

# CTG Expert Insight Session: Developments in VAT

**15 September 2021**

**#charitytax**

## Today's session

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- Richard Bray, CTG Chair – Introduction
- Graham Elliott, CTG Technical Adviser – Presentation

# Expert Insight Developments in VAT

**Graham Elliott**

Director

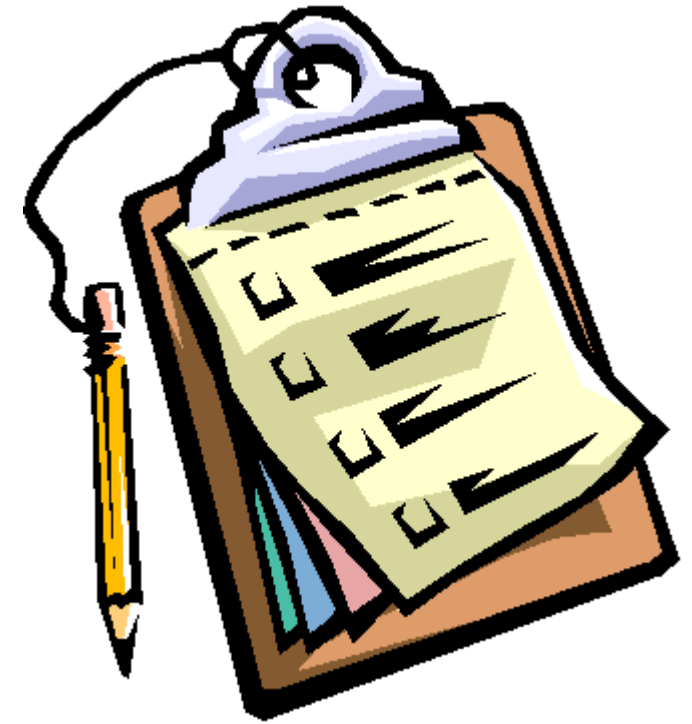
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# Agenda

- The COVID Changes/Concessions
- Literature VAT Liability
- Charity Advertising
- Partial Exemption
- Change of Building Use
- Welfare
- Grants v Supplies
- The Crystal Ball



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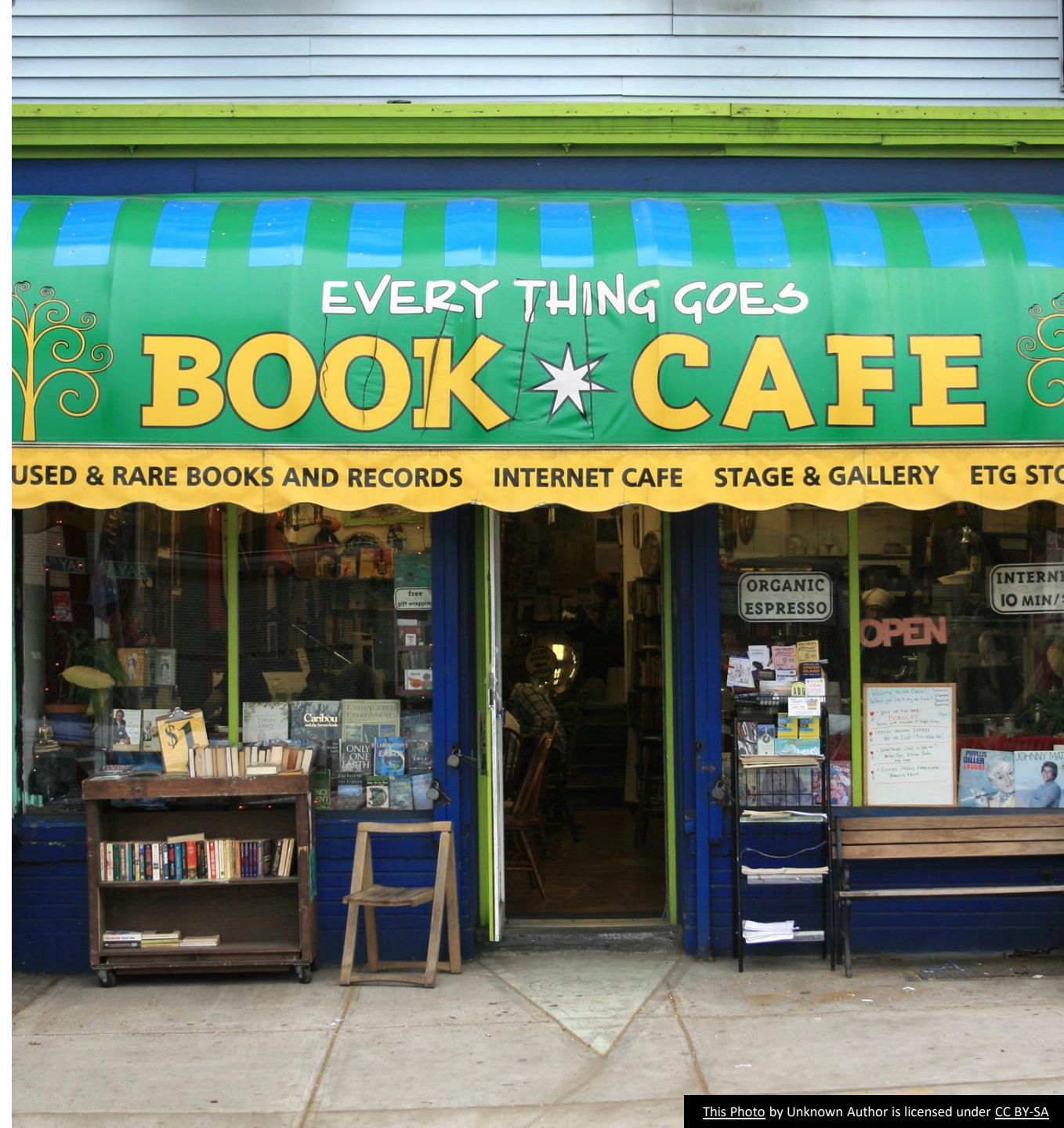
# Covid Change #1

## VAT Reduced Rate for catering and admissions (5%)

- July 2020 to 30 September 2021
- Restaurants/cafes/takeaways
  - (not booze)
- Holiday accommodation
- Museums/Exhibitions
- Zoos/cinemas
  - botanical gardens?
- Theatres/Concerts
- Fairs

*But does not displace cultural exemption*

- ❖ From 1 October 2021 to (probably) 31 March 2022 a rate of **12.5%** will apply.



# Covid Concession #2

## VAT Payment Holiday

- VAT returns rendered during a brief three month period in the first lockdown did not need to be paid
  - But returns had to be submitted on time
- Direct Debits had to be cancelled by the charity
- Later repayment returns did not need to be reduced by debt
- Payment deferred to March 2021
- But also subject to being able to pay this off in equal instalments between March 2021 and March 2022, but only if you applied for it



# Covid Concession #3(?)

Buildings repurposed for Covid-related uses, where the charity had benefited from zero rate relief owing to intended RCP/RRP use...

HMRC agreed to interpret the rules as not requiring a self-supply for change of use, as long as:

- No charges made for the use, save bare recovery of utilities costs
- Strictly for Covid use, and not merely for Covid precautions such as social distancing
- HMRC refused to give any wider examples than this
- Charities asked to contact HMRC if they have made a change of use beyond the above
- Will the same be needed this coming Winter?.....

# Covid Concession #4

Following lobbying from various sectors whose Partial Exemption rates had fallen because of Covid, HMRC issued **R&C Brief 4(2021)** allowing the following:

- Streamlined application of temporary PESM (on application)
- Would accept use of pre-Covid year (or three years if required) to apply to the Covid year, or
- If the above didn't give a fair result, the anticipated income use
- Those using Standard Method to apply Override accordingly if they could, or apply for PESM if they could not
- Ditto to a change in method for a CGS adjustment
- No explicit mention of impact on Non-Business apportionment ....



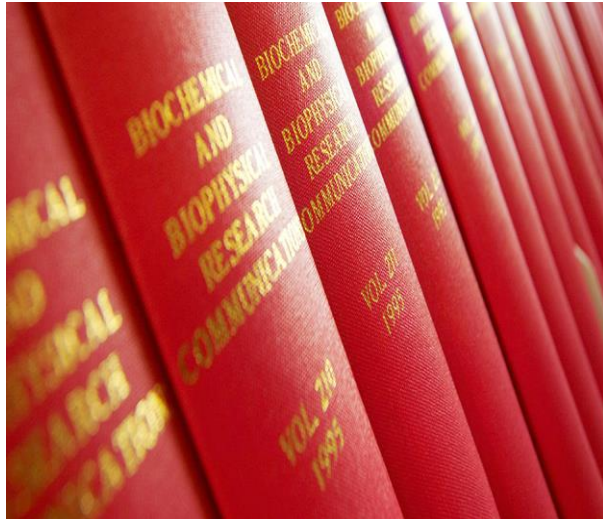
# R&C Brief 4(2021): results?

Significant reports have been received that HMRC has *not* processed the PESM requests expeditiously, resulting in:

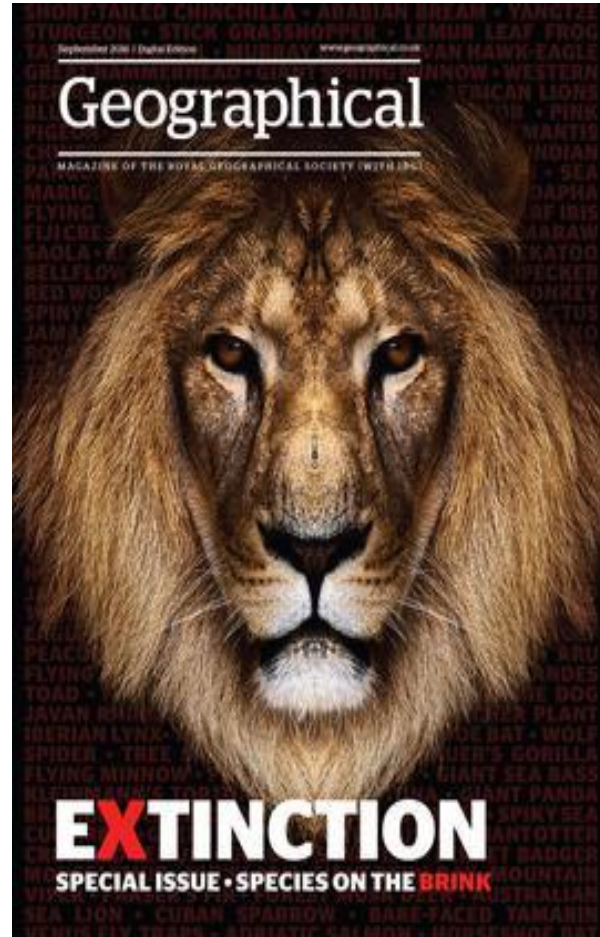
1. Inability to apply the Annual Adjustment on time.
2. Uncertainty as to the end of year accounts figures.

Excuses mentioned have been the sheer number of applications, and short-staffing. It appears that HMRC officers did not take sufficient notice of the contents of the Brief and tried to assess suitability of the methods that the Brief had indicated would be automatically accepted.

# Literature!



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## Growth in the Charity Charism

The charism of charity continues to grow and be nurtured through our Transfer Candidate, Sister Genevieve Nwaizu. Genevieve, pictured on right, is very much involved in her ministry as second grade teacher at Saint Augustine Elementary School, Union City, NJ. She loves the ministry of education and is very much part of all that goes on at St. Augustine.

After teaching Pre-K for a year, Genevieve assumed the position of second grade teacher. This was a special year for her as she had the opportunity and privilege of preparing about 30 young boys and girls for First Holy Communion. She radiates excitement and joy when she shares her experience of working with these beautiful young children who have caught her love for God and Jesus in the Holy Eucharist. Genevieve was very instrumental in helping to prepare the school and students for the recent visit from Middle States. The school, and especially her classroom, was decorated from ceiling to floor with many creative works that were done by her students.

Genevieve shares community with the sisters at Assumption/All Saints Convent in Jersey City. The sisters have welcomed her and because they exude the charism of charity, Genevieve has wonderful role models to learn from. She is very comfortable there where she has lived for almost three years.

Recently Genevieve has had the opportunity to share community life with the sisters at Saint Anthony



Convent in Elizabeth. The six weeks spent with this community have given her the chance to meet more of our sisters and be enriched by the sharing of their stories and they in turn by hers.

Genevieve and Sister Maryanne Tracey, the Director of Formation, were recently invited to Mother Seton Convent in Clark for dinner. This was a great opportunity for Genevieve to meet yet another local community. A good time was had by all as each shared her ministry experiences over dinner.

As summer approaches Genevieve will have more experiences and opportunities to grow in her love for God and the charism of the Sisters of Charity of Saint Elizabeth.

~ Maryanne Tracey, SC

**Inauguration of First National Catholic Sisters' Week**  
**Saint Catherine University, Saint Paul, Minnesota**

# From Tribunal case to change in Law

Printed material (hard copy/physical material) has been zero rated for decades.

But what about digital equivalents?

*Two legal theories vied for attention:*

- That the relief was originally intended for hard copy; and provisions that did not allow extensions of the relief under EU law would prevent any modernising
- That the law never said that it was only the physical product and that each such item could as easily be regarded as the digital equivalent

.....

# *Newscorp* to the rescue(?)

Charities suffered in two ways:

- Environmental and cost dictated the move to digital for newsletters for members
- Buying books and journals had moved to digital

The tax advantage of the zero rate treatment was a barrier against progressive change

Then came the *Newscorp* case for digital newspapers...

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# *Newscorp* result so far

Court of Appeal held that the law should not be read to include modern equivalents (Jan 2021).

- This overturned the Upper Tribunal that thought the zero rate should apply.
- Appeal going to Supreme Court.

**HMRC continues to disagree with that view**

**See R&C Brief 3(2021) which covers the latest position**

If HMRC loses on appeal, then any digital version of products listed in the legislation (or perhaps only 'newspapers') will be deemed to always have been zero rated.

➤ ***Consider making a protective claim!***

# Coincidental change to literature rules

Purely by coincidence (ahem!!) the government had decided to introduce the zero rate on digital literature effective from December (to presage the freedom to do so from leaving the EU).

Because of Covid (though was it really??...) they brought that forward to May 2020... (to encourage reading during lockdown, when the book shops and libraries were shut).



# What's covered by the digital Z/R?

- Books, booklets, pamphlets and leaflets
- Newspapers, journals and periodicals
- Children's picture books (and painting books ... *(why?)*)

*BUT... NOT...*

- Product mainly consisting of video or sound files
- Predominantly advertising material
- Nor digital-readers and similar 'widgets'



# Where does this leave the charity newsletter or information sheet?

- Seek to fit newsletter format into one of the words on previous slide (e.g. leaflet)
- Ditto for information sheet (leaflet or pamphlet)
- Try to keep it as similar as possible to a physical equivalent that you have been zero rating, for the time being at least
- Don't turn it into an actual letter (e.g. avoid intros like "Hi John!!") as this is not similar to a printed newsletter or information sheet
- Keep those adverts to a minimum! Watch out for the paywall protected links put into the publication

# If music be the food of love....

... then “tough!”

Hard copy sheet music is zero rated, but the digital equivalent is not (unless it happens to be a book)...

*Why??*

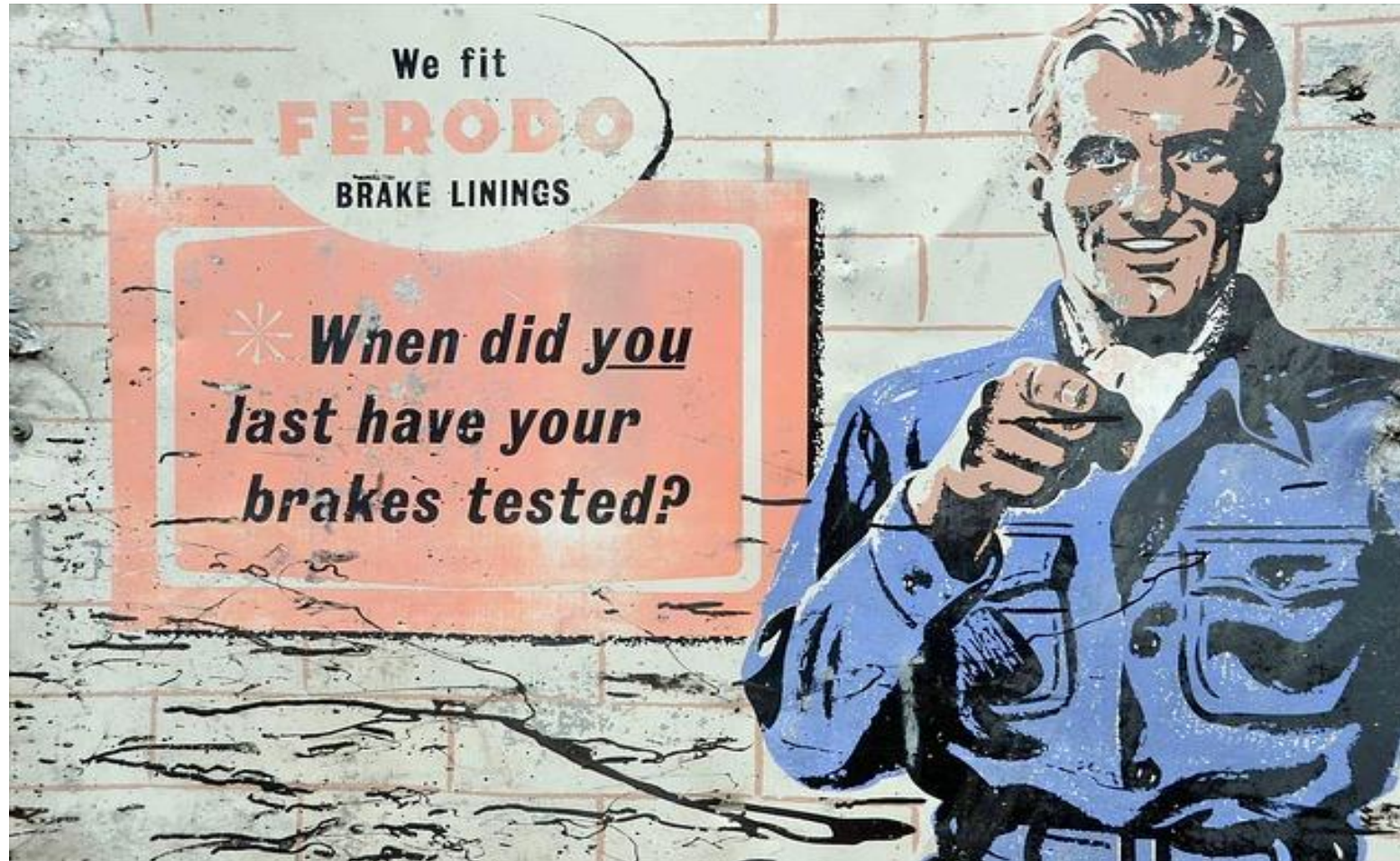
Because music doesn't encourage reading in lockdown, and we don't want singing or strumming to take hold...

*(who needs church choirs anyway?....)*

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# Advertising!



# The Advertising Challenge

3 years ago HMRC revealed that it would not accept that digital advertising could be zero rated, as it (ostensibly) did not satisfy the exclusion in note 10A:

*“Neither of items 8 and 8A includes a supply where any of the members of the public (whether individuals or other persons) who are reached through the medium are selected by or on behalf of the charity. For this purpose “selected” includes selected by address (whether postal address or telephone number, email address or other address for electronic communication purposes) or at random.”*

# Advertising cont.

HMRC said that digital advertising was selective of recipients, and that charities determined the selection.

By contrast, traditional mediums (billboard, TV, magazine etc), did not select the recipient, because everyone could see such adverts....

But... how can I see a billboard in Liverpool? Will I meaningfully see an advert on TV channel A given that I am watching TV channel B? What if I never read the magazine in which the advert appears?

*Answer – that's because I choose not to be in Liverpool etc etc*

# Advertising – our argument (simplified)

We say that this is unrealistic.

- Digital algorithmic selection is driven by **our** inputs which define **our** likely interests
- This is effectively the same as selecting a TV channel or magazine
- These advertisements are not a case of ‘surgical strike’, but are more like ‘carpet bombing’
- As modern communications are increasingly made through a device, the effect is to severely restrict the relief’s application
- This cannot have been Parliament’s purpose

# CTG discussions with HMRC

Following lengthy discussion between the Charity Tax Group and HMRC, R&C Brief 13(2020) was issued conceding the following:

Adverts derived from browsing and received ***otherwise than through social media accounts*** (and subscription websites) are zero rated despite involving selection according to criteria. BUT...

***Since social media accounts have personalised addresses, tax has to be charged on these adverts (rationale inferred)***



# Zero rated digital advertising

- Audience targeting
- Behavioural targeting
- Channel targeting
- Content targeting
- Daypart targeting
- Demographic targeting
- Device targeting
- Direct placements on 3<sup>rd</sup> party websites
- Location targeting
- Lookalike targeting
- Pay-per-click adverts
- Retargeting

# The future for social media adverts

HMRC has said it will continue to engage with external stakeholders..., but this is not a promise to change their stance on social media advertising.

It carries the implication that something has to change in the advertising itself, how it is regulated, or the VAT legislation, for there to be a change of view.

That is a restrictive view of the current legislation, and creates a two tier advertising market that cannot have been intended by Parliament.

Litigation of the issues may unlock further progress (as it has with literature...)

8	User Roles:								Security Demand
10			Type						
11		Role	Admin	Editor	Reader	Anonymous			
12		Admin	X						
13		ManageUsers	X						
14		EditArticles	X	X					
15		ReadArticles	X	X	X				
16		ReadArticlesTitles	X	X	X	X			
17									
18	Authorization Mappings:								
19			User Type						
20	WS Function Name	Security Demand	Admin	Editor	Reader	Anonymous	Status	Comments	
21	AddGuidanceItemsToView	EditArticles	YES	YES	NO	NO			
22	BatchUserCreation	ManageUsers	YES	NO	NO	NO			
23	ClearGUObjects	ReadArticlesTitles	YES	YES	YES	YES			
24	CreateArticle	EditArticles	YES	YES	NO	NO		Done	
25	CreateArticle_Simple	EditArticles	YES	YES	NO	NO		Done	
26	CreateFolder	EditArticles	YES	YES	NO	NO		Done	
27	CreateGuidanceItem	EditArticles	YES	YES	NO	NO			
28	CreateGuidanceType	EditArticles	YES	YES	NO	NO	TO REMOVE		
29	CreateLibrary		YES	YES	NO	NO		Done	
30									

# Apportioning VAT on costs

## Issues

- Investment management fees
- HMRC views on non-business use of costs
- Whether costs linked to all activities or only some activities

# Investment Management Fees

## *University of Cambridge*

- VAT incurred on fees of managing portfolio
- Is this cost an overhead of all the University's activities?
- Or, is it a cost solely of the non-business activity of holding investments?
- *If the former, percentage recovery. If the latter, blocked as costs solely related to non-taxable activity...*

CJEU decided that it was only related to a non-business activity as it was an extension of the act of collecting and managing outside scope donations, and subsidised the fees for supplies, and was not built into those fees...(?)

# *Frank Smart and Newell*

HMRC failed in both of these cases relating to commercial operations:

1. Received grants towards farming and biomass energy
2. Courts resoundingly accepted the receipt of grants to support taxable business did not threaten input tax recovery
3. HMRC will argue *Cambridge University* against charities reclaiming VAT when generating O/S income, but
4. Where charities use grants to support taxable trade (i.e. loss-making trade) then these cases should also apply to charities



# Cost components of Catering

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# Royal Opera House case

(for the purposes of the standard method override or for a special partial exemption method)... should catering supplies be regarded as having a sufficient link with theatrical production costs, that the catering income is counted in the apportionment of those costs?

This could be arguable if the costs of production were used to make the catering supplies.

But this is not the same as merely being a condition precedent or facilitator of those supplies (the “but for test”)



# ROH result

The earlier case of **Chester Zoo** seemed to support the charity, because animal keep costs were deemed apportionable by reference to all income, including catering outlet income.

The First tier Tribunal accepted this analogy, allowing the appeal

The Upper Tribunal overturned this, and applied recent case law (*Frank Smart/University of Cambridge*) and said that production costs are not overheads of the entire business, and did not otherwise have a sufficient link with the catering supplies (i.e. failed the “but for test”)

➤ Appeal to Court of Appeal failed also, for same reasons

# Zoo versus Opera



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# Change of Use of Zero Rated Building

*Balhousie* (Supreme Court)

Care home company issued a certificate for zero rate of new construction.

It then sold the care home specifically as part of a sale and leaseback arrangement, only to raise finance. - No change of use of building intended.

HMRC said its sale was a disposal of its entire interest in the building, thus triggering the self-supply charge on the transaction

# Supreme Court Decision

The Supreme Court considered what the legislation meant by the disposal of the “entire interest” in the property.

The Court of Session had said that the outright sale was such a disposal, and the immediate regrant to the operator was ignored.

But the Supreme Court said that the entire sale & leaseback needed to be considered and to dissect them was artificial and contrary to the purpose of the provisions. Therefore Balhousie did retain some of its interest and accordingly had not triggered the self-supply charge.

# Welfare – whether exempt

## Don't want to be exempt....

Supplies to local authorities are often better taxed, as LAs can reclaim VAT

YMCAs applied VAT to services (and thus reclaimed related input tax) – HMRC said the supplies were 'welfare' and thus exempt

*(Birmingham YMCA et al UKUT0143)*

Similar point in *Lilias Graham Trust* concerning monitoring of parents for the general benefit of the children. LGT wanted supplies to the Council to be taxable, HMRC disagreed.

# YMCA cont.

The Upper Tribunal concluded that the supply was exempt as welfare, because –

- That it was supplied to LA, not recipient, is irrelevant
- The supply was of ‘instruction’, even though it was mainly of ‘advice’ (they are close enough)
- The recipient was incipiently or potentially ‘distressed’, so had to be regarded as falling into the ‘distressed’ category

If so, what’s sauce for the goose is sauce for the gander...

# Welfare – want to be exempt

Where litigation does not provide a solution:

- The charity (Cheshire Centre for Assisted Living) provided a service of running the payroll for employing a personal assistant
- Its customers had learning disabilities, which caused the need for the assistant, and inability to organise their payment
- The assistant provided the care, but the charity enabled it by carrying out essential admin for the employment
- HMRC disagreed that this was exempt, because it was the same as a normal payroll service

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# Litigation mis-fires

The charity won its case at the First Tribunal, and HMRC appealed

HMRC identified one point on which they said they had been misunderstood by the tribunal, and where there was a better argument in their favour

The charity could not afford to defend, and was swayed by that new (or was it new?) point. It withdrew

This means that the Upper Tribunal had to allow the appeal without further consideration. The original decision is technically wrong. (see R&C Brief 16(2020))

# Comparison of cases

- In the YMCA case a service was provided to persons who *might* become distressed (young adults who left parental abode), but were **not yet** distressed, and otherwise were not in need of care, yet this was held to be exempt. (In LGT, services were for the parents, not directly for the children)
- In payroll service case the service was provided to persons who **had** a severe disability and the service was completely necessary to effecting a care solution, but was held to be taxable (by process of litigation at least).
- In the YMCA case (and LGT) the supply was (in law) to an agency but was held to be exempt as care and welfare.
- In the payroll case the supply was to the person with the disability, and was held to be taxable.

***DRAW YOUR OWN CONCLUSIONS...***

# Cost Sharing Exemption and VAT Groups

The CJEU decision in *Kaplan* establishes that:

- You can have a cost sharing group of which a VAT group is a member, but
- All of the members of that VAT group must be members of the cost sharing group or else the VAT group members are all disqualified from receipt of exempt services
- Since the conditions for being in a cost sharing group are specific, the risk of disqualification is considerable
- Particularly if a company joins the VAT Group after the CSG has been set up and thereby taints the entire position of the VAT group in the CSG

# Grants versus Supplies

Upper Tribunal decision in *Colchester Institute Corporation (UKUT0368)* –

Held that SFA and ESF grants were consideration of a supply of education services to students, and not outside scope of VAT.

This is because the grant is calibrated as a ‘per student’ amount rather than simple deficit funding of a general activity.

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# Colchester Cont.

Possible ramifications (subject to HMRC – next slide):

- Cuts across S33 refund status of academies
- Causes other grants that have unitised value metrics to be regarded as payment for services
  - Thus potentially taxable because there isn't an exemption
- Cuts across RCP status for costs incurred on the following
  - Buildings construction
  - Rent
  - Fuel

# HMRC Response to Colchester

HMRC took on board widespread concern about the adverse impact implicit in this decision: and issued

**R&C Brief 8(2021)**

Ostensibly focused only on education bodies, it has relevance to all charities in so far as it explains HMRC intention to find another case to take on these points to seek a change in the Upper Tribunal interpretation.

In the meantime it will not apply the adverse decision (text in next slide)

# Text from R&CB 8(2021)

- In the meantime, HMRC's policy concerning grant funded education will remain unchanged and HMRC will not impose the primary decision on any further education institution. This means that it remains open to institutions, that continue to treat such education as non-business, to claim charitable reliefs, where all the relevant criteria have been met.
- Institutions can choose to apply the conclusion of the Upper Tribunal in Colchester Institute Corporation, treat the education as exempt and submit error correction notices for any under or overpayment of VAT, including adjustments to previous claims for charitable reliefs. HMRC will protect its position to secure tax revenues, pending the outcome of an appeal.



# The wider 'grants' picture

But it remains to be seen what such litigation would produce, so:

- Are many 'grants' laden with obligations that mean they are also 'consideration'?
- Couldn't the charity VAT reliefs be reformed so that RCP = Primary Purpose Trade (or similar)?
- Could we use the change on 1 January 2021 to consider only taxing content values of such sums and not the full amount .... (but that leads to the next section...)

# The Crystal Ball....



# From MTD to RTI

The avowed purpose of MTD was to increase accuracy of VAT accounting by removing human error.

But the “conspicuously ill-concealed” agenda was to set a road map to allowing ‘real time’ accounting to arise from constant communication with HMRC.

This will be likely to involve HMRC being in a position to interrogate VAT accounting records remotely.

When? 2030? Possibly

# VAT Registration Threshold

The 'gig economy' is a fragmented structure which risks revenue loss through failure to tax exchange and consumption.

One 'sticking plaster' solution would be to greatly reduce the VAT registration threshold.

Another 'solution' would be to ensure that the distribution channels are unambiguously treated as the supplier for VAT

Another change could be to tax barter on a C2C basis in a more thorough manner

# Potential Input VAT Rate for Charities

Leaving the EU opens the possibility for different rates for different things

CTG identifies that charities suffer significant irrecoverable input tax, but the social exemptions are too valuable to jettison

Therefore a solution is to allow a charity to certify that the use of a service (or goods) will be charitable, thus benefiting from a VAT rate that is lower than the usual consumer or B2B rate

The excuse that the EU won't allow it no longer applies, but the case for such a change needs to be advocated over the coming years

# Case for recognising values other than consideration (or life after 'split payment')

Since the cases of *Tron Theatre*, *Serpentine Gallery*, it is notable that the value of consideration for VAT purposes is all that is paid to elicit the benefit, and not the actual value of the benefit.

The result often an absurdly high value of benefit

This also causes a mismatch with the gift aid donor benefit concepts

A useful change would be to all a fair & reasonable apportionment between a donation element and a transaction element, without resorting to a split payment agreement.

# Questions and Discussion

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