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# Case Study: The Reverse Charge VAT Trap

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When an entity exceeds the VAT registration threshold it is required to register and account for VAT on taxable supplies.

Many charities do not undertake taxable activities that would contribute towards the VAT registration threshold. However, expenditure on certain costs that are treated under the reverse charge provision do contribute towards the VAT registration threshold.

This case study outliines how one charity was required to register for VAT because of advertising services they purchased.

**Background**

Certain goods and services supplied to charities benefit from relief by being treated as zero rated. This removes the usually irrecoverable VAT cost to the charity. Amongst other supplies, the relief extends to the supply of advertising benefit from the relief. The notable exception to the relief included advertising placed on social media and subscription website accounts which would remain as standard rated. Retaining the standard rating for these services is a key issue in this case study.

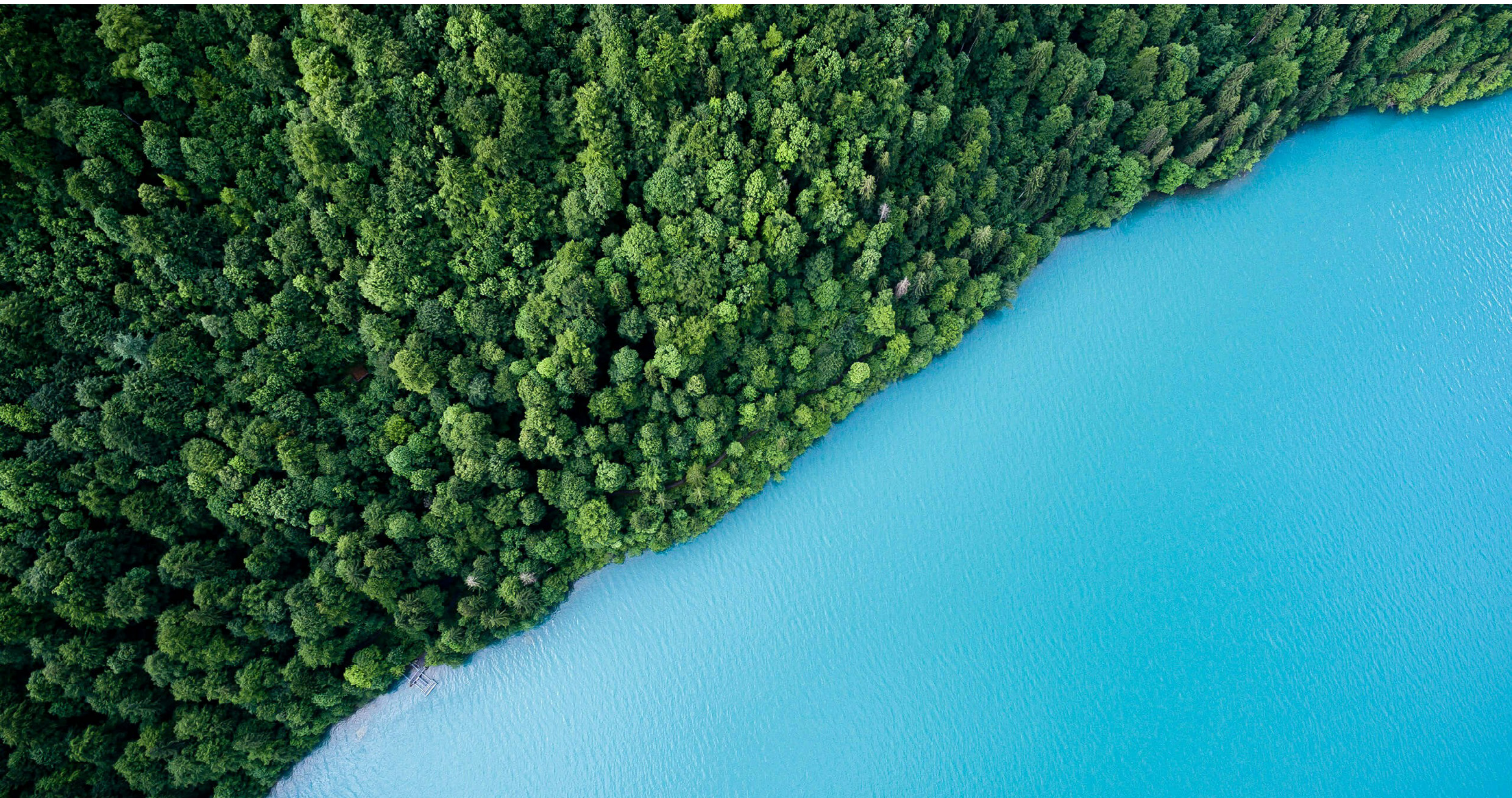
**Case Study**

This case study follows a UK charity whose business activities all fell squarely into the VAT exemption for welfare services and so were unable, and indeed precluded, from registering for VAT. To increase awareness and public funding that charity looked to start an advertising campaign on social media to reach a wider demographic.

Initially, a UK based agency was used to undertake the advertising campaign which meant VAT was charged by the supplier, but to reduce costs the charity looked to move it in-house. Facebook was used extensively, and fees were paid for the ad campaigns run on the social media platform. Facebook are established in Ireland by a business inside the UK would therefore be subject to something called the reverse charge.

The reverse charge is a VAT provision that applies to the purchase of services from Non-UK businesses. It was introduced to maintain fiscal neutrality between UK and non-UK suppliers, ensuring consumers would not be incentivised to use non-UK supplies to avoid the VAT that would have otherwise been charged by UK VAT registered suppliers.

The revers charge mechanism requires the VAT registered purchaser to account for output VAT on the value of the purchase. They would usually be eligible to recover input VAT subject to normal partial exemption rules. For example, Company A, who is VAT registered in the UK, purchases services from Company B in Spain for £1,000.00. Company A would be required to pay £200 of output VAT on the purchased services. However, they would retain the right to recover the £200 of input VAT on the purchased services. However, they would retain the right to recover the £200 of input VAT on the purchase assuming they are not partially exempt. This results in a nil loss/gain position for Company A.



Where the purchaser is not registered for VAT, the value of the reverse charge service contributes towards the purchaser's taxable turnover. Where this exceeds the VAT registration threshold, they would be obliged to register for VAT.

In this case study, the charity was unaware that the value of reverse charge purchases contributed towards the taxable turnover. It was only following a VAT review of the charity that we identified that the value of reverse charge purchases had exceeded the VAT registration threshold meaning they should have been registered for VAT several years prior.

Most VAT registered businesses only make taxable (standard rated, reduce rated or zero rated) supplies of welfare services. Without any taxable supplies the charity does not have the right to recover input VAT on any of its costs. Therefore, the VAT element of the reverse charge purchases was an absolute cost.

As a result of the costs incurred by Facebook the charity was required to retrospectively register for VAT and pay the VAT due on the reverse charge purchases from the date of registration. Usually, such error corrections are subject to a 4-year time limit, however errors regarding VAT registrations have no such time limits.

## MHA Commentary

**VAT is a niche area, and the effect of the reverse charge causing charities to register for VAT is a little-known issue to many. This case highlights the importance of regularly reviewing taxable income on an ongoing basis, but also to review retrospectively and assess if you are at risk of an historic VAT registration obligation. Charities which are already registered for VAT must ensure they identify costs subject to the reverse charge and account for VAT appropriately.**

### How we can help

If you would like to discuss any matter arising from this example policy please contact MHA on info@mha-uk.com or your usual MHA contact.

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**Sudhir Singh**
Partner
**E:** sudhir.singh@mha.co.uk

**Stuart McKay**
Partner
**E:** stuart.mckay@mha.co.uk

**Nicola Mason**
Partner
**E:** nicola.mason@mha.co.uk