

## Property and VAT: another answer to a big question

### What VAT reliefs are available to charities?

Generally charities are not exempt from paying VAT either on goods, services or supplies relating to the property they use. VAT therefore usually represents an irrecoverable additional cost of 20% for the many charities that make few or no taxable supplies for VAT purposes.

VAT reliefs are few and far between. There are, however, some extremely important reliefs in connection with the use of property by charities. One is the right to 'disapply' the landlord's option to tax if a charity uses the vast majority of their property for directly providing a relevant charitable purpose, and the other is the right to zero rate (i.e. not to pay VAT upon) supplies (i.e. building contractors' costs etc.) in relation to the construction of a building 'intended for use solely for ... a relevant charitable purpose'. The recent cases deal with the latter, although the principles are also applicable to the former.

### What are the tests?

The test of use for a relevant charitable purpose as set out in the Value Added Tax Act 1994 is that the use must be either or both:

- a) 'Otherwise than in the course or furtherance of a business' or
- b) 'As a village hall or similarly in providing social or recreational facilities for a local community'.

Item b) will be the subject of a future legal update; it is in respect of a) that the recent case of [Longridge](#) has now changed the recent course of UK law.

The VAT Act 1994 from which the above tests derive represents the UK implementation of European Community Council Directive 2006/112/EC (known as the 'Principal VAT Directive').

The wording of the Principal VAT Directive is in fact different to the VAT Act wording. The Directive states that all supplies of goods for consideration by a 'taxable person' are subject to VAT. A 'taxable person' means any person who *'carries out ... any economic activity, whatever the purpose or results of that activity'*.

The effect of this is that only activities which are not 'economic' are excluded from VAT. This is a slightly different test to activities carried out 'otherwise than in the course or furtherance of a business'.

## **What was the previous position?**

Two cases prior to Longridge which ruled HMRC were the cases of *Yarburgh* and *St Paul's*. In both those cases it was held that the construction of buildings subsequently used for the provision of community nurseries, with fees set at a level which would assist disadvantaged local people, should be zero rated for VAT on the basis that the community nursery would be used by a charity *"otherwise than in the course or furtherance of a business"*.

Whilst it was acknowledged that the UK legislation had to be applied in a way compatible with EU legislation, and that the latter did not allow the 'purpose or results' of the activity to be taken into account when determining whether there was an economic activity, the court nevertheless considered that the charitable nature and purpose of the activity was a relevant factor in assessing whether the activity was indeed 'economic' and 'in the course or furtherance of a business', and they held that it was not.

## **What has happened since?**

In the Longridge case, that existing position has essentially been held to no longer be good law. HMRC's argument was in essence that the ECJ's case law had been moving away from this kind of 'predominant concern' idea and towards a 'general rule' that if there was a direct link between the service and payment for that service, irrespective of any concession given on price or any lack of profit motive, there was a presumption that there was an economic activity, unless particular circumstances existed to rebut that position.

In this case, where a charity provided water based activities for a charge that was modified in accordance with users' means to pay, the construction of a building to be used for that purpose was held to be subject to VAT. Likewise the case effectively stated that if cases such as the community nursery cases above came to court again, the construction of premises for those purposes would be held to be subject to VAT. Lady Justice Arden stated that in her view the UK's domestic case law had started to diverge in some respects from the applicable EU law.

## **Conclusions**

This may be disappointing news for charities who make a charge for their services (albeit at a discounted rate for services which are an intrinsic part of carrying out their objectives and on which they have no intention of making a profit) in order to be sustainable.

It is fairly easy to see why the court in the previous community nursery cases came to a different conclusion on the 'in the course or furtherance of a business' test when presented with community nursery charities which made use of volunteers, collaborated with parents, and had a fee structure designed to ensure that they were accessible to the most disadvantaged children.

It was noted in each of the cases described above that whilst the EU's 'economic' test should be widely construed so as to catch most activities and thereby ensure the principle of tax neutrality between EU member states, it is not intended to apply to activities that are genuinely not 'economic'. Thus, if no fee is intended to be charged for

activities carried out at newly constructed premises, VAT will not be chargeable, and we are sure that other cases will come up where the boundaries of what is 'economic' activity will once again be tested, as well as possible changes post-Brexit.

However, it is clear for now that the test for whether 'economic' activity is taking place is whether a payment is made for a service. If your charity plans to construct a building at which it will provide services for a fee, even if that fee is discounted, it is highly likely that the construction of that building will be subject to VAT.

Visit our [charities](#) pages for further information.

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