

Managing the Impact of Covid-19 on VAT Recovery

RSM Indirect Tax Services

Covid-19 has resulted in many charities suffering a significant decline in revenues, shops, theatres, historic homes, heritage sites and zoos have closed their doors, fundraising events have been cancelled. But baseline operational expenditure is still being incurred, and most non-pay costs are subject to VAT at the standard rate. The current crisis could see irrecoverable VAT costs increase significantly

We recommend that charities should build this reduction into their cash flow projections.

However all is not lost, by being proactive and engaging with HMRC now many charities should be able to mitigate this VAT cost.

Recovery of VAT

VAT incurred on expenditure is only eligible for recovery where it relates to an onward VATable supply. Most charities undertake a range of activities, some of which are not in the course of business, for example free telephone helpline, others which fall within the scope of VAT such as admissions income, catering and retail sales.

In order to determine how much VAT can be recovered most charities have to undertake a three step process.

1. Direct attribution. VAT on costs that are consumed wholly in undertaking:
 - Non business activities or exempt business activities is not eligible for VAT recovery
 - VATable business activities can be recovered in full.

VAT on expenditure that relates to more than one activity will in all likelihood then need to be apportioned by undertaking a:

2. Business/non business calculation. This determines how much of the VAT relates to business activities
3. Partial exemption calculation. This final calculation determines how much VAT relates to taxable business activities and eligible for recovery

Covid -19 will have a significant impact on steps 2. and 3. For example if you use an income based calculation at steps 2 and 3, the closure of shops, venues etc will result in business income values being significantly reduced, which in turn may mean that in step 2 more VAT may be allocated to non-business activities, and less VAT will flow through to step 3. If exempt income remains constant but taxable income levels reduce then less VAT will be recovered. This may also be the case if other methods of apportionment are used such as expenditure values, transaction numbers etc.

How RSM Can Help Your Charity to Mitigate the Additional VAT Costs

By working with RSM and using our VAT recovery questionnaire, we can:

- help you to quickly determine the direct VAT cash impact of Covid-19 on your cashflow projections;
- identify ways to manage, mitigate and where possible eliminate VAT cashflow restrictions;
- support you in developing an appropriate HMRC engagement strategy, the benefit being to agree an appropriate approach to VAT recovery during the crisis period itself; and
- look forward with you exiting lockdown to mitigate the impact of the significant drop in business revenues without the need to renegotiate with HMRC the use of an alternative methodology of VAT recovery.

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