

Grants and VAT

What is VAT?

VAT is a tax on the provision of goods and services in return for a consideration. "Consideration" means everything received in return for the supply of goods or the provision of services (usually payment/money - but could be reciprocal goods/services), including incidental expenses, for example, delivery charges on goods.

Why should I think about VAT?

VAT can add 20% to the cost of funding (if it is applicable), and although it is the funding recipient's responsibility to ensure that they are charging VAT as required, the funder could be liable to pay any unexpected VAT depending on the agreement between the funder and the funding recipient.

When does funding not attract VAT?

Where funding is freely given, with nothing supplied in return (to the funder or another third party), then no VAT is due as the funding is not consideration for any supply and therefore is outside the scope of VAT; this is known as a grant for tax/VAT purposes.

Additionally, attaching conditions or safeguards to the payment of grants to make sure that the money is spent correctly does not turn it into consideration for a supply. Certain 'benefits' to the funder, for example copies of reports, may arise as a result of necessary safeguards to make sure the money is spent correctly. Usually where these are incidental to the primary purpose of the project receiving the funding and are minimal in relation to the amount of funding, the funding is not seen as consideration for a supply and therefore VAT is not chargeable. What is important is whether the funder or another third party receives a supply of goods or services in return for the payment (consideration), and if so, then VAT may be chargeable if the supply being delivered is not exempt from, or zero-rated VAT.

When is funding subject to VAT?

Where the funding given to the recipient, has a direct link to the provision of goods or services to the funder or a third party, then VAT would be applicable. In order to identify a direct link, you should consider whether the payments arise as a result of a milestone or deliverable – an example might be that funding is dependent on a certain volume of activity being undertaken. If there is a direct link then this would indicate a consideration is being made in return for a supply and VAT would be chargeable. The funder carrying out due diligence as to how the funding was spent, does not necessarily mean a supply is being made (as explained above).

Subsidies

Subsidies given would follow the same logic, and if a supply is made in return for a subsidy (consideration), then VAT may be chargeable depending on the liability of the supply.

Below are some further indicators of when a payment may be a true grant for VAT purposes (and therefore outside the scope of VAT), and when a payment may actually be a consideration in return

for a supply (and therefore subject to VAT). These are indicators and all should be looked at to get an accurate overall picture of the facts and circumstances.

Indicators a payment is a grant (outside scope of VAT)

- The payment was made following a grant application process run by an organisation that regularly provides outside the scope public funded grants for wider public benefit, such as central or local government
- In using the payment, the funding recipient should carry out its own charitable aims and objectives with the assistance of the money, for which there is no expectation of a direct benefit in return to the funder
- The funder will not attempt to control how the money is spent beyond seeing that the funds are properly managed. Any monitoring is no more than simply ensuring the payments are appropriately spent for the intended purpose
- The funding recipient will set its own targets as opposed to the funder imposing specific targets
- The payments are not treated as trading income or expenditure in the accounts of either party
- If the funding is withdrawn there is no legal redress for the funding recipient to have the payment reinstated
- Funding is drawn down by the funding recipient as a reimbursement of expenditure incurred, rather than an advance payment for services. Alternatively, there may be a 'deficit funding' arrangement whereby the funder agrees to plug any funding gaps
- The funding is provided under a statutory provision that empowers the funder to make a grant. This would be mainly relevant if the funder is a government department or local authority
- There is a 'clawback' provision within the agreement. Funders use this method to reclaim their funding in circumstances such as where not all the money was spent or if the terms of the agreement were not complied with. In contrast, a contract for a supply should not contain a 'clawback' clause as there is no automatic right to reclaim any money. The money is consideration for the supply and the solution for reclaiming the payment in any subsequent breach of contract is to sue for damages.

Indicators a payment is consideration for a supply (within scope of VAT)

- If the funder is seeking services in return for their payment (e.g. carries out a competitive tender process)
- The funding recipient undertakes outsourced activities on behalf of the funder where the services provided are ones ordinarily provided by the funder (i.e. the funding recipient is a sub-contractor)

- The contract is commercial in nature i.e. it is a legally binding contract connected to a business activity. This means looking for indicators such as penalty clauses being in place if the funding recipient does not fulfil their responsibilities and so is in breach of contract
- The supplies are undertaken as an economic activity. It is not necessary for the funding recipient to have a profit motive, but the type of supplies should have the potential to make a profit
- The payments made by the funder to the funding recipient are made specifically for the funding recipient to provide particular services to its clients. The fact that the funder may not know at the time the specific nature of the service, or who the end recipient of the service is, does not affect this position.
- Each activity carried out by the funding recipient gives rise to a specific and identifiable payment (i.e. payments are tied to milestones/deliverables). This is an agreed sum, either a single payment or a sum per activity i.e. the more work done, the greater the payment. For this to happen there is probably a detailed recording system for timekeeping, outputs achieved etc.
- The funder will attempt to control how the money is spent, maybe imposing specific targets in terms of quantity, quality, timeframes etc. Any monitoring is more than simply ensuring the payments are spent properly and is to ensure that specific supplies are made
- If the funding is withdrawn there is legal redress for the funding recipient to have the payment reinstated or claim compensation
- The payments are treated as trading income or expenditure in the accounts of either party
- The funder believes they are receiving something in return for the payment.

Although the above factors should provide a solid idea of the nature of the payment for VAT purposes, and as mentioned above, all factors need to be considered. The more indicators there are from each section the greater the evidence for a decision, however, it is not simply a matter of 'indicators for' exceeding 'indicators against' or vice versa, a balanced view needs to be formed taking all the applicable indicators into account. You must consider the economic reality, not just the contractual terms or grant agreement.

The main question to answer is whether the funding given by the funder to the recipient is the consideration or part of the consideration for any specific supply to the funder or to enable a third party to obtain a specific service (or to obtain it more cheaply). For there to be a supply of services for VAT purposes, there must be a direct and immediate link between the payment made and a service provided and if there is, then the funding is consideration and therefore subject to VAT. If this direct link is not established then the payment can be treated as a grant and therefore outside the scope of VAT.

For more information you can read through HMRC Manual VATSC50400 which can be accessed here: <https://www.gov.uk/hmrc-internal-manuals/vat-supply-and-consideration/vatsc50400>.

If you have any questions on the above, please get in touch with your hub contact.