



# Charities

## VAT Guide | VATGCH1

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# 1. Charities – Guidance Note

## 1.1. Overview

### 1.1.1. Short brief

VAT has been introduced with effect from 1 January 2018 in the UAE. As a general consumption tax on the supply of goods and services, its effects must be understood by charities in the UAE in two contexts:

- its application to the activities of all charities; and
- the approach that should be taken by charities in the UAE when determining the amount of VAT on costs (i.e. input tax) which they are eligible to reclaim, specifically where they are engaged in both business and non-business activities (for example, such as where they provide goods or services without charging for these).

In particular, certain charities in the UAE will, under the Federal Decree Law No. 8 of 2017 on Value Added Tax (referred to hereafter as the “VAT Law”), be treated as Designated Charities. Where designated in that manner, Designated Charities will be entitled to recovery of VAT under a special regime.

### 1.1.2 Purpose of this document

This document contains guidance about the characteristics of a charity which must be present in order for it to qualify as a Designated Charity for VAT purposes.

In addition, this document provides guidance for charities seeking to understand which of the services they provide are business activities and which are non-business activities, and in turn, the extent to which VAT recovery on costs is possible.

### 1.1.3 Who should read this document?

This document should be read by key stakeholders in charities who are responsible for tax matters.

It is intended to be read in conjunction with the Taxable Person Guide for Value Added Tax.

## 2. Charities

### 2.1. Charities and their activities

#### 2.1.1. VAT treatment of charities

VAT is a general consumption tax imposed on most supplies of goods and services in the UAE. In that respect it will, by default, be chargeable on goods and services supplied by charities in the UAE.

Charities will therefore be subject to the usual rules of VAT regarding the making of supplies. For further details on the general VAT rules, please refer to the Taxable Person Guide for Value Added Tax.

#### 2.1.2. Business activities for VAT purposes

Charities will typically make a mixture of supplies of goods and services with differing VAT liabilities. Where such goods and services are supplied for a charge, this is a business activity for VAT purposes and VAT will have to be charged where the charity is considered to be a taxable person.

The charity will be able to recover VAT on costs which directly relate to onward activities which are liable to VAT, subject to the normal VAT recovery rules applicable to all businesses.

#### 2.1.3. Donated goods and services

In the normal course of their operation, charities often receive donations of goods and services and may then use these as part of their onward provision of charitable activities. Where these activities are undertaken and a charge is made, this is also a business activity for VAT purposes and VAT may be required to be charged.

Since the relevant goods or services would be received by a charity free of charge, the charity will not have incurred any costs in relation to these and accordingly, there will be no VAT on costs to recover in such circumstances.

#### 2.1.4. Non-business activities for VAT purposes

Where an activity is performed by a charity that is acting in its charitable capacity ("relevant charitable activity"), and it makes no charge for the supply of goods or services concerned, the activity would ordinarily not be treated as being liable to UAE VAT as there is no charge, unless the supply is treated as a deemed supply (please see below).

It is worth noting that in some cases the relevant charitable activity will be subsidised by grants or donations. Provided the grantor is not entitled to any benefit in return for the grant or donation (beyond a simple acknowledgement), no VAT would be chargeable as this is not a supply for consideration.

Ordinarily, no VAT on direct costs relating to such free provision of goods and services by the charity would be recoverable in such circumstances. However, certain Designated Charities will be entitled to recover VAT relating to their relevant charitable activities where they make such free provision of services and goods under a special VAT refund scheme.

#### 2.1.5. Deemed supplies

Under the normal VAT rules where VAT has been recovered on items of expenditure (goods or services) which are then used for non-business purposes, the consequence is that such goods and services will be treated as deemed supplies for VAT purposes. This often would happen where assets are given away or used for non-business reasons.

Since activities of the charities often require goods and services to be given away or used for non-business purposes, it has to be considered whether the deemed supply provisions could apply. Specifically, the VAT legislation stipulates that there may be a deemed supply in the following common situations:

- Where there is a supply of goods or services for which input tax was recovered but the goods or services were used, in part or whole, for purposes other than Business; and
- Where there is a supply of goods or services for no consideration, where those goods or services formed whole or part of assets of a taxable person, but are no longer considered to be as such.

For a deemed supply of goods or services to take place, the supplier must have recovered input tax relating to these goods or services.

Applied to charities, the Authority considers that the definition of 'business' for VAT purposes is broad and may include charity using goods and services within the terms of charitable activity. Therefore, where goods or services are used for such charitable purposes – e.g. property made available for free for events or kitchen appliances used in providing free meals – then this is not a deemed supply for VAT purposes if the relevant goods and services remain part of the assets of the charity.

On the other hand, if the charity claims VAT in respect of acquisition of goods, and then gives them away for free outright, the supply will be treated as a deemed supply for VAT purposes. For example, where a charity has purchased food and then donated it to poor, the charity should account for the output tax on the deemed supply of the food.

It is worth reiterating that the deemed supply rules only apply when input tax has been recovered in respect of the relevant goods or services. Therefore, where the charity does not recover VAT on the goods or services, no deemed supply of those goods or services will take place.

In addition, it should also be noted that where the total VAT due for all of the deemed supplies made by a charity for any 12-month period is less than AED 2,000, those supplies will be considered de minimis and therefore not subject to the deemed supply provisions in any case.

## 2.2. Designated Charities

As discussed in Chapter 3 of this Guide, “Designated Charities” are subject to special VAT recover rules.

There are **four criteria** which must be present in order for a charity<sup>1</sup> to be treated as a Designated Charity undertaking relevant charitable activities and therefore eligible for the special VAT refund scheme. It must be:

1. Approved by the Ministry of Community Development to carry out a charitable activity in the UAE, or established as a charity under Federal or Emirate Decree, or otherwise licenced to operate as a charity by an agency of the Federal or Emirate Governments authorised to grant such licences, with its objectives including for instance, advancing health, education, public welfare, religion, culture, science, and similar activities;
2. Operated within the terms of any approval, licence or other authorisation which has been granted by the aforementioned bodies in respect of its charitable activities;
3. Operated on a not-for-profit basis;
4. Funded primarily by means of grants or donations.

Charities eligible for this special VAT refund scheme will be specifically identified by way of a Cabinet Decision as “Designated Charities”.

**Important:** unless the Cabinet decides otherwise, only where a charity meets all four tests can be it treated as a Designated Charity. The Cabinet Decision only applies to the entity named and any trading subsidiary set up by a charity will not be included.

It should be noted that, in order, to benefit from the special recovery rules, Designated Charities need to apply and register for VAT. Such VAT registration also means that the Designated Charities will have to charge VAT on all taxable supplies they make.

## 2.3. VAT registration of charities

Any charity carrying on a business activity in the UAE and making taxable supplies in excess of the mandatory VAT registration threshold must apply to be registered for VAT purposes.

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<sup>1</sup> Charities in the UAE include societies and associations of public welfare, cultural awareness and similar.

In addition, any charity carrying on a business activity and making taxable supplies or incurring expenses subject to VAT in excess of the voluntary VAT registration threshold may apply to register for VAT purposes.

For further details on VAT registration, please refer to the Taxable Person Guide for Value Added Tax on the FTA website.

Designated Charities need to apply and register for VAT in order to benefit from recovery of input tax, disregarding whether they meet the threshold or not.

Furthermore, charities may register with other entities as a tax group. However, it is important to note that a Designated Charity may only form or join a tax group comprising other Designated Charities.

## 2.4. Special situations

### 2.4.1. VAT treatment of sales or leases of new buildings to charities

The first supply of a new building or part of a building will be subject to VAT at the zero rate where the following conditions are met:

- The charity is a Designated Charity;
- It must be the first supply of that building. Subsequent supplies are taxable at the standard rate (if it is not residential);
- The building, or part thereof, must be specifically designed to be used by the charity solely for its relevant charitable purpose: this means the building must have been designed specifically with the charity as the tenant in mind and for its own use (for example it cannot simply be an office building built speculatively that a charity then chose to occupy);
- “Relevant charitable activity” means:
  - an activity other than for the purpose of profit or benefit to any proprietor, member, or shareholder of the Charity; and
  - one which is undertaken by the Charity in the course or furtherance of its charitable purpose or objectives to carry out a charitable activity in the UAE as approved by the Ministry of Community Development, or under the conditions of its establishment as a charity under Federal or Emirate Decree, or as otherwise licensed to operate as a charity by an agency of the Federal or Emirate Governments authorised to grant such licenses.

Such charitable purposes and objectives include but are not limited to: advancing health, education, public welfare, religion, culture, science and similar activities.

Where the conditions for zero-rating outlined above are not met, the first supply of a new building or part thereof will be liable to VAT at the standard rate unless it qualifies as a residential building, in which case the special rules applicable to residential buildings may apply.

Subsequent supplies of buildings or parts thereof to be used for relevant charitable purposes will also be subject to their normal VAT rate.

It is therefore possible for the renting of a building to be zero-rated for the first rent and subsequently for the rent to be taxable. Since Designated Charities can recover incurred VAT under the special refund rules in any event, the relief acts largely as a cash-flow benefit in preventing a large amount of VAT being charged to the charity on the purchase of a building.

## 3. VAT recovery rules for charities

### 3.1. Overview

A charity may be making taxable supplies and also undertake non-taxable activities.

The VAT incurred in respect of taxable supplies will be recoverable under the normal rules. The remaining VAT will be recoverable by Designated Charities under the special refund rules applicable to such charities.

VAT incurred in respect of exempt supplies however, can never be recoverable nor will any VAT on specific input tax for “blocked” items, such as business entertainment.

Consequently, a charity may need to apportion VAT incurred on costs so that only that amount which is eligible to be reclaimed can be so reclaimed (see sections 3.2 and 3.3).

**Important:** in all cases, VAT which is specifically blocked from recovery under the VAT Law cannot be reclaimed, whether or not the body concerned is a Designated Charity or otherwise.

### 3.2. VAT recovery by charities which are not Designated Charities

Charities that are not Designated Charities are subject to the normal VAT recovery rules. What this means is that VAT is generally only recoverable where it relates to taxable supplies.

Therefore, where a charity which is not a Designated Charity incurs VAT in respect of activities which do not generate taxable supplies, the VAT will not be recoverable.

Likewise, where a charity incurs VAT which relates to exempt supplies this VAT is also not recoverable.

Charities will therefore be required to allocate and apportion VAT recovery between taxable activities (recoverable) and non-taxable activities / exempt activities (non-recoverable).

The FTA has set out below a method that it will normally accept as giving rise to a reasonable method of apportionment for costs that relate to both non-taxable and taxable activities for charities that are not Designated Charities.

#### 3.2.1 Step 1: Direct attribution

In all cases, in each tax period, all input tax which can be wholly attributed to any particular supply must be attributed to that supply and either recovered or blocked from recovery depending on whether the supply is taxable or exempt or does not relate to the making of taxable supplies. This is referred to as direct attribution.

For example, a charity may incur legal fees in respect of setting up a new facility from which to provide free services to its beneficiaries. The input tax would be non-recoverable as it relates to free services ('non-taxable' activities). It may also incur VAT on goods that it purchases to sell on, in order to raise charitable funds. The VAT is recoverable since VAT will be due on the sales of the goods (taxable activities). It may incur legal fees associated with the sale of a bare piece of land (which would be exempt), and that VAT cannot be recoverable, as it relates to exempt supplies. Finally, it may also incur an annual audit fee – this relates to all the activities and thus must be apportioned.

Any input tax which cannot be wholly attributed in this manner must be apportioned by way of a method in order to establish that part which may be recovered and that part which must not. A charity may use the standard input tax apportionment method to apportion input tax between exempt use and non-taxable use (see step 2 below), or by application to and approval of the Authority a special input tax apportionment method in order to undertake the necessary apportionment. Special methods will only be available with effect from 1 January 2019.

### 3.2.2 Step 2: attribution of the residual input tax via the standard method

On a VAT quarterly / monthly basis, all input tax that cannot be wholly attributed under step 1 ('residual input tax' or R) is to be apportioned between taxable, exempt and non-taxable use in the following manner:

1. Determine the recovery ratio as a percentage:

$\frac{\text{Input tax directly attributable to supplies allowing VAT recovery in the period concerned (T)}}{\text{Input tax directly attributable to supplies allowing VAT recovery in the period concerned and input tax that cannot be recovered in the tax period concerned}}$
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2. The resulting figure is expressed as a percentage and rounded to the nearest whole number. Apply the recovery ratio percentage to the residual input tax:

$\text{Residual} \times \text{Recovery Ratio \%} = \text{Proportion of residual attributable to supplies for which input tax is recoverable (R2)}$
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3. Treat that proportion of the residual which is attributable to taxable supplies as recoverable (and include in the tax return for the tax period in which the calculation was undertaken).
4. The total recoverable input tax = T + R2.

In the first period following the end of the previous tax year, a calculation for the whole of the preceding tax year should be carried out, using the same principles as above. This is known as the 'annual adjustment' and may render an increase or a decrease in the amount of input tax previously treated as recoverable on a quarterly

or monthly basis under (3). The required adjustment should be included in the return submitted for the first tax period following the end of the relevant tax year.

Please refer to the Input Tax Apportionment Guide for further details.

### 3.3. VAT recovery by a Designated Charity

A Designated Charity may recover VAT on any expenses incurred by it as long as the expenses do not relate to exempt supplies made by the charity and are not the type of expenses for which input tax deductions are “blocked”.

This means that a Designated Charity may recover VAT on expenses even if those expenses do not specifically relate to supplies that typically allow VAT recovery. Therefore, where a Designated Charity is not engaged in exempt activities and which does not have any “blocked” expenses, may treat all VAT incurred on costs as recoverable in full.

However, where the Designated Charity carries on activities which allow for VAT recovery and also exempt activities, it may need to apportion VAT incurred between those activities so as to accurately determine the amount for which it is entitled to reclaim.

Similar to charities which are not Designated Charities, the first step is to do a direct attribution of input tax incurred.

- Input tax which is wholly attributable to supplies allowing VAT recovery (such as taxable supplies) (T) may be recovered in full.
- Input tax which is wholly attributable to exempt supplies (E) may not be recovered.
- Input tax which is attributable to other non-taxable supplies / activities (C) may be recovered in full due to the special VAT recovery scheme.

Following the direct attribution, the Designated Charity would need to apportion input tax which cannot be fully attributed as per above.

1. The remaining input tax is non-attributable, or “residual” (R). It is necessary to calculate that which is partly attributable to activities which allow for VAT recovery and that which is attributable to exempt activities. The following calculation should be carried out:

$$\frac{\text{Input tax wholly attributable to supplies allowing VAT recovery (T) + input tax attributable to other recoverable activities (C) in the period concerned}}{\text{Input tax wholly attributable to supplies allowing VAT recovery (T) + input tax wholly attributable to other recoverable activities (C) + input tax wholly attributable to exempt supplies (E)}}$$

The resulting figure is expressed as a percentage and rounded to the nearest whole number. The percentage is applied to the total amount of input tax to be apportioned (R) to calculate the further amount of recoverable input tax (R2).

2. The total recoverable input tax = T + C + R2.

In the first period following the end of the previous tax year (this will vary depending on the charity's tax periods), a calculation for whole of the preceding tax year should be carried out, using the same principles as above. This is known as the 'annual adjustment' and may render an increase or a decrease in the amount of input tax previously treated as recoverable on a quarterly or monthly basis under (1). The required adjustment should be included in the return submitted for the first tax period following the end of the relevant tax year.

Please refer to the Input Tax Apportionment Guide for further details.

## 4. Designated Charities

To date, there have been two Cabinet Decisions listing Designated Charities, namely:

- Cabinet Decision No. 55 of 2017 on Charities that May Recover Input Tax;
- Cabinet Decision No. 15 of 2018 on Amending the List of Charities Annexed to the Cabinet Decision No. (55) of 2017 on Charities That May Recover Input Tax.

Please refer to the updated list of Designated Charities on [www.tax.gov.ae](http://www.tax.gov.ae).