

Grants vs Contracts

Most people within the sector are aware of the general shift in government funding from grants to the award of contracts. Many, however, remain unaware of the implications of such change.

Generally speaking, grant funding is outside the scope of VAT as a grant does not equate to the provision of a service. Contracts however, whether for the delivery of goods or services, usually attract VAT. Depending on the nature of the goods or services being supplied the services may be exempt, zero rated or chargeable to VAT at the prevailing rate. Many charities suffer VAT as a real cost because the services they supply are exempt and as such they cannot recover the input tax they have paid on goods and services they have bought.

The VAT Tribunal has recently determined that certain payments made to Hope in the Community, a Kent-based umbrella body for religious organisations, pursuant to “grant” agreements, were in fact contractual payments upon which VAT should have been paid.

The distinctions are not always clear. In entering into any sort of funding agreement you need to think carefully about what the true relationship is. It doesn't matter that the agreement states it is a grant throughout.

Whether it is a grant or a contract will depend on a number of factors. Regrettably these factors are not definitive. These are:

- grants are generally made to benefit a section of the public;
- the grant funding is usually specified to be applied for a particular purpose;
- grant terms often require that any money left over at the end of the grant period is to be returned to the funder. In a contract situation the surplus would constitute a “profit” or surplus and can be retained by the delivery organisation;
- in the context of a grant, a funder can usually only require repayment of funds that are misspent or unspent. However pursuant to a contract a funder could also recover any “losses” it has suffered as a result of a breach of contract, for example the cost of re-procuring the service and any additional costs incurred with a new supplier.

One example of where one might argue that something that looked like a grant was in fact a contract is in the public service realm. Where a public body has a legal duty to provide a particular service, it is certainly arguable that a charity which provides that service on behalf of the public body is fulfilling that public body's obligations, or in other words providing a service to that public body. If the charity is providing a service then this arrangement would equate to a contract even if the funding was awarded by means of a grant. Often however one would argue that the services were being provided to the beneficiary group or society at

large and not to the public body, and as such, no consideration was being paid for those services and no VAT should be charged. This demonstrates exactly why the distinction is often unclear and can lead to unfortunate and significant financial consequences.

As an aside there are also public procurement issues that need to be considered. If a body awards a grant, this falls outside the scope of the public procurement regulations. However, where there is a contract to be awarded and subject to the relevant thresholds being met, it is likely a procurement process will need to be followed. If a public body awards a grant where a contract would have been more appropriate the award could theoretically be challenged under the procurement regulations.

Russell-Cooke is delighted to welcome Jane Innes as a consultant. Jane has fifteen years experience advising on business tax issues and will provide a valuable additional source advising on both tax and VAT issues.

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