

VAT On Income – An Introduction

Introduction

This guide helps charities and youth organisations understand how VAT applies when earning income from providing goods or services, including when they are not VAT registered. It explains when VAT applies, what income counts toward the VAT registration threshold, and how different types of income should be treated.

Commissioned by YIF Central Support, the guide was developed in 2024 by Ross Palmer, Tax Director at Sayer Vincent. Sayer Vincent has worked exclusively with charities for over 40 years and has been supporting Youth Investment Fund recipients since March 2024, providing specialist VAT advice.

This guide covers:

- When an organisation needs to register for VAT
- The difference between non-business, exempt, and taxable income
- Which income counts toward the VAT registration threshold
- How to apply the correct VAT rate (standard, reduced, or zero)
- Common VAT exemptions relevant to charities
- A simple 3-step process for assessing the VAT status of income
- How VAT rules link to charity reliefs and potential cost savings

The guide provides a practical starting point to help organisations stay compliant and avoid unexpected VAT liabilities. As VAT rules can be complex and fact-specific, specialist advice should be sought where circumstances are unclear.

VAT classification of activities

For VAT purposes, activities are divided into the following categories:

- Non-business activities (outside the scope of VAT) – No VAT is charged
- Business activities (within the scope of VAT). There are two categories of business activities:
 - Exempt activities – no VAT is charged. Many of the VAT exemptions are for activities in the public interest and commonly undertaken by charities, such as the provision of medical care, welfare services, education, sports facilities and admissions to cultural events.
 - Taxable activities – subject to VAT. Output VAT is added at the appropriate rate to sales invoices, either standard rate (20%), reduced rate (5%) or zero rate (0%). It is important to note that zero-rated activities are taxable, they just carry VAT at a zero rate.

VAT Registration

Organisations must register for VAT if their taxable income exceeds the VAT registration threshold (£90,000 as of January 2025) on either the past or future turnover test.

- Past turnover test – At the end of any calendar month, taxable income in the last 12 calendar months has exceeded the VAT registration threshold. This is the relevant test for the majority of organisations.
- Future turnover test – At any time, there are reasonable grounds for believing that the taxable income in the next 30 days alone will exceed the VAT registration threshold

Only taxable income contributes towards the threshold. Exempt and non-business income is not included.

How to categorise income for VAT

This is generally a three-step process. It is important that organisations document their conclusions and why this was reached to support their actions in the event of any query from HMRC.

Step 1 – Identify whether a transaction is subject to VAT

To be subject to VAT, a transaction must meet both of the following conditions:

- It must be a supply. It must be a supply of goods or services, provided in return for consideration (usually money), and,
- It must be a business supply. The supply of goods or services for consideration must be in the course or furtherance of a business activity of the supplier.

Consideration does not have to be paid by the beneficiary of the supply, it can be paid by a third party, for example, a local authority paying for a care contract.

A transaction is not a supply for VAT if a payment is made but nothing is provided in return. For example, donations or grants are payments but generally without any goods or services provided or expected in return.

If a transaction is not subject to VAT it is classified as non-business, or outside the scope of VAT. This income would not contribute to the VAT registration threshold, and would not be subject to VAT, even if received by a VAT registered organisation. Transactions in the scope of VAT then move on to step 2.

Step 2 – Identify whether any exemptions apply

Exemptions apply when certain conditions and requirements are met. Common examples of exemptions are:

- Welfare services provided by a charity
- Supplies of education by an eligible body
- Admission charges to museums, galleries, art exhibitions or zoos, or to a theatrical, musical or cultural performance.
- Sale and rental of property
- Supplies connected to qualifying fundraising events
- Sporting activities
- Youth club and membership subscriptions

VAT exempt supplies are within the scope of VAT, however no VAT is charged on the income, and it does not count towards the VAT registration threshold. These supplies do count as business activities for the purposes of determining whether charity VAT reliefs can apply.

All exemptions are subject to detailed rules as to whether they apply, so it is important to review the service being supplied if a charity is seeking to rely on an exemption to not register for VAT.

Step 3 – Identify the rate of VAT to charge

By default, VAT is chargeable at the standard rate of 20%. However, certain supplies can be subject to either the zero, or reduced rate of VAT. Common examples that can apply to charities all relate to zero rating, covering:

- Sales of publications (both written and electronic)
- Children’s clothing and footwear
- Certain items of food and drink
- Sale of donated goods

Note that both reduced and zero-rated supplies contribute towards the VAT registration threshold.