

This is an area that HMRC will review as part of normal compliance activity with customers. Therefore, if you identify any issues when applying this guidance or identify any potential errors, please contact your HMRC Customer Compliance Manager

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 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>.

Grants Examples

Example 1

A government department engaged with a public-sector body to part fund a scheme. A grant agreement was signed and implemented for this funding.

The grant agreement was reviewed and on balance, was held to be a taxable supply of services rather than grant funding. There were a number of indicators of a taxable supply, including:

1. The agreement outlined the expectations of how the scheme would be delivered (by the public-sector body), who would receive the benefits, and the culture of how the public-sector body scheme staff would work. This was deemed a level of control beyond simply carrying out 'due diligence'.
2. The payment mechanism also held taxable indicators – as part of the funding was only made available to the public-sector body upon completion of specific deliverables, and also the payments were based on a per participant basis and the service was capped to a maximum number of overall participants (as specified by the agreement). This meant that there was a direct link between the supply made (activity undertaken) and the consideration (payment made).
3. A very similar service to that required by the agreement was already being delivered by private sector organisations engaged by the same government department. It was the government department's responsibility to provide these types of services to the public, but they had engaged private sector organisations to do this on their behalf. If the public-sector supplier did not charge VAT, then they would be able to offer a similar service at a cheaper rate than the private sector (as the private sector would always have to charge VAT where applicable), thus representing a distortion of competition in the market.

Determining that VAT was accountable on the service was also important to identify whether the proposed funding under the grant agreement was inclusive or exclusive of VAT. The grant agreement itself made no reference to VAT at all as the assumption had been that VAT was not applicable, therefore the VAT was an additional cost in this instance.

Example 2

A government department had two grant agreements in place with a private sector body. The grant agreement was awarded following an open competition for innovative ways to provide more efficient internet technology.

The first agreement provided funding to develop an infrastructure for the technology to work on. As this was a brand-new technology, the only persons able to benefit from the infrastructure was the grant recipient; no other identifiable persons had any interest or right in the infrastructure, neither was any specific activity undertaken for any persons in return for the funding. This first agreement was therefore deemed an Outside of Scope grant for tax purposes.

The second agreement with the same private sector body (which was separate and independent to the first agreement) was for the supply of subsidised hardware to third party customers. The subsidy was paid per sale and the end customer was unaware and was not invoiced for the subsidised amount. Due to the direct link between the payment (consideration) and individual receipt of goods (supply made), it was deemed that VAT was due.

In this example, the funding agreement specifically stated that funding was exclusive of any VAT due, meaning that the department would ultimately have to cover any VAT arising from the agreement.

Example 3

A public-sector body provided grant funding to organisations for the purpose of increasing youth literacy within a geographic area. The applying organisations made proposals of how they would accomplish this and set their own targets for success.

The public-sector body stipulated that the successful organisation should provide accounts for how the grant funding was used and the evidence of success. The public-sector body also reserved the right to cease funding in the event that the money was inappropriately used, or where the self-imposed targets were unrealistic and therefore funding did not offer value for money. This limited the control over specific spending by the successful organisation but also protected the public-sector body from future funding commitments.

The public-sector body did not specifically direct how their money was spent, (apart from carrying out due diligence), and did not provide the funding on the basis that any specific individuals or numbers of individuals would benefit. This meant that there was no direct link between the funding given and who received the benefit.

With the lack of control and direct link between the payment and the services, no supply was deemed to have occurred for VAT purposes, and so the funding was considered Outside the Scope of VAT.

Example 4

A government department provided funding to a charitable organisation with the general aim of increasing welfare for asylum seekers.

The funding was awarded as a result of a grant application process and the charitable organisation selected had responsibility over how the funding would be spent, in order to meet the purpose of the funding.

The government department did not specify the number of asylum seekers to be supported, or the specific activities to be undertaken by the charitable organisation – however spending reports and management information reports were requested by the government department to ensure monies were being spent on the intended purpose. Additionally, if any due diligence undertaken by the department was to expose careless or inappropriate spending by the charitable organisation, then provisions were made in the grant agreement to ‘clawback’ relevant portions of the funding.

As there was no direct link between the funding given and any specific activities undertaken by the funding recipient, this funding was deemed to be an Outside the Scope (of VAT) grant.

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