
The Charity Law & Practice Review

CHARITIES, VALUE ADDED TAX AND BUSINESS

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Last year the Charities Tax Reform Group estimated² that the charity sector as a whole suffered £300m a year irrecoverable VAT and KPMG, as a result of a survey, came to a figure of £200m for the top 2,000 fundraising charities.³ A major reason why the figures are so high is that many of the activities of charities are exempt from VAT, for example, the provision of education⁴ and the provision of health and welfare services.⁵ Many charities, however, fail to recover VAT because they are not clear when their activities are within the net of VAT and when they are outside.

An examination of the law which governs when activities generally are subject to VAT shows that an important criterion is the carrying on of a business. That criterion has proved a difficult one to apply to the activities of charities but there has now been sufficient case law to make it possible to draw out some general guidelines to assist charities in determining whether they must account for VAT on their particular activities.

The importance of 'business'

The basic liability to VAT is set out in section 4(1) of the Value Added Tax Act 1994 which provides:

"VAT shall be charged on any supply of goods or services made in the United Kingdom, where it is a taxable supply made by a

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² "Charity", Nov. 1993, p.6.

³ "Charities and trading. A recent survey" (1994) KPMG.

⁴ See Value Added Tax Act 1994 Sched 9 Group 6.

⁵ See Value Added Tax Act 1994 Sched 9 Group 7.

taxable person in the course or furtherance of any business carried on by him."

Thus for a charity to come within the ambit of VAT it must both carry on a business and make taxable supplies. This reflects the EU provision in article 4(1) of the Sixth VAT Directive⁶ which defines a taxable person as someone independently carrying out any economic activity. Once registered for VAT, a charity can only recover input tax on those goods or services used for the purposes of any business carried on.⁷ Even if charities are carrying out solely exempt activities they cannot ignore the concept of business if they are involved in the construction of a new building or the reconstruction of a listed building. Supplies in connection with such construction or reconstruction will only be zero-rated if the charity does not intend to use the building in the course or furtherance of a business.⁸

Definition of 'business'

'Business' is defined in section 94(1) of the 1994 Act as including any trade, profession or vocation. The courts' approach is to give the word 'business' its natural or ordinary meaning in the context of the 1994 Act.⁹ The fact that a charity is regarded as carrying on a business or trading for the purposes of another statute is not conclusive. For example, a one-off activity may amount to trading for the purposes of liability to income tax but may not amount to a business for the purposes of VAT.

The scope of 'business' for the purposes of VAT has been considered in several cases¹⁰ from which a definition of 'business' as 'a serious undertaking earnestly

⁶ Directive 77/388. 'Economic activity' is defined widely and objectively, see *Van Tiem v Staatssecretaris van Financien* [1993] STC 91; *EC Commission v Netherlands* [1988] ECR 1471.

⁷ Value Added Tax Act 1994 s.24.

⁸ Value Added Tax Act 1994 Sched 8 Groups 5 & 6; see *The Royal Academy of Music v Customs & Excise Commissioners* unreported LON/92/2416, Decision No. 11871 [1994] VATTR 105.

⁹ *Customs & Excise Commissioners v Morrison's Academy Boarding Houses Association* [1978] STC 1, 5; *Customs & Excise Commissioners v Lord Fisher* [1981] STC 238, 247.

¹⁰ See *Customs & Excise Commissioners v Morrison's Academy Boarding Houses Association* [1978] STC 1; *National Water Council v Customs & Excise Commissioners* [1979] STC 157; *Customs & Excise Commissioners v Lord Fisher* [1981] STC 238.

pursued' emerges. A useful summary of the court's approach is the following passage from the decision of His Honour Stephen Oliver QC in *The National Society for the Prevention of Cruelty to Children v Customs & Excise Commissioners*¹¹:

"The United Kingdom decisions establish that, for an activity to qualify as 'business' for VAT purposes it must amount to a continuing activity which is predominantly concerned with the making of supplies to others for a consideration. There are, in effect, two parts to the test. First, for there to be an "activity" there must be sufficiency of scale to the supplies and they must be continued over a period of time. Second, the predominant concern of the person conducting the activity must be the making of supplies."

It is essential before a charity can be said to be carrying on a business that it is making supplies, that is, supplies of goods or services in exchange for consideration.¹² There will not be any supplies if there is no direct link between the money received by a charity and any services provided.¹³ Thus a charity may be carrying on many activities but if it relies totally on donations to cover its running costs it will not be regarded as carrying on a business for the purposes of VAT.¹⁴

Charities by their very nature are non-profit distributing. If the activities of a charity otherwise amount to a business, the fact that the charity does not intend to make a profit, but merely to cover its costs, does not prevent it carrying on a business for the purposes of VAT.¹⁵

The definition of 'business' is extended by section 94(2)(a) of the 1994 Act to cover the provision by a club, association or organisation for a subscription or other consideration of the facilities or advantages available to its members. Section 94(3) provides an exception for bodies established for political, religious, philanthropic or patriotic objects in the public domain where the only facilities the members receive in return for their subscription are the right to participate in

¹¹ [1992] VATTR 417, 422.

¹² Value Added Tax Act 1994 s.5(2).

¹³ *Staatssecretaris van Financien v Co-operatieve Aardappelenbewaarplaats GA* [1981] 3 CMLR 337; *Apple and Pear Development Council v Customs & Excise Commissioners* [1988] STC 221.

¹⁴ See the text at fn. 17 below.

¹⁵ *Customs & Excise Commissioners v Morrison's Academy Boarding Houses Association* [1978] STC 1.

management and to receive reports on the body's activities. This exception is restricted because 'reports' has been held to mean simply an annual report and not a journal.¹⁶

The admission of persons to any premises for a consideration is also deemed to be the carrying on of a business by section 94(2)(b).

Charities and business

The difficulties of determining whether a charity is carrying on a business for the purposes of VAT can be seen when individual activities of charities are considered

Fundraising

It has long been considered that the giving and receiving of donations has nothing to do with VAT. Thus a charity which raises money but which provides nothing directly in return is not carrying on a business. This is so even if the charity can be described as 'a serious undertaking earnestly pursued'. For example, the Royal Exchange Theatre Trust which raised funds very effectively and efficiently to construct a theatre in Manchester was held not to be carrying on a business because it made a gift of the theatre to the Royal Exchange Theatre Trustees Ltd.¹⁷

It has recently been confirmed that this approach is consistent with the EU provisions. *Tolsma v Inspecteur der Orizetbelasting Leeuwarden*¹⁸ held that Mr Tolsma was not within the ambit of VAT when he played a barrel organ on the public highway and rattled a collecting tin for donations. The active solicitation of donations did not amount to a supply for a consideration even if some activity was carried on with the intention of attracting donations because there was no legal relationship between Mr Tolsma and those who gave him money.

Grants are similarly outside the scope of VAT where the grant giver does not require any specific services to be supplied in return for the grant, even if the grant giver monitors how the grant is being used by the charity. Thus, it was held that as there was no direct link between grants provided by the Borough of Hillingdon and the London Borough Grants Unit to the Hillingdon Legal Resources

¹⁶ *English-Speaking Union of the Commonwealth v Customs & Excise Commissioners* [1981] 1 CMLR 581.

¹⁷ *Customs & Excise Commissioners v Royal Exchange Theatre* [1979] 3 All ER 797.

¹⁸ [1994] STC 509.

Centre and the free legal advice and assistance provided by the Centre, such activity was a non-business activity.¹⁹

If funding is sought by means of sponsorship it is more likely that a charity will be held to be carrying on a business. For example, the Tron Theatre in Glasgow issued a brochure, inviting members of the public to sponsor a new seat in the theatre by paying £150, which contained the following statement:

"Sponsoring a seat in the Tron Theatre's auditorium entitles you to an exclusive range of benefits:

PERSONALISED BRASS PLAQUE DISPLAYED ON EACH SEAT
ACKNOWLEDGMENT ON BOARD FEATURED IN TRON THEATRE'S MAIN FOYER
LIMITED EDITION PRINT BY GLASGOW ARTIST JOHNNY TAYLOR, SPECIALLY COMMISSIONED BY THE TRON TO COMMEMORATE THIS MAJOR APPEAL
PRIORITY BOOKING FOR TWO GALA EVENINGS WHEN WE WILL UNVEIL THE NEW SEATING AND CELEBRATE IN GRAND STYLE"

The value of the benefits was about £5 and the theatre regarded them as no more than inducements to persuade the public to contribute to the theatre. The Lord President (Hope) held²⁰ that the statement in the brochure constituted an offer which was accepted by each sponsor on payment of £150. There was thus a supply of services in return for consideration and the Tron Theatre was obliged to charge VAT on the £150. Similarly, if a sponsor sets out the benefits he is to receive when making a payment to a charity, rather than seeking a simple acknowledgement, there will be a supply of services rather than a donation.²¹

¹⁹ *Hillingdon Legal Resources Centre Ltd v Customs & Excise Commissioners* [1991] VATTR 39.

²⁰ *Customs & Excise Commissioners v Tron Theatre Ltd* [1994] STC 177. See also *The City of Norwich v Customs & Excise Commissioners* unreported LON/93/1950, Decision No. 11822.

²¹ See *Oxford Foundation v Customs & Excise Commissioners* unreported LON/89/911. Customs & Excise have indicated that they consider that there will be non-business activity if a donation from a company is merely acknowledged, see VAT leaflet 701/1/92 para 10(e).

Any fundraising event which involves charging for admission will be deemed to be the carrying on of a business by virtue of section 94(2)(b) of the 1994 Act.²² Liability to VAT may be reduced by fixing a basic minimum charged and asking for voluntary contributions.²³ The total price of a ticket will be liable to VAT, however, even if it is stated that part of the payment will be regarded as a voluntary contribution, if it appears that payment of the full price is compulsory.²⁴

Community Services

Simply to provide free facilities for the community will not amount to a business because there will be no supplies for a consideration. Thus the Whitechapel Art Gallery was not carrying on a business in relation to its main activity of mounting free displays of works of art.²⁵ The provision of a voluntary service to the community such as first aid at public functions is not a business activity. The fact that the charity operates efficiently and that its expenses are reimbursed does not convert a voluntary service into a business.²⁶

A service provided to the community will, however, amount to a business if the charity charges a fee to individuals using the services; the fact that the service is subsidised appears to be irrelevant. Thus the Royal Society for the Prevention of Cruelty to Animals was held to be carrying on a business of providing veterinary services through its hospitals and clinics because it made a charge to each person using the hospital or clinic. There was a business for VAT purposes even though the fees were lower than those charged in private practice and no steps were taken to recover unpaid fees.²⁷ Similarly, the Yoga for Health Foundation was held to be carrying on a business because it provided facilities in a regular businesslike manner; that conclusion was not disturbed by the fact that not everyone using the

²² A one-off event may be exempt - Value Added Tax Act 1994 Sched 9 Group 12.

²³ See VAT leaflet 701/2/92 para 36.

²⁴ See *Glasgow Miles Better Mid Summer 5th Anniversary Ball v Customs & Excise Commissioners* unreported EDN/89/95.

²⁵ *Whitechapel Art Gallery v Customs & Excise Commissioners* [1986] STC 156.

²⁶ *Greater London Red Cross Blood Transfusion Service v Customs & Excise Commissioners* [1983] VATTR 241.

²⁷ *RSPCA v Customs & Excise Commissioners* [1991] VATTR 407.

facilities was charged full rates and that the balance of income was made up from donations.²⁸

In many cases a particular service will be provided by a charity for the sole reason that that is the way in which the charity's objects are carried out. Indeed, it may not be possible to provide the service without subvention from the charity's own endowment funds. The *Royal Academy of Music*²⁹ case, however, makes it clear that there is no reason why a body pursuing a charitable object should not also be carrying on a business or carrying out an economic activity.

Advice giving

A charity does not carry on a business for the purposes of VAT by making grants and performing the advisory and administrative functions associated with those grants.³⁰ However, if a charity provides advice to members who have paid a subscription, it will be deemed to be carrying on a business by section 94(2)(a) of the 1994 Act.

Religious activities

The provision of places of worship and the conducting of rites of worship does not amount to a business for the purposes of VAT even if donations, for example, church collections, are received.³¹ The fact that a charity is propagating a religious philosophy will not prevent it being held to be carrying on a business, however, if all the other criteria for business activity are satisfied even if the operation is being conducted at a loss.³² Thus the Church of Scientology was held to be carrying on a business because it provided courses for fees on a regular basis; it was irrelevant that it did not make a profit.³³ Similarly, commercial

²⁸ *Yoga for Health Foundation v Customs & Excise Commissioners* [1983] VATTR 297.

²⁹ Unreported LON/92/2461, Decision No 11871.

³⁰ *The Arts Council of Great Britain v Customs & Excise Commissioners* [1994] STI 713.

³¹ See *The Dean and Chapter of Hereford Cathedral v Customs & Excise Commissioners* [1994] STI 539.

³² *The Holy Spirit Association for the Unification of World Christianity v Customs & Excise Commissioners* unreported LON/84/179.

³³ *Church of Scientology of California v Customs & Excise Commissioners* [1979] STC 297.

hirings of buildings, exhibitions for which entrance fees are charged, a shop, a restaurant and library are all business activities of a cathedral.³⁴

Membership activities

A charity will be deemed to be carrying on a business by virtue of s.94(2)(a) even if the subscriptions paid by the members are not sufficient to cover the cost of the facilities provided and the shortfall is made up from grants.³⁵ There will be no deemed business, however, if any benefits received by the members are provided by a third party. Thus the Friends of Ironbridge Gorge Museum were not a business because free admission and other benefits were provided by the Museum and not the Friends.³⁶

An umbrella organisation will not be deemed to be carrying on a business if it simply acts as a co-ordinating committee for its members³⁷ but it will be if it provides services for its members, for example, a panel of experts³⁸ or research assistance.³⁹

Investment

It is not clear whether the active management by a charity of its investments can amount to a business activity for the purposes of VAT. Such activity has been held not to amount to a business on the grounds that the predominant concern of the charity is not the making of investment supplies. The position was set out by

³⁴ See *The Dean and Chapter of Hereford Cathedral v Customs & Excise Commissioners* [1994] STI 539.

³⁵ *Hunmanby Bowling Club v Customs & Excise Commissioners* [1991] VATTR 97.

³⁶ *Friends of Ironbridge Gorge Museum v Customs & Excise Commissioners* [1991] VATTR 97.

³⁷ See *Universities Athletic Union v Customs & Excise Commissioners* [1974] VATTR 118.

³⁸ See *Cricket Club Conference v Customs & Excise Commissioners* [1973] VATTR 53.

³⁹ See *The Welding Institute v Customs & Excise Commissioners* [1974] VATTR 228.

His Honour Stephen Oliver QC in *The National Society for the Prevention of Cruelty to Children v Customs & Excise Commissioners* where he said:⁴⁰

"The investment activities are not, in the view of the tribunal, significantly different from those of any body of persons with fiduciary obligations to invest the funds held for the purposes of giving effect to their charitable objects: nor are they significantly different from a commercial undertaking that has reserves which are invested in order to support its commercial activities. In all those situations the making of supplies for a consideration, whether these be selling shares and securities or lending money at interest, will not be the predominant concern of the trustees or the commercial undertaking as the case may be. Specifically, in the case of a body such as the Society, the predominant concern will be the carrying out of its fiduciary obligation to maintain its investments in order to provide funds, whether proceeds of realisations or investment income, for furthering its main charitable objectives."

The value of the investments in that case amounted to £16,500,000 which were managed by professional fund managers.

It is possible, however, that a charity's activities in relation to its investments may reach such a scale that they may constitute a business. In *The Wellcome Trust Ltd v Customs & Excise Commissioners*⁴¹ the tribunal referred to the Court of Justice of the European Community a number of questions to help to determine whether the Trust's share dealings amounted to an economic activity within art. 4(2) of the 6th Directive. In the particular case, the trust property consisted of shares in Wellcome plc; 21% of the holding had been sold in 1987 and the £200m received was invested under almost unlimited investment powers. In 1992, a further 288 million shares were sold for £2.3 billion. The tribunal considered that if the question was to be decided simply as a matter of fact and degree, the Trust's investment activities did amount to an economic activity.

Conclusion

Two general propositions would appear to emerge from the cases to guide charities in determining whether their activities are a business for the purposes of VAT. First, no activity will amount to a business unless there is a legal relationship and

⁴⁰ [1992] VATTR 417, 423.

⁴¹ [1994] STI 1113.

reciprocal performance between the charity and a third party.⁴² Without a direct link between the money received and any services provided there can be no supply which is essential for business activity. Secondly, if supplies are being made with some degree of continuity, there is an increasing tendency for the courts and tribunals to find that a charity is carrying on a business, regardless of the details of the funding, motive or purpose of the activity.⁴³

⁴² See, in particular, *Tolsma v Inspecteur der Orizetbelasting Leeuwarden* [1994] STC 509 and the text at fn. 18 above.

⁴³ This would appear to accord with the objective approach of the ECJ to the question of whether there is economic activity; see *EC Commission v Netherlands* [1988] ECR 1471.