

Danish charities get compensation for VAT expenses

Casestudy, prepared by ISOBRO and Deloitte 11 November 2010

In meetings held during the autumn of 2005, ISOBRO presented a memorandum to government financial policies spokesmen showing that charitable organisations pay DKK 236 million every year in input VAT of goods and services paid for by privately raised funds. The aim was to establish a national compensation scheme.

In 2006, the Minister for Taxation received confirmation of the EU Commission standpoint, namely that it is possible to give full compensation to charities for their input VAT as long as the scheme is established outside the VAT system. The Minister of Finance said in September 2006: “We do wish to support voluntary activities where special efforts are made to raise own funds.” Thus the government wanted to reduce the organisations’ VAT expenses in order to give them a better basis for solving their tasks.

The organisations covered by the scheme are international charities, church-based, social and humanitarian organisations, organisations working for nature, environment, animal protection, disabled persons, sports activities, and disease-combating organisations. The scheme only applies to organisations that are characterised by being predominantly self-financing, i.e. organisations that are approved in accordance with section 8 A or section 12(3) of the Danish Tax Assessment Act.

The compensation scheme was implemented at the beginning of the financial year 2007, when the scheme was adopted. At first, it only comprised a compensation that covered the increase in VAT expenses calculated from the base year 2004, and based on the organisations’ self-financing ratio. Starting in 2008, the scheme was improved to the effect that it became possible to use the base year to recalculate certain expenses, related to some purchases and to extraordinary costs which subject to detailed definitions could be removed from the accounts, which meant that the amount refunded to each organisation was increased.

Total compensation amounts paid since the scheme was introduced:

2007: DKK 27 million

2008: DKK 50 million

2009: DKK 79 million

2010: DKK 115 million

Basically, the rationale of the scheme is that the individual organisation is compensated for the VAT expenses incurred by purchasing any kind of goods or services. However, the scheme has two limitations. One is that compensation is granted for the increase in input VAT expenses since 2004, however with certain significant modifications of the 2004 accounts. The other is that compensation is granted relative to the organisation's self-financing ratio. As the government does not know in advance the size of the compensation amount to be paid, an annual supplementary grant is made to the current state budget.

ISOBRO does not have any actual measurements of changes in economic behaviour in connection with the VAT compensation, but the compensation appears to stimulate a number of new activities. In particular, a number of construction works that were previously put on hold have been launched, which is demonstrated in the case of The Danish Cancer Society. In addition, the scheme has put an end to the problem that many foundations only support purchases exclusive of VAT.

The compensation scheme has also led to changes in the basis upon which organisations make operational decisions. Where outsourcing was earlier burdened by VAT expenses, the compensation improves the prospect of outsourcing as an alternative to permanent employees.

The present scheme is complicated by the fact that it is based on the political possibilities in force at the time of its inception, and also by the fact that it has to ensure a VAT calculation method that reflects the legislation in force. However, the organisations' freedom to spend the funds received as compensation provides a considerable development potential that makes the scheme extremely attractive to organisations at large. The increase in refunded amounts is a direct indication that the organisations have seized the opportunity to increase their capacity significantly.

Case study Danish Cancer Society

Background

This case study is about a Danish non-profit organisation the aim of which is to eliminate cancer through research, prevention/advocacy and patient support. The society is supported by 35,000 volunteers and has 619 full-time employees (FY 2009).

The Danish Cancer Society is organised as a society, is currently supported by 455,000 members and has a turnover of DKK 509 million (FY 2009).

The main fundraising activities of the society are VAT exempt. This means that input VAT incurred generally functions as a cost or, from an economic point of view, as a 20 percent reduction of the society's purchasing power.

The society qualifies for compensation of VAT under a compensation scheme that is currently operated outside the directive-based VAT system.

Although input VAT is partially compensated for, VAT costs prevent the society from gaining full value of the funds raised for the cause.

Below, the effects of the input VAT in specific areas are described.

The effects of VAT

The Danish Cancer Society has calculated its compensation entitlement for FY 2009 to amount to DKK 23 million, which will be refunded in December 2010.

The effect of VAT on legal form

The way the Danish VAT regime operates determines the legal framework in which activities are conducted.

Compensation of VAT is granted to associations, foundations, organisations etc. and thus serves as an indirectly decisive factor in maintaining their legal structure, which is often historically determined. The result is that no other types of legal structure are established, and that existing activities are not split up into independent legal entities such as eg limited companies.

The effect of VAT on activities and level of activities/investments (research)

Because the Danish Cancer Society is structured as a non-profit NGO, funds are spent as effectively as possible and for the potential good of the population at large.

Under the current Danish VAT regime, public institutions that perform activities, eg cancer research, comparable to those of the Danish Cancer Society, receive a refund of their VAT expenses.

However, under a VAT regime that does not provide equal conditions for a public institution and an NGO like the Danish Cancer Society it is not possible to keep up the same level for privately raised funds as is the case for public funds; this puts at a disadvantage the research and development that could have been conducted if the terms had been equal.

The VAT compensation scheme, however, enables the society to work within approximately the same framework as a public institution with respect to VAT, even though the organisation's funding primarily originates from privately raised funds.

The effect of VAT on the administrative burden

Handling VAT implies administrative costs. Under certain conditions, some commercial activities are not included in the organisation's VAT exemption, and such a categorisation may require expert advice and assistance. In addition, the Danish VAT compensation scheme necessitates the involvement of the organisation's auditor, and also that the organisation from the outset is able to finance input VAT for a period lasting from 11 months and up to as much as 23 months before VAT compensation is paid.

The effect of VAT on decisions to outsource

VAT may not directly have an effect on a decision to outsource, but from an economic perspective, incurred input VAT that is not refunded or compensated for will lead to an increased cost base and a potential loss of purchasing power for the society.

By using external resources to solve tasks that it would be inefficient or disproportionately expensive in salaries or wages to solve internally, the VAT burden is an unfortunate extra cost for the Danish Cancer Society, which would not burden a similar public institution or commercial research business as heavily.

The VAT compensation scheme to some degree alleviates this inequality, particularly when collected funds constitute a predominant part of the organisation's income, as is the case of the Danish Cancer Society.

Solution

The society's VAT burden in 2009 was DKK 23 million, while the VAT compensation received in 2009 amounted to DKK 7.1 million, in 2008 it was DKK 5.1 million, and in 2007 DKK 2.0 million.

Receiving compensation for input VAT has significantly extended the scope and range of the activities that the society is able to perform. As an example, still more cancer survivors have an urgent need for more extensive patient support facilities and rehabilitation research that will help get former cancer patients back to a normal life; this includes both having a normal family life and returning to the labour market. The VAT funds have enabled the organisation to establish two new counselling centres and improve an existing research centre to a level where it may now be incorporated into the Danish national health service.

Future funds received from the VAT compensation scheme will be used to invest in early diagnosis research, which will greatly enhance the prospects for a much more effective and individualised treatment of cancer patients, which in turn will result in increased survival rates.

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