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PULSE

Quarterly Newsletter of Deloitte's Charities and Not for Profit Group

This edition of PULSE has a very interesting take on how Brexit is likely to affect the charity and not for profit sectors. The, most important aspect of Brexit is 'uncertainty'; however, there are specific areas that affect the sectors directly.

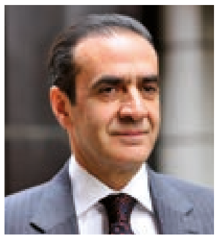
Under the increased regulatory framework charities operate, there have been yet more developments. The article on the developments considers three topical areas and has related guidance on what the sector should do; the areas of compliance are significant and there are not many exemptions available to charities.

Finally, there is an article in VAT recovery and the latest developments in that area which may well affect charities.

Happy reading!

Please note that the views expressed in this publication are those of the authors and not of Deloitte. In the complicated environment in which we all operate, always seek professional advice specifically and don't rely on contents of articles that have been written for general guidance only.

Reza Motazedi



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Brexit: Thoughts and considerations for the third sector

Pretty much everyone agrees that the UK's referendum has put us into a world of uncertainty and elevated risk. However, saying that things are "uncertain" is obvious but not very helpful. Quite naturally theories, speculation and forecasts multiply.

Brexit has some elements in common with the failure of Lehman Brothers in 2008. That was an economic shock, one which threatened the solvency of the banking system and triggered a credit crunch. Brexit is a political shock. Its impact on the economy is more indirect, at least in the short term, and come via financial markets and the knock on effects on business and consumer confidence.

However, to generate a full-blown recession consumers, who account for two-thirds of GDP, would need to stop consuming, as they did in 2009-10. The worry is that a toxic combination of uncertainty and a squeeze on spending power from high inflation and weaker earnings does just that. This increases the demand for services from the third sector at a point in time when income streams are potentially under further strain. There are a number of regions within the UK which were in receipt of funding from the EU where there is further uncertainty as to how this funding is to be continued, with a lack of clarity from government as to how the gaps will be met.

In the short term the most useful response would be for the government to signal the direction of travel for the UK in its negotiations with the EU. In markets and business as in life, intent matters. With the new Prime Minister already in place and notwithstanding the current Labour leadership contest, the government could work with the other parties to develop a set of principles for a post-EU settlement. To date this appears to be focussed on the need for the UK to remain an open, trading economy with debate over the control migration.

Shock in Europe

The vote is as much a shock for the EU as the UK. A British exit from the EU would represent the greatest political setback to the EU in its 65-year history. This comes at a time when the EU is coping with a migration crisis and is trying to strengthen the euro area against future shocks. After a period of rapid economic and political integration in the '90s and '00s, Europe is seeing slower, more divergent growth and a loss of political momentum.

More extreme, anti-establishment political parties such as the Freedom Party in Austria, the Five Star Movement in Italy, the Front National in France and the Freedom Party in the Netherlands are gaining ground. The immediate concern is the risk of a domino effect as eurosceptic parties elsewhere in the EU demand their own referenda. Recent research conducted by Deloitte and the German employers' organisation BDI found that 66% of German businesses believe a British exit would lead to further such votes in the EU.

A complicating factor for any UK negotiations with the EU is a series of national elections, most crucially in the Netherlands (March 2017), France (April to May 2017) and Germany (August to October 2017). It is possible that Europe's de facto leaders, Angela Merkel and Francois Hollande, will leave office in 2017.

The UK's departure from the EU also raises questions about the future direction of the trade bloc. Without the UK, the EU loses a significant supporter of free trade and free-market policies. Analysis by the Open Europe think tank suggests that the UK's exit from the EU will tilt the balance of power in the EU under Qualified Majority Voting significantly towards a more protectionist, less free-market, approach.

Faced with the risk of further secessions across Europe, and seeking to avoid political drift, EU leaders may seek to 'double-down' on ever closer union. Press reports have suggested that European leaders have already been drawing up plans for a future union without the UK, developing a so-called "Plan B" focused on closer security and defence cooperation.

Contextually, in terms of the fundamentals, assessed in terms of international measures of competitiveness, the UK looks in decent shape. The World Bank, the World Economic Forum and the Heritage Foundation rank the UK in the top tier of their league tables of competitiveness, up there with countries like the Netherlands, Denmark and Australia. This ranking speaks of a flexibility and resilience which will be vital to the UK as it navigates what lies ahead.

What does the UK corporate sector think?

To provide an indication of the response of the corporate sector we have summarised below the second quarter Deloitte survey of UK Chief Financial Officers. The survey took place between June 28th and July 8th against a backdrop of elevated political and economic uncertainty. To download the report please visit:

http://www2.deloitte.com/uk/en/pages/finance/articles/deloitte-cfo-survey.html

Key findings from the report include:

- CFOs' perceptions of uncertainty have soared in the wake of the vote to levels last associated with the euro crisis five years ago. Uncertainty has had a toxic effect on business sentiment with optimism dropping to the lowest level since the survey started in 2007, lower, even, than in the wake of the failure of Lehman in late 2008. Corporate willingness to take risk has also declined sharply. Just 8% of CFOs say now is a good time to take risk onto their balance sheet, down from 25% in the first quarter and 59% a year ago;

- CFOs believe that the UK's exit from the EU will have a significant dampening effect on their own spending plans in the next three years. 58% expect capital spending to be somewhat or significantly lower; 66% expect hiring to be lower and 74% see discretionary spending being lower over this period;

- Large companies do not seem to be waiting for growth to slow before adjusting direction. CFOs have shifted to markedly more defensive balance sheet strategies in the wake of the referendum. The top priorities are increasing cash flow and cutting costs. Conversely CFOs are placing less weight on introducing new products or services and investment;

- Expectations for growth in capital spending, hiring and discretionary spending are at levels that were last seen just before the so-called "double dip" slowdown of 2012. Since the referendum the Bank of England has eased bank capital requirements to help bolster the supply of credit; the CFO Survey suggests that a further risk is a lack of appetite for credit from the UK's largest companies;

- When asked what the authorities can do to support economic activity an overwhelming majority – 91% of CFOs – said that giving a clear signal about the government's aims in the negotiations with the EU should be a strong priority. Yet CFOs are sceptical that the UK will be able to preserve all the advantages of the UK's current situation outside the EU. In a finding which underscores the pressure on the UK government 68% of CFOs believe that leaving the EU will lead to a long-term deterioration in the UK business environment;

- The second policy aim for the government, according to CFOs, should be maintaining the solvency and liquidity of the banking system, with 88% rating this as a strong priority. The government's budget deficit reduction plan was ranked third, with 25% saying it should be a strong priority. Enthusiasm for cutting interest rates, restarting Quantitative Easing or cutting taxes was muted – in each case fewer than 10% of CFOs rated these strategies as strong priorities.

This should be caveated, in that the survey took place in the aftermath of a huge shock, during the Conservative leadership election. CFO confidence responded by dropping to even lower levels than in 2008, after the failure of Lehman Brothers. Yet Lehman was a global, systemic financial crisis, which heralded a deep recession in the advanced economies. Brexit is a more localised, political shock, albeit one with significant implications for growth in the UK in the short and long term. Stepping back from the short-term volatility and long-term uncertainties, UK fundamentals look pretty good. Judged on international yardsticks, such as the World Economic Forum's Global Competitiveness Report, the UK business environment is one of the best in the world.

Given that data shoots all over the place in response to big shocks it is too early to be sure of the how much damage the referendum vote has done. Sometimes external shocks generate one month, or one quarter declines in activity which are subsequently recouped. We will need to see at least another couple of months' UK economic data to get an accurate picture of the near term economic damage wrought by the referendum vote.

What does this mean for the charity sector?

So what does all of this mean for the charity sector? Uncertainty across the corporate sector has a potential feed through, with companies focussing on their core strategies and potentially reducing their wider social responsibility strategies such as pro bono programmes, charity partnerships and sponsorships.

Any negative economic impact has a potential knock on effect in an individual's propensity to give, both in terms of money and time, and as such, there is a risk that previous assumptions regarding fundraising income streams should be revised. There is also the opportunity to offset this in part through retail income increases during an economic downturn.

In a wider sense, recent commentaries indicate that the economic impact will not be universal across the UK, with potential negative regional impacts, particularly in areas which are in receipt of considerable EU funding. This may require a further response from the third sector and an increased "regionalisation" of support strategies and support infrastructure, particularly as there is no indication of increased funding for local government.

However, in line with the corporate sectors view on risk – the level of uncertainty may act as a constraint on charities in their future strategies – uncertainty over the political and economic environment may result in consolidation strategies and increasing retention of reserves in order to sustain core operations in the future.

A more immediate impact relates to EU migration and the impact on the third sector. In the short term there is a potential negative response in relation to research activity – this would be most keenly felt in UK Higher Education, (the EU has historically allocated less than 10% of its research budget to non-EU institutions) there is still a potential associated risk to the sector which funds and works with research institutions Although existing contracts will continue, there is an uncertainty as to whether the current levels of support for UK Higher Education will continue – as such, there is a question for those charities which fund research (which is predominantly at the individual academic level) as to where the work will be funded and what the EU academic community appetite is to UK funded research and institutions as well as the impact on existing UK academic partnerships.

There is a more general impact upon the labour force – if the government is successful in reducing net migration, then this potentially impacts the workforce which supports the lower end of the pay scale of works in the charitable sector, examples including retail, residential care and support workers. There is an indication this may raise the lower end of the wage spectrum slightly. However, for charities locked into local government and NHS related contracts there is a direct impact on the bottom line from any increase in wages or use of agency staffing to address vacancies.

There is also the impact of a reduction of recruitment from across the EU in the higher paid roles within charities, although this may not crystallise until the timing of Brexit becomes clearer. This may be offset somewhat by an increase in retention of staff as people choose to adopt a "wait and see" attitude and elect not to move organisations, as well as the potential to recruit staff from the corporate sector.

For a number of charities where I work there appears very much a "business as usual" approach with strategies and responses to be determined when the terms and timing of the Brexit become clearer. Whilst fully understandable, this period represents a prime opportunity to prepare for the different scenarios and key emerging risks – as such, I'd recommend giving thought to quantifying exposures to income and expenditure streams over the next 2-3 years and to consider the impact upon your core activities.

The above commentary was based on the personal views of Ian Stewart, Deloitte's Chief Economist in the UK, detailed in the Monday briefings, with additional sector perspective the view of Richard Evans, Director, Risk Advisory, responsible for delivering risk management, internal audit and advisory assignments to the charity sector.

If you would like to hear more on the current economic climate our regular Monday briefings can be found at https://www.deloitte.co.uk/aem/monday-briefing.cfm

Keeping up with changing regulation

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At a time where charities appear to be under greater regulatory and media scrutiny than ever, it can be difficult for charity trustees to keep up to speed with the latest statutory reporting obligations, as they are introduced. This task becomes harder still where charities are subject to regulations which are not designed with the third sector in mind.

Over the past year, a raft of new legislation has been introduced, designed to combat fraud and to ensure corporate and financial transparency. Whilst the intentions behind the legislation may be sound, its applicability to charities appears to have been little more than an afterthought. In theory, the consequences for failing to comply with the new requirements are serious, including criminal offences for the organisation and its officers. In practice the regulations are yet to be tested, and whilst the most stringent penalties are likely to be reserved for deliberate breaches, charity trustees will nonetheless be concerned to understand whether their own charity is likely to be caught, and what they will need to do to ensure compliance.

Three new regimes which can affect charities are:

- The Common Reporting Standard – which is designed to ensure tax compliance on an international scale, by requiring the reporting by financial institutions of cash distributions made overseas;
- The register for people with significant control – which is designed to promote transparency in UK companies, and to highlight where the beneficial ownership of a company vests in few individuals; and
- The Modern Slavery Act – which is designed to promote transparency in supply chains and to avoid slavery and human trafficking.

Common reporting standard (CRS)

The CRS regime was introduced by the OECD and is intended to have a global reach as an international extension of the US focused Foreign Account Tax Compliance Act (FATCA). It has been implemented in the EU by a tax-related Directive, which in turn has been implemented by the UK through regulations – specifically, the International Tax Compliance Regulations 2015.

The CRS is already in force in the UK, and many grant making charities are subject to its regulations. They will have to provide details to HMRC about how their grants are applied for sharing with the equivalent regulators in other jurisdictions where the CRS also applies. The first reporting period under the regime is the 2016 calendar year, in respect of which reports must be filed to HMRC by 31 May 2017.

What is the CRS?
The CRS is an international automatic information exchange regime designed to promote tax transparency and prevent fraud and tax evasion. UK based "financial institutions" are obliged to report to HMRC on the tax compliance of their "account holders" and of the recipients of funds that are transferred overseas. That information will be shared with tax regulators in other jurisdictions which are subject to the CRS to ensure that there are no discrepancies.

Why does this apply to charities?
The CRS regulations are designed to apply to the banking and financial sectors, but unlike FATCA, no exemption is provided for charities. This means that certain types of charities will be caught by the regulations and be obliged to report to HMRC accordingly. The legislators have insisted that this is deliberate, due to the risk of charities being used for fraudulent purposes.

Which charities will be subject to the CRS?
The CRS regulations apply to "financial institutions" or "FIs". There are various sub-categories of FI, one of which is an "investment entity". An investment entity is an organisation which:

- derives more than 50% of its gross income from financial assets; and

- has any part of those assets under management via a discretionary investment mandate.

Consequently, a charity which has investments or endowment funds under the delegated control of an investment manager and whose charitable activities are funded by the investment income deriving from those funds, is likely to be caught. Also affected will be not for profits and organisations with links to charities – for example livery companies, and endowment trusts and/or pooling funds.

If a charity is subject to the CRS regime, what must it do?
A FI based in the UK needs to identify all its "account holders" and obtain certain information from them to confirm their compliance with tax regulation, for each reporting period; elements of this information must be passed to HMRC. For a charity which is deemed to be a FI, an account holder will be anyone to whom the charity has made a grant in the reporting period.

As part of its due diligence into its account holders, a charity FI must do a number of things:

- A process must be established to obtain the relevant information from all grant recipients. Banks use "self-certification" forms that the recipient must complete. Charities might want to explore similar options with their financial or legal advisors.

- The collection process must capture relevant information both for new grants going forward and those already made since 1 January 2016.

- Charities' grant terms and conditions ought to be updated, to make it clear to grant recipients that the charity is subject to CRS reporting requirements and that relevant information must be reported to HMRC under the CRS (and that this means it may be passed on to other jurisdictions which have signed up for automatic exchange of information under CRS). Existing grant recipients from 2016 onwards should be informed of the same point.

- Finally, a separate process must be established to report the information gathered to HMRC in 2017.

What information must be reported?
Whilst FIs must collect information for all their account holders, the requirement to report to HMRC only applies in respect of grantees that are tax resident in another jurisdiction which has signed up to CRS. There are 56 countries already committed to report in 2017 (including the UK), and a further 40 are due to join in 2018 (including China, Russia and Saudi Arabia). Charities should cross reference their grant recipient locations with the lists, which are available on the *OECD Automatic Exchange Portal*.

http://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/crs-by-jurisdiction/

Charity FIs will be able to rely on grant recipients' (i.e. account holders') self-certification forms for reporting purposes, unless the charity knows or has reason to know the self-certification is incorrect or unreliable.

Reporting will need to be done by a separate registration/reporting service, not via the organisation's usual tax return.

Are there any exceptions?
HMRC has issued very basic *guidance for charities*, which does little more than outline what the regime is and explain that certain charities may be caught by it. More detailed guidance has been promised but is yet to be published (it is due early autumn 2016). It is understood, but not yet confirmed officially, that HMRC is likely to draw a distinction between corporate and non-corporate charities regarding the CRS requirements.

https://www.gov.uk/guidance/automatic-exchange-of-information-guidance-for-charities

The guidance is expected to confirm that unincorporated charities that are caught by the regulations will need to carry out due diligence and report on their grant recipients/beneficiaries as outlined above. However, corporate grant making charities, making grants from their corporate funds (i.e. not as a trustee), are expected to have different reporting requirements under the CRS regime.

The reason for this is that the CRS requires recording of debt and equity interests in FIs. For non-corporate charities, equity interests are interpreted to include beneficiaries of charity funds, such as grantees; for corporate charities grantees will not be considered to hold equity interests unless they have an interest in the profits or capital.

If HMRC's guidance confirms the above, then unincorporated grant-making charities which are concerned about the impact of the CRS on their activities may wish to consider whether incorporation would be appropriate for their charity.

The impact of CRS on charities
As noted above, the immediate impact on organisations caught by the CRS regime is one of increased administration, which could prove to be a huge undertaking.

Until the regime beds in and has been tested, there remain questions regarding how far the due diligence needs to go. Technically, all grants would be caught, no matter how small, and the regime applies to all recipients, whether received directly or indirectly. For example, it remains unclear if reports must be made if a charity FI makes a grant to a UK based charity in knowledge that the recipient will use the money to make a series of grants overseas in CRS compliant jurisdictions (which could constitute an indirect distribution of the originating charity's funds).

Of key importance for affected charities is that they demonstrate compliance by putting in place systems and controls to obtain the right information, and report accordingly. HMRC is thought to be aiming for a light touch approach, so may be less concerned about small individual reporting failures in the early years provided bona fide attempts to comply can be shown.

Charity specific concerns with CRS
All of this gives rise to a number of valid concerns for charities required to comply with the regime:

- Complex administrative burden – Charities will need to educate themselves about the regime and implement processes from a standing start. This will come at a cost – in terms of both time and resources – which is multiplied by the complexity of a regime designed to apply to another sector.

- Retrospective – Charities must report on activity dating back to 1 January 2016 but are yet to receive practical guidance on the information they need to collect and what they will need to report, so they are already on the back foot regarding their obligations.

- Data protection – the information to be passed to HMRC includes sensitive information, such as Tax Identification Number, date of birth and residential address. Charities will need to check and update as necessary their data protection processes to take account of the new requirements and must notify grantees about the use of their information. There are also concerns and doubt about the onward transfer of information by HMRC to the tax authorities of other jurisdictions and the responsibility for ensuring that the data will be safe, once it is transferred.

- Human rights – Charities working with vulnerable groups, especially groups which may be at odds with the law in their home territories (e.g. religious or LGBT groups), will be concerned that detailed information about grant recipients will be passed by HMRC to the tax authorities in those territories, potentially putting grant recipients at risk of prosecution, intimidation or worse. There are theoretical safeguards in place, but they are untested.

The cumulative impact of all these concerns could lead to charities changing their practices (for example, by only making grants to UK tax resident recipients). Those that help the more excluded and vulnerable may be deterred from helping people directly if the requirement to provide self-certification information is so impractical that it means that it feels unable to comply with the CRS regime. On the other side of the equation, grantees who might be at risk if their details are passed to their tax authorities may be deterred from applying for grants.

For the moment, HMRC's more detailed guidance is awaited, but with time ticking on, charities with reporting obligations face an uphill struggle to comply.

People With Significant Control (PSC)
The PSC regime is a new transparency regime designed to identify to the public who really owns or controls UK companies and LLPs. The regime is underpinned by the concept of "beneficial ownership" which does not sit well with charities, which are not strictly 'owned' but which exist to further their purposes. Corporate charities (and the trading subsidiaries of all charities) are nonetheless subject to the regulations.

Under the regime, UK companies and LLPs are required to keep a register of their "people with significant control" and provide their details to the public registry at Companies House. Those registrable can be individuals (**PSCs**) or UK companies or LLPs ("relevant legal entities" or **RLEs**).

The requirement to keep a PSC register started on 6 April 2016; registers must be kept up to date continuously (as with all company books). Since 30 June 2016 it has been a requirement for companies to file details of their PSCs with Companies House as part of the new "confirmation statement", which replaces the annual return.

Who does it affect?
The regime applies to all UK companies and LLPs, other than companies listed on UK regulated or specified international markets, which are exempted. There is no exemption for charities.

Companies/LLPs within the regime must take "reasonable steps" to identify and obtain the relevant information about their PSCs and RLEs.

This process may be straightforward, but it can mean a lengthy detection exercise and sending out a series of notices to those who may need to be recorded as a PSC or RLE on a company's register.

Broadly, PSC's will be individuals who and RLEs will be companies which:

- directly or indirectly hold more than 25% of the shares in a company;
- directly or indirectly hold more than 25% of the voting rights in a company;
- directly or indirectly hold the right to appoint or remove a majority of directors;
- otherwise have the right to exercise, or actually exercise, significant influence or control over the company; or
- have the right to exercise, or actually exercise, significant influence or control over the activities of a trust or firm which is not a legal entity, but would itself satisfy any of the first four conditions if it were an individual.

There are criminal offences for failure to comply, which can apply not only to the companies/LLPs and their officers, but also to PSCs/RLEs and anyone served notice under the regime to provide information about PSCs/RLEs.

How will it affect charities?
Charitable companies fall within the regime. CIOs, non-corporate charities and charitable corporations established by Royal Charter or statute are outside the regime, but any of these can be affected if they have a company within their structure (e.g. a trading subsidiary) – the regime is not designed with charities and their different legal forms in mind.

There is a limited protection regime to suppress an individual's information where they or someone living with them is at serious risk of being subjected to violence or intimidation if the PSC information is disclosed. This may be a risk for charities operating in sensitive fields of work.

What do charities need to do?
If they have not yet done so, charitable companies and trading companies of charities need to identify their PSCs/RLEs now to create their PSC register. In some cases, this may be a complex exercise, requiring a review of the charity's constitution and the practice of how the company is run.

Any charities with a company in their structure must consider whether information relating to the charity trustees or others needs to be entered in the PSC register of the company.

The Department for Business, Energy & Industrial Strategy (in its former incarnation, as the Department for Business Innovation & Skills) issued *guidance on the regime*, although it should be noted that it is not designed for charities.

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/515720/Non-statutory_guidance_for_companies__LLPs_and_SEsv4.pdf

The regime may be founded on good intentions but, with its complexity and numerous criminal sanctions, it risks criminalising a substantial portion of the population, including charity trustees. Those wishing to avoid being one of that number should act now.

Modern Slavery Act – Follow Up
The Spring edition of Pulse included a full analysis of the Modern Slavery Act 2015 and its impact on the charity sector. More recent analysis of the regulations that have come into force in support of the Act, described further below, suggest the Act's applicability to charities may not be as far reaching as first understood.

The Modern Slavery Act 2015 takes an expanded approach to tackling crimes of slavery and human trafficking by promoting increased transparency in business supply chains. The idea is that organisations with "significant resources and purchasing power" can influence global supply chains with a view to eliminating abuse of individuals and driving up standards along the chain. The Act requires such organisations to publish an annual statement on their website, setting out what activity the organisation is undertaking to eliminate slavery and human trafficking from their business. If they have not taken any steps, they must still publish a statement to that effect. The requirements apply to financial years ending after 31 March 2016.

Whilst the Act is primarily aimed at significant commercial operations, there is no exemption for charities and not for profit organisations (NFPs). In summary, those caught by the requirement to report will include "commercial organisations" which supply goods or services and which have a turnover (including that of any subsidiaries) of more than £36 million and which carry on business in the UK. Commercial organisations will include companies, CIOs, Royal Charter corporations and statutory corporations; unincorporated organisations are excluded. "Business" is not defined in any more detail than including a "trade or profession".

There is a question over the extent to which charities must be subject to the requirements arising from the interpretation of how the £36m "turnover" should be calculated. Turnover is defined as "*the amount derived from the provision of goods and services falling within the ordinary activities of the commercial organisation or subsidiary*". The argument is that charities which derive significant parts of their income from grant funding should not have to count that income towards their turnover for the purposes of the Act, as it does not derive directly from the charities' services. On a straight reading of the regulations, it appears that this interpretation must be correct, although in practice the position may yet be tested, as the Act beds in.

If there is any doubt about the position, the safer approach for trustees would be to report in accordance with the Act. Many charities may also feel that it is difficult to argue that the principle of transparency that the Act seeks to promote should be ignored.

VAT Recovery – the Challenge Faced by the Not for Profit sector

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VAT recovery has always been a complex area for the not-for-profit sector, especially where free activities are carried out or income that is 'outside the scope' of VAT is received.

A recent case at the Upper Tribunal serves as a useful reminder of the basic premise that VAT is only recoverable to the extent it relates to a taxable business activity.

Vehicle Control Services

Vehicle Control Services (VCS) operated a car park and received 8% of its income from parking permits – subject to VAT – and 92% of its income from parking charge notices ('PCNs') which it issued to motorists who were in breach of the parking rules. The Court of Appeal had previously decided in 2013 that the PCN income represented damages for trespass or breach of contract and was therefore outside the scope of VAT.

Following the Court of Appeal decision there was a disagreement between VCS and HMRC in respect of the extent to which VCS was entitled to recover VAT incurred on costs. Both parties agreed that VCS could not recover VAT incurred on costs that wholly related to PCN income and that VCS was entitled to fully recover VAT that wholly related to parking permit income. The Upper Tribunal was asked to decide whether VCS was fully entitled to recover VAT incurred on overhead costs (as VCS argued) or whether an apportionment was necessary (as HMRC argued).

The Upper Tribunal decided that it was necessary to apportion VAT and that HMRC's proposed income based apportionment was acceptable (resulting in only 8% VAT recovery on overhead costs). The Upper Tribunal decided that that the PCN income was generated from a 'business' activity, but that an apportionment was still necessary because VAT can only be recovered to the extent it relates to taxable business supplies.

We await confirmation from VCS as to whether it will appeal the decision.

Grants, donations, subsidies… it's complicated for charities

Further complexities arise in the not-for-profit sector because in order to determine whether VAT incurred on costs relates to taxable business supplies, it is firstly necessary to understand whether an activity is business or non-business. This can be challenging where an organisation charges for its services at a rate below market value (or even cost) and where activities are heavily or fully subsidised by grants or donations. Many in the not-for-profit sector have non-business and partial exemption apportionment methods to allocate VAT incurred on costs between the various activities carried out. With HMRC's focus firmly on the sector, it is important to make sure that these apportionment methods are up-to-date and accurately reflect the activities currently carried out by your organisation.

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