



# VAT recovery and Covid 19 grant income

## Receipt of income

The receipt of a grant in whatever form is outside the scope of VAT, as nothing is done in return for the cash received. For the receipt of cash to signify that a supply has taken place, there must be something done in return for the payment received. Any grant funding including the job retention scheme (JRS) would not be included on the VAT return as income within the scope of VAT.

## VAT recovery

HMRC do routinely attempt to restrict VAT recovery on costs which relate to the receipt of income which is not within the scope of VAT. It is a basic condition of VAT recovery that VAT can only be treated as input tax if it is a cost component of a taxable supply. This is most commonly an issue in the charity sector in relation to funding from a variety of public sector bodies and from the lottery.

In the private sector, it has recently been an issue in relation to renewable heat incentives and generation tariffs paid for solar panels, neither of which are subject to VAT. HMRC tend to fail if the grant funding received is supportive of the business, rather than an end in itself.

In addition to costs that relate directly to the receipt of grant funding, HMRC may attempt to impose a restriction of VAT recovery on general business costs through a business/non-business (BNB) apportionment, using income from the respective sources. This is similar to the restriction caused for businesses generating exempt income.

## Calculating recoverable VAT

We should emphasise that any grant that is not intended to directly fund non-business activities, should be excluded from any business/non-business calculations. You should carefully review any written agreements with HMRC about the calculation of any BNB apportionment of costs just in case there are any unintended consequences.

The government has also promised up to £750m additional support for charities during the crisis, including money from the National Lottery. Whether or not this income should be

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included in a BNB method will need to be reviewed on a case by case basis. If this grant income is used to directly finance non-business activities, it may need to be included in an income-based apportionment, but each entity will be different. You may wish to seek professional advice to ensure you obtain the best possible outcome.

## Charities

With the enforced closure of a whole range of retail and leisure outlets, an income based method of VAT recovery may produce a result which is not beneficial for your charity. For example, the closure of charity shops and other trading activities could suppress the VAT recovery percentage whilst lockdown continues.

One solution would be to use last year's activity levels as a fairer representation of the charity's mix of activities. Such an approach may ultimately need to be agreed with HMRC, but the government is clearly committed to being as helpful as possible, including supporting the vital work of the not-for-profit sector. Charities should therefore expect a sympathetic hearing from HMRC to any reasonable request.

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## Conclusion

- We would question whether there are any significant external costs related directly to the receipt of this grant income. There is unlikely to be any restriction of VAT on this basis.
- We would also resist the business/non-business split on the grounds that the JRS grant funding is clearly supportive and not an end in itself. HM Treasury intends it to be used to keep you afloat through the lockdown, not to help increase the wealth of the charity.
- More generally, think about your current basis for VAT recovery. There may be options to improve the position.

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