Charity VAT recovery and 'culture'

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The theme of VAT recovery continues. This relates to an interesting announcement made by a senior policy officer of HMRC in the VAT Practitioners' Group conference in June 2014. The point was not limited to charities, but is likely to impact upon charities more than on most other sectors. It is a rather technical matter, but the gist of it is that legal arguments are being honed in order to limit the ability of a charity to reclaim VAT where the charity does not seek to make any return on capital employed, but rather to provide services at a loss from the expenditure that has been sunk. This can happen where products are bought and then sold at a lower price, or where products are manufactured out of raw materials which cost more than the sale price of the resulting product. It can also arise where capital expenditure is incurred, such as in land and property, where the charges made provide a 'yield' which cannot match the cost of acquisition.

In all such cases, the supplier would be trading at an intentional loss. HMRC is now saying that the extent of that loss should also be reflected in the extent of VAT non-recovery. This applies despite there being no apparent allegation that the activity is not being carried on as a business (since, in that case, there would be no VAT recovery and no VAT to declare on the supplies). Nor is it being alleged simply in regard to charities which also perform exempt and non-business activities, such that the costs are being apportioned between those activities. No. The policy clearly indicates that, even were a charity to incur costs purely in regard to fully taxable supplies (whether zero, reduced, or standard rated), it would not be able to reclaim VAT in full unless it was going to cover its costs from charges in the long run. Under this theory, if you only recover 40% of your costs in charges, you only get 40% VAT recovery.

For the technically minded, this relies upon the concept of the 'cost component' and the fact that this determines whether there is a sufficient 'direct and immediate link' between the costs and the supplies made. If HMRC were successful with this policy, the effect on the charity sector would be pretty devastating. It is known that HMRC has issued assessments deploying this theory, and there is certain to be litigation. Their idea appears so novel as to be entirely alien to the VAT system as we understand it. In my view it is simply wrong. We will keep an eye open for its impact as time goes by.

Culture – What is it?

HMRC has manned the barricades to defend their limited definition of 'culture' in order to limit the scope of the exemption available to certain kinds of non-profit suppliers, but once again met with resistance in the courts. The narrow issue was whether cinema is 'culture'. Of course, commercial cinema is taxable whether or not it is 'culture'. The point only applies to cinema provided by a qualifying body, so is the view reconfirmed by the courts of any broad interest? Well, perhaps.

It casts doubt on the list of activities that HMRC acknowledges as culture and thus makes it possible for other activities that arise in cultural contexts to be exempted by eligible bodies without the need to wrestle with the list. Whereas an art gallery is already covered by the list, it can now exempt admission to a film it makes about the art it shows, and it may think of another way of spreading the cultural word, and the exemption seems more likely to apply to that other idea.

Of course, HMRC may appeal again, and the case is strictly of relevance to a past period, but HMRC is very unlikely to prevail in the end, and the points made against them are so fundamental that they will have to change the law to reflect them.

Disability Relief

HMRC is currently reviewing the VAT relief on motor vehicles adapted for disabled people, and has issued a consultation document with a closing date of 19 September. The problem is that the zero rate applies to the full price of a car which has been adapted substantially and permanently for use by a disabled person. The relief only applies where a disabled person purchases the car (or a charity does so for him). HMRC has found that rather a lot of these cars are high value items, usually costing more than £40,000. It alleges that certain of the adaptations are relatively ephemeral (and even says that some of them are dangerous). Many of these vehicles are then sold on by their disabled original owners, without having suffered VAT and, presumably, are reverse-adapted to a more normal state.

One can only assume that HMRC has got this right and this clearly is an unacceptable abuse, seemingly by a group of people for whom the relief was intended to provide state assistance. It might be naïve to say that such behaviour on their part beggars belief but it is certainly extremely disappointing. Because of the behaviour of a few poorly motivated individuals, we now have to suffer potential restriction to a valuable relief.

HMRC seeks suggestions as to how to limit the relief to stop the abuse. These range from such things as limiting the number or frequency of purchases that can be made by any one disabled person, such as to match their own personal use, or requiring that the costs of the works to be

carried out to justify the zero rate match or exceed the amount of VAT that would be saved on the price of the base model. These seem to be proportionate responses to the problem that HMRC has identified, but the question is whether there are unintended consequences, and whether they are practicable and can be policed. This will no doubt be debated once the consultation has closed.

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