

Guidance Note 6

Value Added Tax

Value Added Tax (VAT) is often viewed as a complex and difficult subject that is best left to the 'expert'.

The basic concept of VAT is relatively easy to grasp but the difficulty lies more in keeping abreast of the changes to myriad VAT regulations and in the interpretation and understanding of key terms and calculations.

This guidance note offers general advice and guidance that should be helpful in structuring your discussion with VAT experts. The note is based upon expert advice given to a local authority's officers with an interest in external funding matters and should be read in this context. Whilst some content may not be applicable to your organisation the general tenet should be suitable for all sectors.

VAT and Projects

VAT is an important consideration in the design of a project's finances because it is highly likely that your organisation will buy goods and services from other organisations who have factored VAT into their prices, even if your organisation is 'exempt' from payment.

VAT is currently levied at a rate of 17.5% on a wide range of goods and services and therefore could account for up to 17.5% of your project's costs. VAT could thus account for a 17.5% underspend or a 17.5% overspend depending on whether you are able to recover the VAT paid on goods and services required to deliver your project, and whether you accounted for VAT at the outset of your project's design.

If you are the person in your organisation who is ultimately responsible for the project in question it follows that you should know a little about VAT to avoid the embarrassment of underspend or overspend resulting from VAT payments.

Taxable supplies and turnover

All goods and services which are liable to VAT at the standard, reduced or zero rate are called 'taxable supplies', whether or not you are registered for VAT. The total value of these supplies is called your 'taxable turnover'.

If your taxable turnover reaches or is likely to reach the registration threshold (currently £58,000) you will probably have to register for VAT. If you need to register, you must charge VAT on your taxable supplies from the date you first needed to be registered.

If you receive certain services from abroad, for example advertising, data processing, consultancy or legal, accounting or professional services, these will be treated as if you supplied them and you must include the value in your taxable turnover.

For a full list of these services, see HM Customs and Excise <http://www.hmce.gov.uk/forms/notices/link-to-700.htm> Section 31.

Input and Output tax

If your customers are registered for VAT - and what you sell them is used for their business - the VAT you charge them is their input tax and therefore also your output tax. In the same way, the VAT charged by suppliers to you on your business purchases is your input tax.

You deduct your input tax from your output tax and pay the difference to Customs & Excise on your VAT return. If your input tax is greater than your output tax you can reclaim the difference.

However, if your input tax relates to both taxable and exempt supplies, you can normally deduct only the amount of input tax that relates to your taxable supplies.

For more information see HM Customs & Excise <http://www.hmce.gov.uk/forms/notices/706.htm>.

Who can and cannot recover VAT input tax ?

⚡ **Partnerships established to facilitate a specific project.**

Where schemes/initiatives/projects etc. attract external funding it is usual to find that more than one body is involved in delivering the output. In such cases one organisation **MUST** be nominated as the Accountable Body given responsibility to draw down funding, monitor expenditure, make payments to other partners etc. The accountable body is frequently the lead partner of the scheme / project.

Many of these partners will deal with their own operational income and expenditure incurred during the delivery of their part of the scheme/project and can recover input tax subject to the restrictions covering that business.

The occasion that frequently gives greatest cause for concern is when an accountable body / lead partner makes payments on behalf of other partners. This can occur for a variety of laudable reasons including that the partner in question does not have the resources to make such payments, or that the accountable body wishes to retain control.

Although the accountable body is at liberty to make such payments, it cannot and must not recover the input tax pertaining to the partner in question.

Exceptionally, the accountable body may make payments on behalf of a partner, reclaim the input tax, and then charge the partner on output tax by raising a VAT only invoice. This is a highly complex area and one fraught with financial dangers within the minefield of sometimes contradictory VAT rules and regulations. Thus, if a lead body / accountable body intends to make project payments on behalf of partners organisations, seek the advice of a VAT accountant and discuss with your local HM Customs & Excise officers from the outset long before any payments are made.

Record everything said in these discussions and agree in writing with HM Customs & Excise the regime under which the project / scheme will operate.

These considerations / discussions form an important part of your project preparations and adequate time should be allowed for this activity (you should think in terms of months rather than weeks).

⚡ **Local authorities**

Are able to recover VAT incurred on carrying out their non-business and taxable business functions (for more information on non-business and taxable business functions, you should contact you nearest District Council, Treasurers Department).

VAT recovery is also permitted in making exempt supplies however this can be restricted (the 'partial exemption') – sometimes to the degree that you cannot recover the VAT because your 'quota' has been used-up. All local authorities have a partial exemption quota and you should discuss this with a District or County / Unitary council Treasurer's Department (or its equivalent) during the preparation of the project because your project may impact on this quota (once its used up, VAT payments can't be recovered in that financial year).

Recoverable VAT must relate to the assets of the legal entity making the payments (i.e. the organisation, e.g. a local authority). Assets usually relate to tangible items such as a building or computers, but sometimes also to the less tangible such as services to which intellectual rights are attached (e.g. a novel software program).

⚡ **Commercial businesses**

Are permitted to recover the input tax they incur in the course of making taxable (standard rate, lower rate or zero rate) supplies. But commercial businesses are **NOT** permitted to recover the input tax they incur in the course of making exempt supplies, nor are they able to recover input tax in undertaking non-business activities.

⚡ **Providers of education who are not local authorities (such as a College of Further Education) and Housing Associations.**

These organisations work to similar rules to those applied to commercial businesses: they are permitted to recover the input tax they incur in the course of making taxable (standard rate, lower rate or zero rate) supplies. Likewise they are **NOT** permitted to recover the input tax they incur in the course of making exempt supplies, nor are they able to recover input tax in undertaking non-business activities.

⌘ **NHS establishments (including health authorities, health trusts, ambulance trusts, Primary Care Trusts etc.).**

Are covered by separate VAT legislation and have very limited VAT recovery but are in the main similarly disadvantaged to educational establishments.

⌘ **Action Zones** (e.g. Health Action Zones etc.)

Are not covered by local authority VAT registration and as a consequence are unable to recover all input tax, however the status of each type of action zone needs to be established as the rules pertaining to such bodies are subject to change. You will need to involve your local HM Customs & Excise office in these discussions from the outset.

Accounting for VAT in your preparation of an application for funding

Here are some of the issues that need to be considered during the preparation of the project and its attendant bid:

- ⌘ Who signs the cheques for the costs of the project ?
- ⌘ Who will receive income which may be generated by the project as a by-product ?
- ⌘ To whom will "shared assets" actually belong ?
- ⌘ Are all the partners familiar with their VAT liabilities under the project ?
- ⌘ What happens if the project is aborted ?
- ⌘ Preparation time

Sufficient time for preparation before a bid is to be submitted is often a luxury that we do not possess and in this situation you'll need to assume that VAT payments must be made on certain goods and services provided through the activities of the project, thereby inflating these costs at the relevant rate of taxation. You then need to consider whether or not you'll be able to recover this tax from HM Customs & Excise.

As a general rule, if you cannot recover the VAT then the funding provider will pay for it. Thus you can safely factor the VAT into your financial plan.

But if you can recover the VAT the external funding provider will as a general rule not pay for it. This means that you run the risk of a cash problem in the intervening time that will elapse between your payment of VAT and your subsequent recovery of the payment (the difference in which may be up to a year). Whether the organisation is big or small, this issue needs to be factored into the project's financial plan and the relevant people made aware of this factoring.

There are a variety of ways in which this can be done but the best is simply to anticipate the timing and scale of the payment within the financial plan and make contingencies accordingly (for instance, drawing upon your financial reserves in the short term).

The crucial point is whether your organisation can withstand the cash shortfall caused by the delay in recovering the VAT, or not. If it can't, you need to think carefully about your involvement in the project.

Making good use of the 'delay'

The preparation of the bid for funding and its subsequent submission is often only part of the application process and you can expect a period of time to pass between the submission of the application form (the 'bid'), discussions with the funding provider, and the issuing of a contract for funding support. To the applicant this is frequently viewed as a delay but to the funding provider it is time allowed for normal administrative procedure.

Any VAT issues can be addressed within this period of time but once your financial calculations have been accepted by the funding provider in final contract discussions you'll likely be held to them (although some funding regimes allow some flexibility later during the lifetime of the project).

Local Authority lead projects

VAT is only recoverable by a local authority where the assets is legally owned by the council.

Where funding is secured by a local authority toward the cost of a project involving external partners the authority is precluded from recovering input tax on expenditure on assets / provision of services, or funding, to these external bodies.

If the authority chooses to recover the input VAT it should raise a VAT only invoice against the external partner in question (seek advice from the authority VAT accountant). Recovery of tax in this circumstance is usually made in error but the error will likely be spotted by HM Customs & Excise in their routine checks and penalties for non-compliance are severe.

Projects in which the partners receive an indirect benefit

Projects often gain the support of local communities, businesses and other bodies who are prepared to make a contribution to the scheme and also to receive a benefit in return for this contribution either directly or indirectly.

This may give rise to a 'taxable supply' which means that VAT has either to be charged on top of the sum contributed, or accounted for out of the sum contributed. In either case this will have a financial impact on one or both parties.

It is important therefore that this position is clarified to the satisfaction of all parties before funding is applied for / received; additionally, agreements, contracts and any other such documentation (including letters of correspondence) must be carefully worded to avoid a connotation other than that intended being perceived by HM Customs & Excise.

In this respect, it is important to consider that a contribution is not always financial and that goods and services are subject to the same rules.

Further assistance

HM Customs and Excise have produced a concise guide to VAT for small businesses which is recommended reading if you are unfamiliar with VAT.

www.hmce.gov.uk/business/vat/beginners-guide.htm

Please see the following information sheets on Plymouth Informed Funding Guidance:

- ## Guidance Note 6 – Annex 1: VAT Classifications
- ## Guidance Note 6 – Annex 2: VAT Rates and Codes
- ## Guidance Note 6 – Annex 3: VAT Expenditure and Reclaim
- ## Guidance Note 6 – Annex 4: VAT Income

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