



The European Charities' Committee on VAT

Challenges of the current VAT system for charities

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ECCVAT: who we are

- **Who?** A group of charities, foundations and representative bodies established in 1992
- **Why?** To research the impact of VAT and other taxes on the work of NGOs and to make representations to the EU institutions and national governments on behalf of the sector

Charities and VAT: the problem



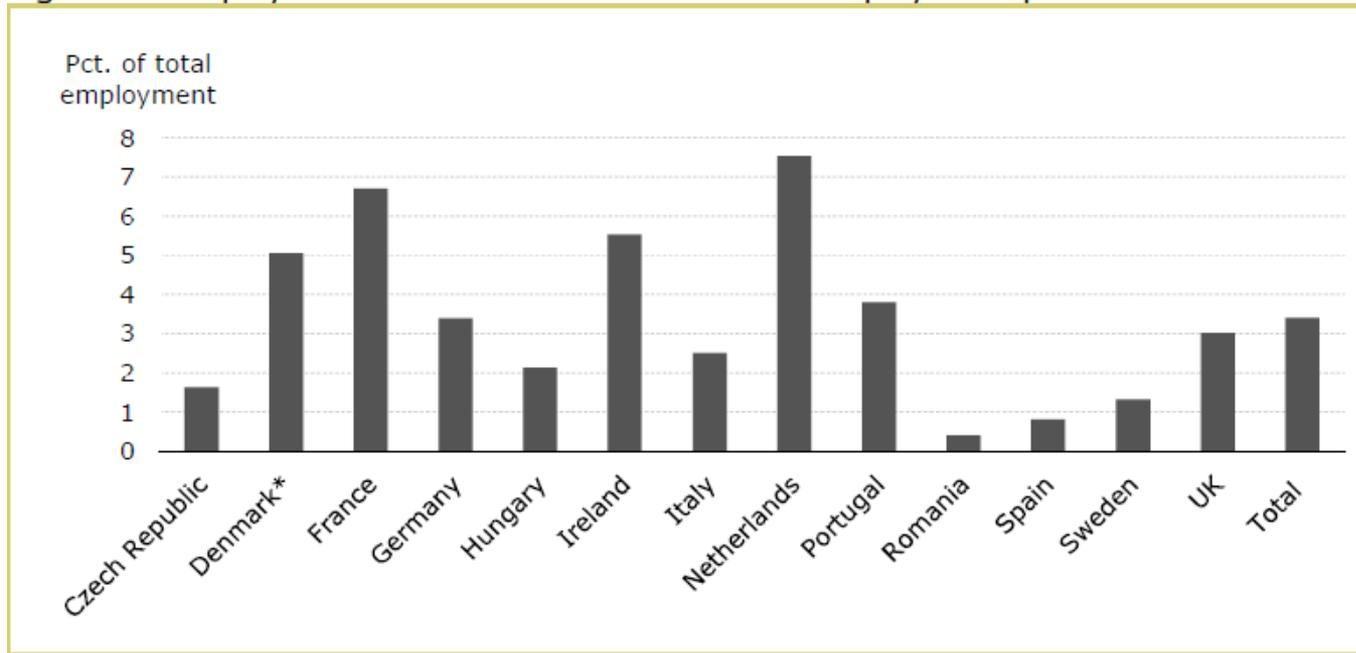
- Most of the services that charities provide are either:
 - **exempt** OR
 - **outside of the scope of VAT** because they are provided free of charge or with a substantial subsidy
- In both cases the charity cannot charge VAT and so cannot recover the VAT on its expenditure: “irrecoverable VAT”
- Irrecoverable VAT has grown significantly over the years as VAT rates and the range of services provided by charities have increased
- Irrecoverable VAT causes significant reduction in the resources charities have to spend on their charitable purposes and can also cause economic distortions

Charities and VAT: the developing role



- Given the constraint on public finances, charities are under pressure from governments to increase front-line services
- As a result, they are playing an increasing role in supplementing and even replacing state provision of vital social and healthcare services
- Charities are generally closer to the communities they serve and can provide services more effectively than the public sector – the volunteer resource helps the sector mobilise quickly and cost-effectively
- **BUT** VAT often gets in the way

Figure 4.2: Employment in charities as a share of total employment, per cent



Note: The data pertains to different years in the period 2004-2010.

Source: ECCVAT.

- On average charities employ more than 3% of the total number of people employed in each Member State. This rises to as much as 7.5 % in the Netherlands
- **Figures do not include high number of volunteers**

Charities and VAT: the cost



- Irrecoverable VAT burden for four Member States (Denmark, Ireland, Sweden and UK) estimated to be €1.6 billion
- Total irrecoverable VAT cost for all Member States approximately €6bn



Charities and VAT: the five categories

- 1) Fundraising and “free” supply: *means no recovery of input VAT*
- 2) Grant-giving: *means no recovery of input VAT*
- 3) Service-providing – where clients or the state pay directly as consideration under contract: *these services may be exempt or taxable - if exempt, means no recovery of input VAT*
- 4) Grant-funded by the state – where the activities supported are not carried out for consideration under contract: *these services are outside the scope of VAT which means no recovery of input VAT*
- 5) Hybrid – when activities or services are a mixture of the above: *means very complicated VAT calculations and some irrecoverable VAT!*



Copenhagen Economics (CE) Report 2013

- ECCVAT welcomes the recognition in the CE Report of problems charities face in current VAT system
- But the recommendations only deal with part of the VAT issue facing charities and ignores problems of grant-giving and “free supply” charities
- The diverse nature of the charity sector and the services it provides means that a **“one size fits all” solution does not fit all types of charity or all Member States**

- CE Report finds strong evidence that real and serious distortions do exist as a result of differential VAT treatment:
 - *on the input side* as a reduced incentive to contract out support services
 - *on the output side* as reduced competitiveness of private entities *vis-à-vis* VAT exempt providers

“The inability to deduct input VAT causes extra costs when a non-taxable public body considers investments or a contracting-out services to the private sector. However, they avoid this extra cost by choosing to self supply.” (CE Report p61)
- The Report argues that there should be a way of removing this strong disincentive to contracting-out by public bodies under the present system

CE Report: Option 1 – Full taxation model



It is argued that the best solution to remove distortions on both input and output sides is to introduce a full taxation model **BUT**:

- implies a large increase in EU charities' overall VAT burden, especially in a standard rate version – compensation unlikely
- even a reduced rate model is not fiscally-neutral
- fiscally-neutral approach would require a super-reduced rate tailored by each Member State to reflect actual scope and rate of VAT
- does not resolve the VAT problem for grant-giving and “free supply” charities
- endangers contribution that charities can make to society

CE Report: Option 2 – Rebate scheme



- The Report looks at VAT Rebate Schemes and:
 - points out that they already exist in 8 Member States as matched-funding schemes completely outside the VAT system
 - proposes extending rebate schemes covering expenditure on BOTH non-taxable and exempt services to both public and private bodies operating in the selected service sectors
- The Commission has indicated its support for this proposal and does not appear to see any fundamental objection in EU law



CE Report: Option 2 – Rebate scheme

- ECCVAT strongly supports the rebate scheme solution, *provided the CE recommendation is adopted in full*
- A rebate scheme confined to public bodies does not resolve the irrecoverable VAT problem in relation to exempt or non-taxable activities
- Extension to charities directly providing contracted-out services is **ESSENTIAL** to resolve the input-side distortion (disincentive to contracting-out)
- It should also apply to exempt as well as outside the scope activities – otherwise a major part of the problem is unresolved

CE Report: Option 2 – Rebate scheme



Rebate schemes work well elsewhere:

- **Danish model:** Partial VAT compensation granted proportionately to charities based on their level of growth and self-financing – helps the sector thrive and develop
- **Canadian model:** GST Refund Scheme available for public service bodies, not public sector only (at different % rates). Applies to charities, not-for-profit organisations, municipalities, universities, public colleges and hospital authorities



CE Report: Option 3 – abolition of Article 13

- Privileged VAT position of state bodies causes distortion in reinforcing the bias that already exists for self supply using own resources
- Even worse when rebate scheme refunds VAT only to public bodies
- Widely varied application of the distortion of competition criteria causes great uncertainty and looks difficult to resolve
- ECCVAT favours creation of a more even playing field and removal of the self-supply bias caused by Article 13, which is made worse by its inconsistent implementation in practice



Another solution – an option to tax

- Introduce an option to tax exempt social and healthcare services at a reduced rate
- Included in 2011 CE Report but omitted in 2013 CE Report
- Individual Member States may prefer it to rebates as a “technical solution”
- ECCVAT urges the Commission to reconsider this option

Conclusion



- Distortions in the current VAT system are serious and getting worse as the scope of the tax has widened and rates increased
- Problem will worsen as charities are pressed to supply more services
- Full taxation model would damage charity sector and would **not** be supported
- **ECCVAT strongly supports CE option 2** – the rebate scheme – *provided the CE extended model is adopted*
- **ECCVAT strongly supports the introduction of an option to tax** at a reduced rate where appropriate



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