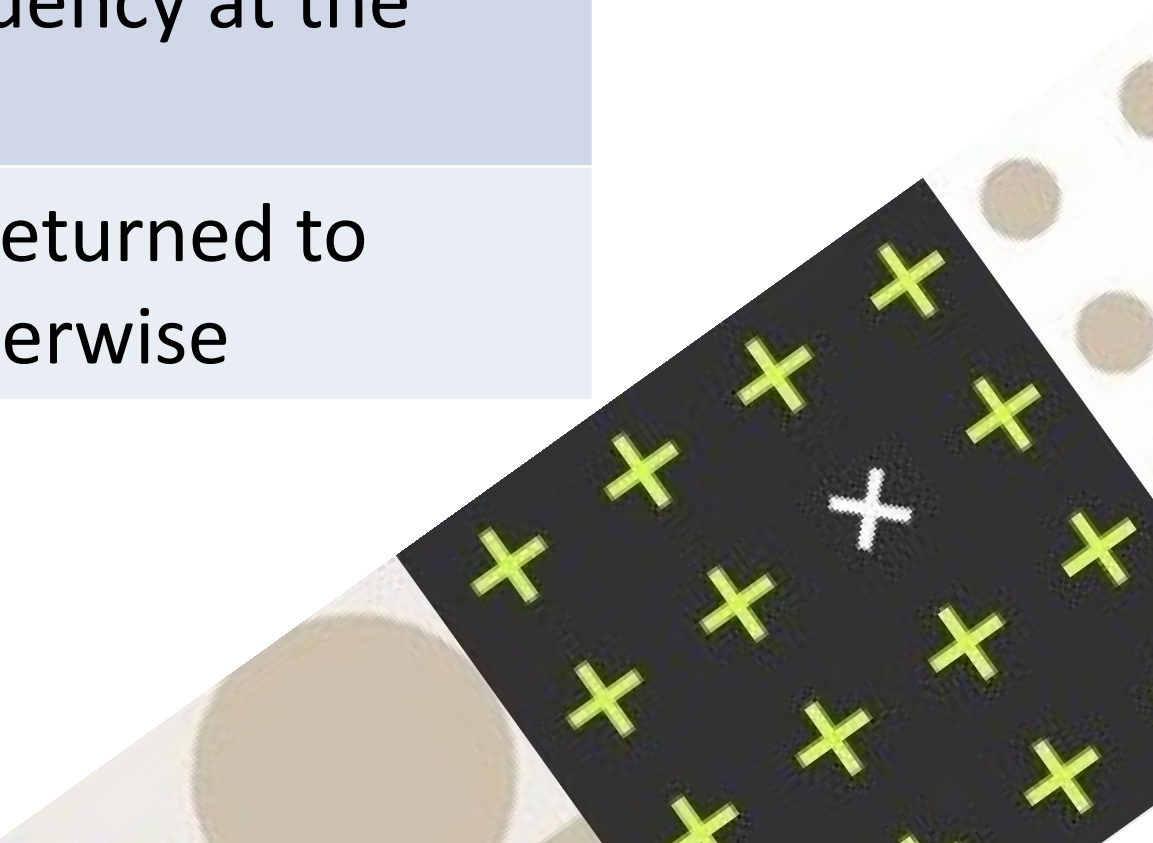
A genuine grant will not be subject to VAT but contracts (where registered for VAT) may mean charging VAT on the services provided. *This can be complex as some contract will be for exempt services.*

A grant agreement is about providing funding for the objects of the charity / organisation and/ or providing that certain outcomes are met. A contract is to provide a service at a particular level.



# Grants and Contracts (overview)

Contract	Grant
Commissioned service	Existing or new service seeking funding
Specification of services to be provided / IPR generated and owned by the funder	Indication of likely areas of benefit
Based on a price for services	Based on funding of costs incurred
Direct link between service provided and the recipient	Beneficiaries receive the service and a third party funds it
Binding agreement between the parties	Grant is a donation freely given with the timing, amount and frequency at the discretion of the donor
Profits can be retained	Unspent amounts to be returned to funder unless agreed otherwise



# Grants and Contracts – Case law

## **Bowthorpe Community Trust**

The local authority provided funding for the training of disabled people and also referred disabled people to the centre. It was held that the training service was being provided to the trainees and not the LA. The only service provided to the LA was the annual report and this not held to be sufficient.

## **Wolverhampton Citizen's Advice Bureau (CAB)**

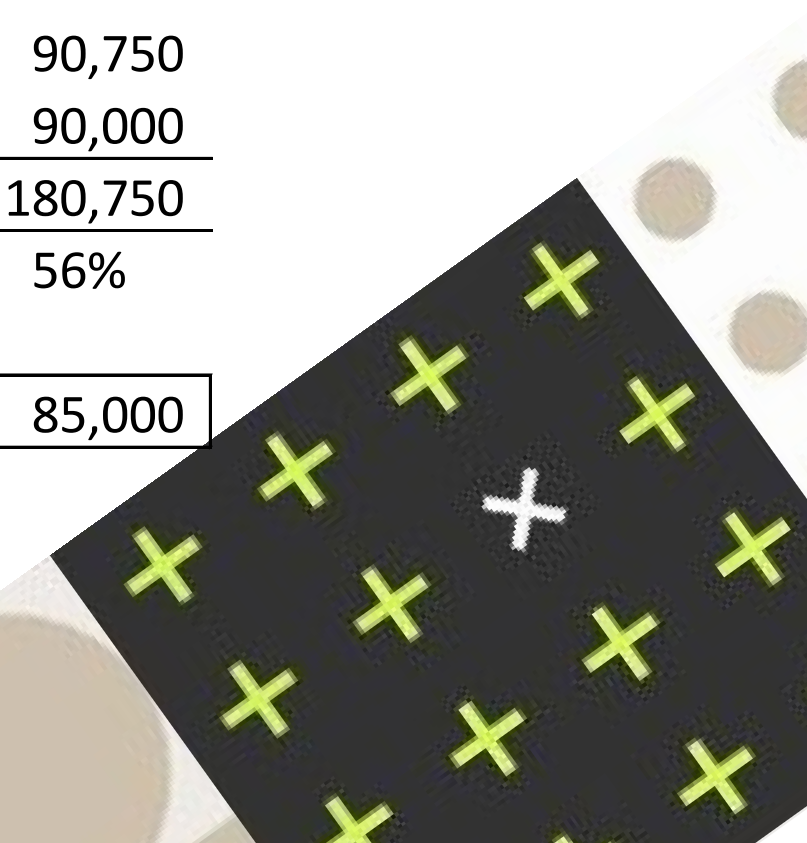
There was an SLA with the local authority, so the intention was to create a contract and a taxable supply for VAT purposes was evident in the agreement. However it was held that the CAB was providing a free service to the public and was not providing a service to the LA. Hence Wolverhampton CAB was not able to recover the VAT on costs incurred on refurbishing their premises



# Case Study

## Midminster Youth CIO – 5 Year VATable Income

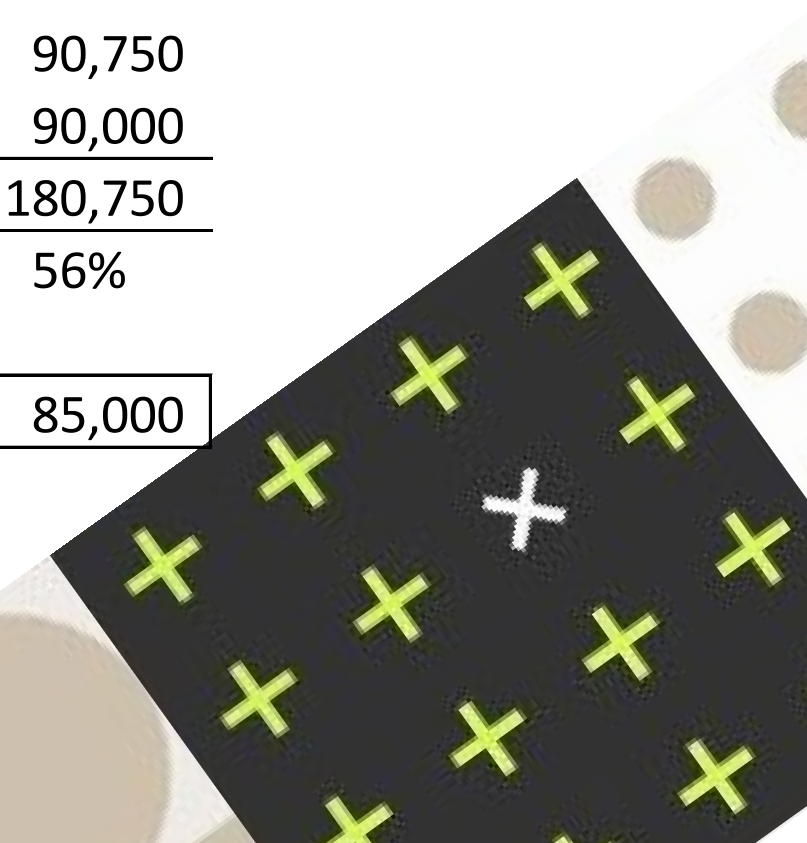
		Year 1	Year 2	Year 3	Year 4	Year 5
		£	£	£	£	£
<b>INCOME</b>						
Grants	Non Business	100,000	100,000	100,000	100,000	100,000
Donations	Non Business	12,000	13,000	13,000	13,000	13,000
Café	Vatable	60,000	66,000	75,000	82,500	90,750
Counselling services	Exempt	20,000	22,000	25,000	25,000	30,000
Rental and room hire income	Exempt / Vatable	80,000	80,000	82,000	85,000	90,000
		<b>272,000</b>	<b>281,000</b>	<b>295,000</b>	<b>305,500</b>	<b>323,750</b>
<b>a) No Opt to tax - Vatable Income</b>						
Café		60,000	66,000	75,000	82,500	90,750
		22%	23%	25%	27%	28%
<b>b) Opt to tax - Vatable Income</b>						
Café		60,000	66,000	75,000	82,500	90,750
Rental and room hire income		80,000	80,000	82,000	85,000	90,000
		<b>140,000</b>	<b>146,000</b>	<b>157,000</b>	<b>167,500</b>	<b>180,750</b>
		51%	52%	53%	55%	56%
VAT Threshold		85,000	85,000	85,000	85,000	85,000



# Case Study

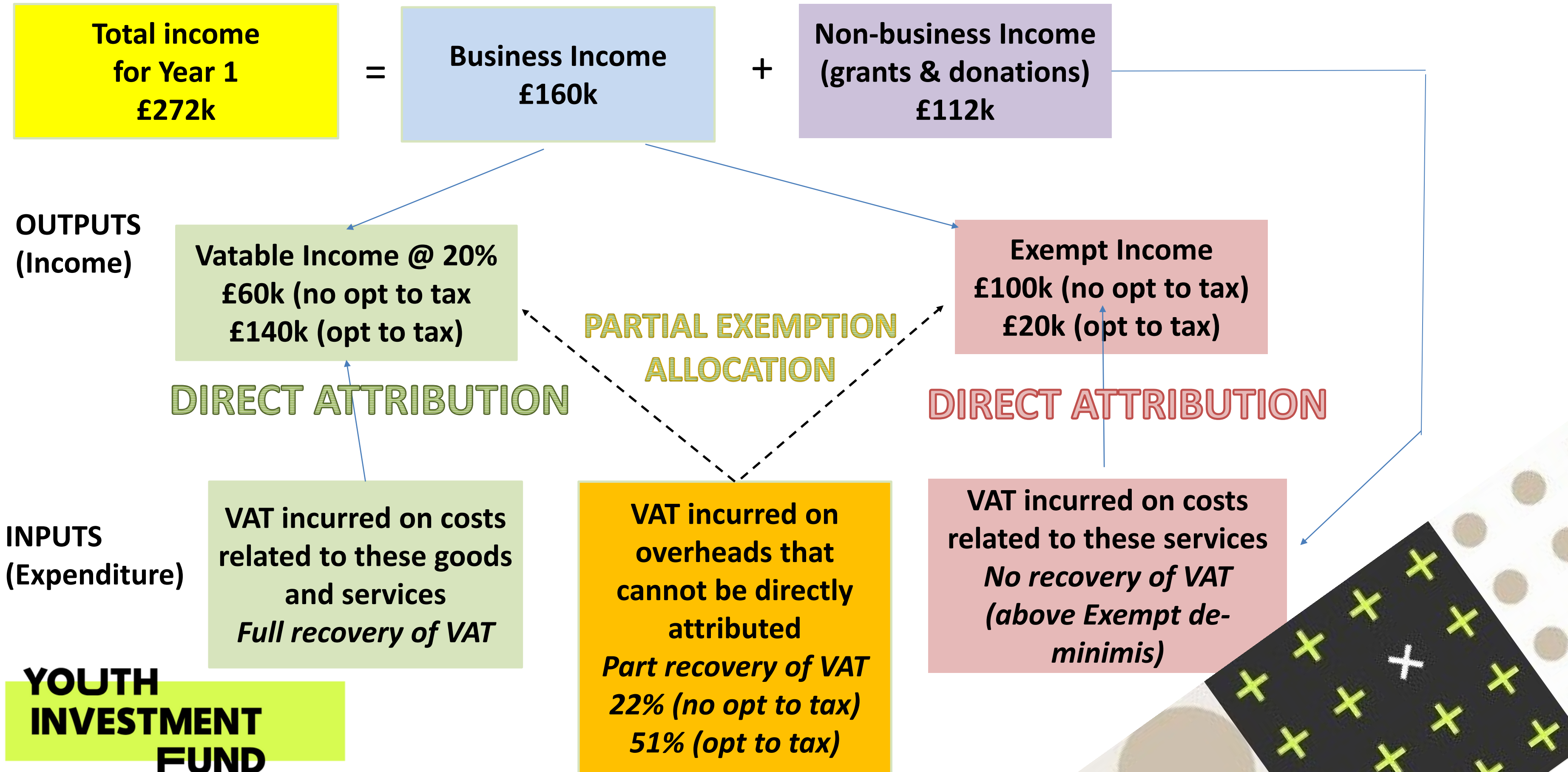
## Midminster Youth CIO – 5 Year VATable Income

			Year 1	Year 2	Year 3	Year 4	Year 5
			£	£	£	£	£
<b>INCOME</b>							
Grants	Non Business		100,000	100,000	100,000	100,000	100,000
Donations	Non Business		12,000	13,000	13,000	13,000	13,000
Café	Vatable		60,000	66,000	75,000	82,500	90,750
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Rental and room hire income			80,000	80,000	82,000	85,000	90,000
			140,000	146,000	157,000	167,500	180,750
			51%	52%	53%	55%	56%
VAT Threshold			85,000	85,000	85,000	85,000	85,000





# Partial Exemption (income method) - Case study (figures from year 1)



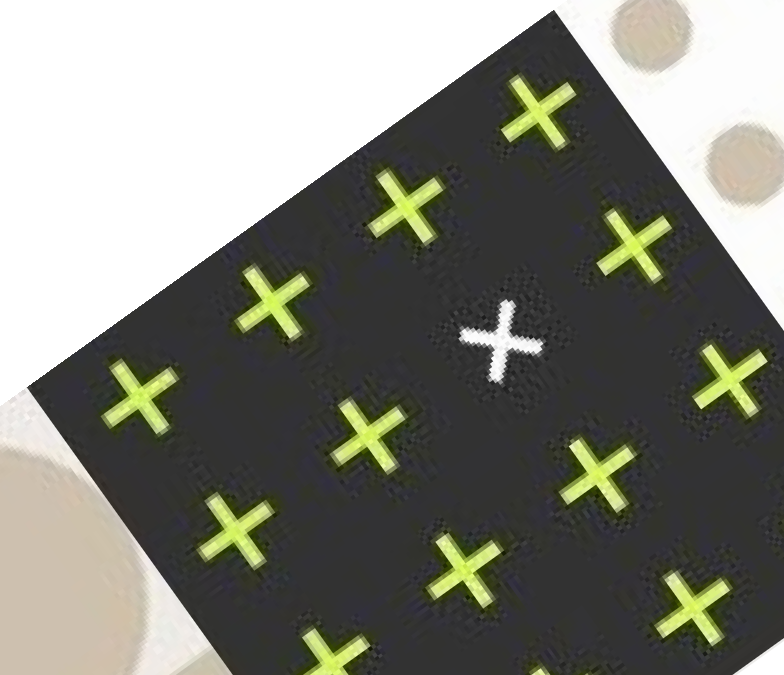
# Case Study

## Midminster Youth CIO– VAT Strategies

Tax Strategy	VAT Recovery on capital build		Implications	Illustrative based on year 1					5 Years (incl capital)	10 Years (incl capital)
	%	£		Output VAT	Input VAT recoverable	VAT Payable to HMRC	Non recoverable VAT	Total annual VAT cost (excl capital)		
				£	£	£	£	£		
1. <b>To not register</b> (as taxable income below the £85k threshold)	0%	-	No VAT charged on café or rental/room hire, no reclaim of VAT on expenditure	-	-	-	4,400	4,400	22,000	44,000
2. <b>Register for VAT</b> but no opt to tax	22%	44,118	VAT charged on café but not on rental/room hire, some reclaim of VAT on expenditure (ie related to the café)	12,000	971	11,029	3,429	14,459	17,147	100,471
3. <b>Register for VAT and opt to tax</b>	51%	102,941	VAT charged on café and rental/room hire, some reclaim of VAT on expenditure (ie related to the café/rental)	28,000	2,265	25,735	2,135	27,871	10,676	175,765

**This is just an example. Every project is different and dependent on the specific circumstances, so other projects may show a very different outcome**

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# The Capital Goods Scheme (CGS)

- The CGS applies to capital expenditure on land and buildings with a value of £250,000 or more (excl VAT) and which was subject to VAT at the standard or reduced rate.
- The CGS also applies to other assets including a single computer (£50k or more) as well as the purchase of aircraft, ships and boats.
- For assets subject to the CGS an adjustment period applies. For land and buildings this is 10 years.
- Each year during the adjustment period a review needs to be made as to the assets use for taxable purposes (i.e. making taxable supplies) and adjustments made to the input VAT originally claimed if it has changed
- Any over claim of VAT calculated for each year, needs to be repaid to HMRC whilst under claims can be refunded
- A final adjustment is calculated if the asset is sold in the adjustment period.



# The Capital Goods Scheme (CGS) Midminster Youth CIO

Financial year	Financial year	VAT incurred on building	Annual recovery rate	Input tax claimed	VAT subject to adjustment	CGS adjustment to pay or (refund)
Year 1	Year 1	200,000	51%	102,941	10,294	-
Year 2	Year 2		52%		10,294	(97)
Year 3	Year 3		53%		10,294	(350)
Year 4	Year 4		55%		10,294	(672)
Year 5	Year 5		56%		10,294	(872)
Year 6	Year 6		56%		10,294	(872)
Year 7	Year 7		56%		10,294	(872)
Year 8	Year 8		56%		10,294	(872)
Year 9	Year 9		56%		10,294	(872)
Year 10	Year 10		56%		10,294	(872)
					102,941	

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# Strategic implications of VAT - Issues to understand

## Cashflow

- Cashflow forecasts should include VAT and include making payments to HMRC
- Consider the cash accounting scheme where debtors pay very slowly and/or where purchases are significantly in advance of debtors receipts

## Social enterprises and community cafés

- Social enterprises can increase VATable turnover. This could trigger a need to register and can leave the organisation worse off if not understood or managed.
- If already registered, social enterprises can help to increase the partial recovery rate on overheads.

## Trading subsidiaries

- Be clear about the VAT implications of transactions between group organisations, especially if only one is registered or where both are, where one is subject to partial exemption rules



# Strategic implications of VAT - Issues to understand

## **Buildings** (*Midminster Youth CIO should consider these*)

- Understanding the impact of building projects on VAT recovery
- For large capital projects consider the option to tax on the longer term including how it may affect this to cover the business and pricing models.
- Look at alternative options such as finding alternative funding or financing or reducing the scope of the project Consider the implications of social enterprise activity including in-house and outsourcing options

## **Other VAT issues**

- Understanding and planning for when registration may be needed
- Whether any VAT reliefs for charities apply
- Cost sharing exemption
- Flat rate and annual accounting schemes
- Implications for resources, systems and processes



# The Main VAT schemes

## Standard VAT accounting method (accrual accounting)

- VAT is accounted for on sales and purchases based on the transaction/invoice dates A quarterly VAT return is submitted and payment is usually due on the 7th of the month following the end of the quarter (about 5 weeks from return date).

## Annual accounting VAT scheme (for turnover up to £1.35m)

- Similar to standard VAT accounting method, except that instead of quarterly returns there is an annual VAT reporting and payment deadline. Interim quarterly payments are made based on estimates. This can help budgeting, but could lead to under/over payments during the year and then a final adjustment.

## Flat rate scheme (turnover must be below £150k when registering)

- Under this scheme, the VAT payment is based on percentage of total turnover
- The actual amount to pay depends on the type of business – different industries have different flat VAT rates
- Be careful – Exempt income is treated as standard rated in the Flat Rate scheme..

## Cash accounting scheme

- VAT is accounted for on the date of payment or receipt.
- This can help those businesses with slow payers or where purchases are paid for in advance of sales.



# Webinar Case Study - conclusions

- Recovery of VAT is complex and estimated at £44k (registration only), or £102k (with opt to tax).
- Many grant agreements do not allow VAT recovered to be claimed from the funder This could mean that the organisation is no better off or indeed often worse than keeping the VAT non-recoverable
- If opted to tax, this means charging VAT on rent which would take prices above competitor levels, so would need to be absorbed as a cost, potentially making the business model not viable and more expensive in the long term
- Given the business activities, the construction probably does not qualify for zero rating, although it may be worth seeking professional VAT advice in case it may be possible
- Consideration should be made as to whether to fund/finance the £100k gap through other fundraising or through changes to scope of the project
- **Now that the trustees have a better understanding, they could seek professional VAT advice in case it may be possible to have the construction zero rated and/or around agreeing the best recovery method and rate with HMRC**





# VAT problems we see at community organisations

- VAT not accounted for properly and not understanding partial exemption rules properly
- Not having the right accounting system or not set up properly
- Lack of clarity between grants and contracts
- Treating income wrongly (e.g. charging VAT on room hire when no “Opt to Tax” exists)
- Cashflow issues and in some cases the build up of VAT arrears
- The cost of irrecoverable VAT not properly budgeted for
- Making decisions on Opt to Tax (or indeed not considering it at all) without proper advice
- Significant over or under recovery on capital projects
- Not understanding the VAT implications of trading activities (e.g. cafés)
- Not taking specialist advice when needed
- Non-registration when VATable income is over the threshold



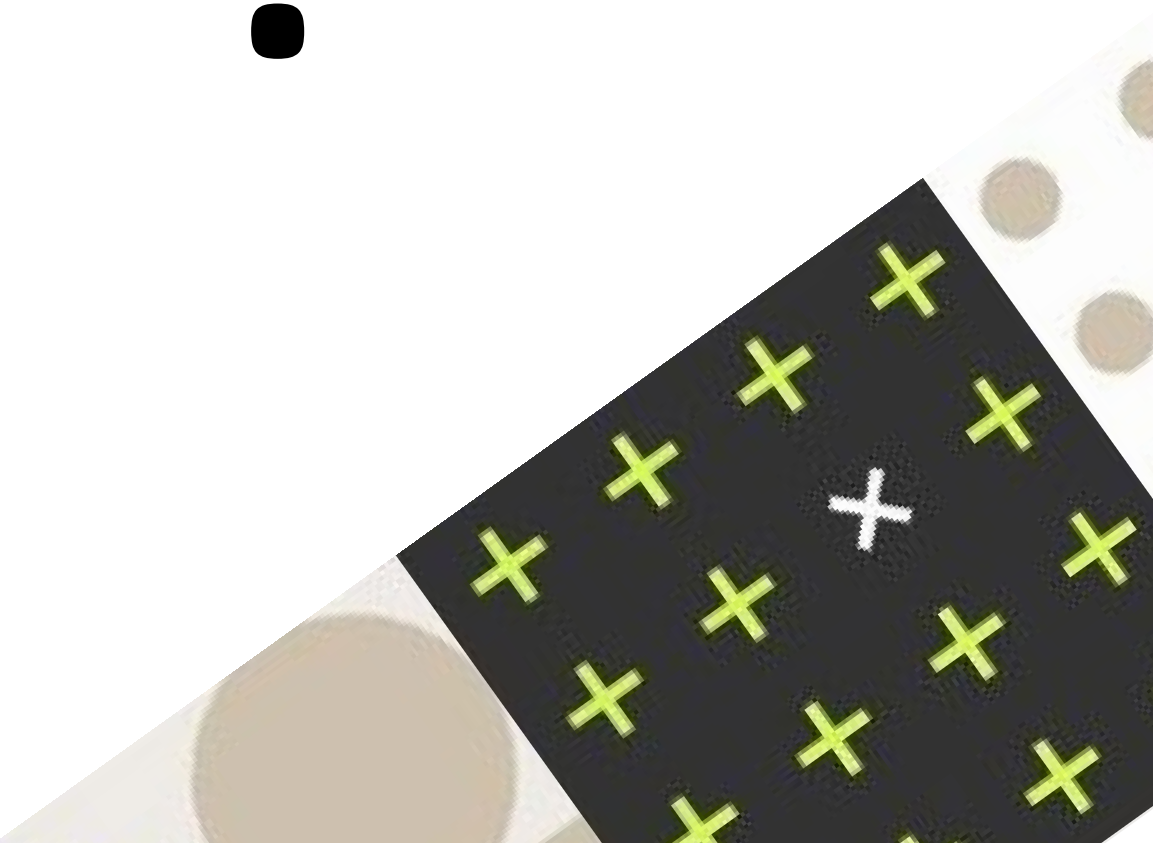
## Poll 3 – Topics you want to understand more

- Year-end accounts for charities (in greater depth)
- Year-end accounts for CICs and other social enterprises
- Management accounts and reporting (in greater depth)
- Deciding on a suitable accounting system
- Using cloud accounting systems better including set up for capital projects
- Budgeting and cashflow forecasting
- Financial modelling (using Excel)
- VAT and community building and projects (in further depth)
- Other (use the chat box)

# Questions

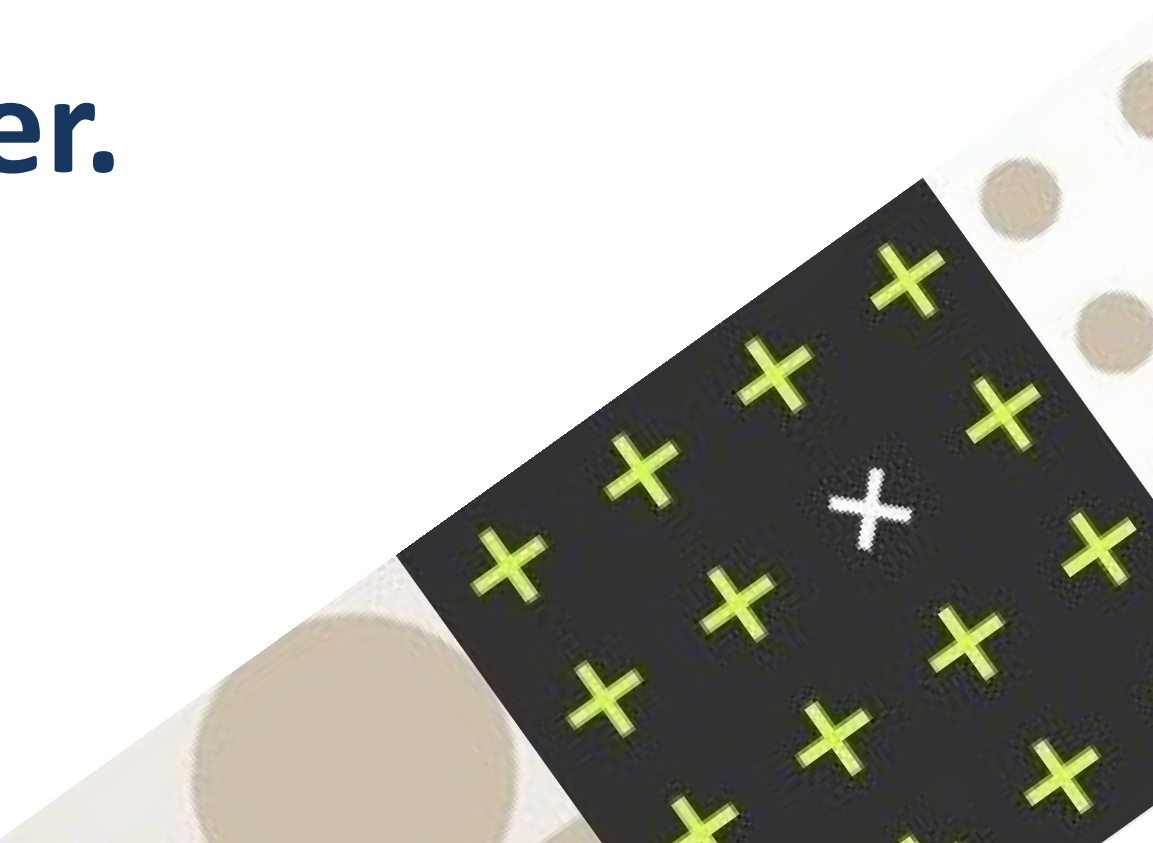


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