

The Options for Charities

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A Perspective on the Problem

- In many Member States, including the UK, philanthropic social welfare, religious and educational activities by voluntary bodies have traditionally been relieved of direct tax (eg corporate income tax, capital gains tax, real estate taxes)
- In the UK, charities enjoy in practice almost complete relief from direct tax, either through exemption of their core activities, or by the 'gift aid' route (tax reliefs on donations and on profits earned by trading subsidiaries).

- VAT treats charities quite differently (and harshly).
- Their “outputs” are either non-business (eg social welfare or rescue activities carried out for no consideration and fundraising activities) or they are business but exempt (eg education and social welfare).
- In both these cases there is no right to input tax credit on related expenditure.
- Effectively, except where they have taxable trading activities, charities are equated to final consumers for VAT purposes.

VAT Reliefs

- There are reasonably extensive reliefs by exemption for charitable activity.
- The social reliefs in Article 13 (Sixth Directive) apply in the main to outputs of charities, eg
 - Fund-raising events
 - Welfare services (care, treatment and instruction of elderly, sick, distressed or disabled persons, protection of minors and spiritual welfare).
 - Children’s or young persons education.
 - Certain sporting and cultural services.

Reliefs Cont'd.

- There are also 'transitional' reliefs by zero-rating or super reduced rates in some countries, eg UK and Ireland.
- Some are of general application for social reasons (eg food, transport, children's clothing and shoes).
- Others are targeted specifically at either the expenditure or the supplies by charities, or both (eg charity shops).

- The "input" reliefs tend to be highly selective and somewhat arbitrary – eg new construction but not repair and maintenance of charity building, some goods and works for the disabled (toilets but not kitchens), some equipment and medicines for medical use and research use, donations to and sales by charity shops.
- The only major 'input' relief at EU level is for lifeboats used for rescue at sea (Article 15(4)) – effectively a zero rate.

The Present State

- There are therefore a 'hotch potch' of existing VAT reliefs, which charities (and VAT authorities) often have difficulty in understanding and applying properly.
- The problem of irrecoverable VAT has grown as VAT standard rates have crept up over the years – the norm is now 20% or more (25% in Sweden and Denmark) and rates are generally over 20% in the 10 Accession countries.
- In 1979, the increase in the UK from 8% to 15% (and then to 17.5%) came as a severe blow to charities.

- Irrecoverable VAT in the UK is estimated to be € 0.75 billion (Ireland €69 million) in relation to non-business activities. VAT blocked because of exemption is at least the same again.
- This demonstrably restricts how much charities can do (how far their hard raised donations will go) and what people are prepared to give (especially for projects, eg purchase or restoration of buildings or equipment, with a visible VAT cost (the widow's mite going to the Treasury's maw).

So What Are the Options?

- (1) Radical reform of the present system – a new VAT deal for charities.
- (2) An EU wide system for refunding VAT to charities on their non-business ESSENTIAL expenditure.
- (3) Retailing the present reliefs (including all the exemptions and transitional rates) and concentrating on incremental improvements, especially in the application of reduced rates.

Option (1)

- Move charities squarely into the VAT system, by abolishing the exemptions in Article 13.
- All their outputs become taxable, so freeing up all their input tax on related expenditure (ie cost components needed to fulfil their charitable objectives).
- This requires their non-trading (ie more commercial activities) to be taxed at a reduced rate (to achieve a broadly neutral effect).
- Exemption in the UK on outputs, where the standard rate is 17.5%, but where the tax base is reduced by extensive zero rates (from which charities benefit), would probably equate to a reduced rate of 2%-3%. In a country with a 25% rate, but fewer reliefs, this would be higher, may be 4% - 5%.

How Would This be of benefit?

- The gain (over neutrality) arises if the non-business activities of charities are effectively ignored (eg fund-raising) and activities for no consideration (eg sea rescue) are equated to taxable activities.
- This system would also significantly reduce the administrative burden of charities – no non-business apportionments or partial exemption calculations.

The Drawbacks:-

- It would require unanimous agreement.
- It would be politically difficult to sell – because it appears to increase taxation of charities.
- Above all, the Member States are highly unlikely to agree to a super reduced rate, and without this there would be a real increase in taxation.

Option (2)

- This would be similar to the VAT rebate schemes which apply in a limited number of countries to State and local Government bodies.
- Such a scheme depends on calculating and paying a matching grant equivalent to some or all of the VAT incurred on ESSENTIAL expenditure.
- Why: it would be reasonably easy to check and monitor.
- It would be 'outside the VAT system', and therefore not in breach of the Sixth Directive (any more than existing rebate schemes for State bodies, eg UK's Section 33).

The Drawbacks:-

- Finance Ministries seem implacably opposed to it.
- It would never be imposed in all 15 (and soon 25) Member States – there are no powers to do so.
- It involves public expenditure as well as taxation issues (theology!)

Option (3)

- This is almost certainly the politically possible option.
- The various reliefs – the scope and intention behind each of the social exemptions in Article 13 – need to be better explained and then properly implemented in all Member States.
- The reform of the reduced rates in Annex H presents a real opportunity.

The Reduced Rates Issue

- Annex H to be reformed at end of this year (when the special reduced rate for labour intensive industries expires).
- At present it is a discretionary list which Member States can ignore if they wish.
- It includes at point 14 a reduced rate for charities which no one really understands.

This reads:-

- “Supply of goods and services by organisations recognised as charities by Member States and engaged in welfare or social security work, insofar as these supplies are not exempt under Article 13.”

Annex H – Reduced Rates

- The Commission’s proposal is to replace the current list with a core list of mandatory reduced rates, and a wider discretionary list.
- The present point 14 opens some interesting possibilities.
- Is it meant to cover some trading activities, eg sales of Christmas cards, not exempt in Article 13?
- Generally, Member States do not appear to have implemented it.

Annex H – Reduced Rates

- The aim should be:-
 - (a) To make point 14 (or something like it) mandatory and to define the outputs it would apply to (eg any supplies connected with the social welfare and fundraising activities of a charity, including non-exempt supplies falling outside the social welfare, cultural, sporting and spiritual services in Article 13, and specified trading activities, eg sale of Christmas card and similar products).
 - (b) To extend point 14 to apply also to the inputs of charities, either generally, or if necessary to restricted essential expenditure (eg real estate purchases, renovation and repairs where used for a social purpose – which could be up to one third of irrecoverable VAT costs of some social welfare charities).

- Drawbacks
 - Member States may see any relief for inputs of charities as a trojan horse for a wider rebate scheme.
 - It would cost money.
- Advantages
 - It would apply across the whole EU as an intrinsic part of the VAT system.
 - It would partly address the main problem charities face – even if the minimum 5% for reduced rates is preserved (as is likely).

Conclusion

- Most charities can do more to take full advantage of existing reliefs, and by careful but not “abusive” planning, make the existing VAT system work better for them.
- There is still considerable scope for lobbying to secure incremental improvements and better (ie more favourable) interpretations of existing reliefs.
- Charities would be well advised to hang on to ALL the relief they have – and press for more in the area of reduced rates, which are under review anyway.