



# Grants and Contracts

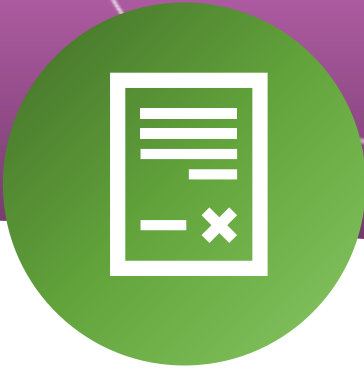
Made Simple



Ross Palmer and  
Jon Williamson

12 November 2025





### Types of agreement

There is no overall exemption from VAT for charities. Need to assess the VAT status of income streams



### Why it matters?

What VAT principles are we addressing?



### VAT - HMRC's guidance

What guidance does HMRC have on the distinction for VAT?



### Reviewing the factors

How do you apply the guidance?



...

...

# Types of agreement

...




## Types of agreement

Over time there have been changes to how activities are funded/delivered:

- Increased use of commissioning vs grant funding
- Change to consortium arrangements can change nature of funding
- Funding from public bodies, particularly Local Government can come in many different forms

Sometimes it can be unclear whether a funding agreement is a freely given grant, or a contract for services





## What facts are we considering?

Agreements sometimes doesn't include all of the information and facts about how funds are received and activities undertaken. Other relevant sources of information can be:

- Correspondence with funder
- Invitations to submit bids/tenders
- Bid proposals and budgets
- (If applicable) correspondence with partner organisations

...

Why does the  
form of the  
agreement matter?

...



**Accounting and  
Income  
recognition**



**Tax – VAT &  
Trading**



**Legal**

# Accounting – income recognition

| Grants  | Contracts  |
|---|--|
| Recognise under donations and legacies or charitable activities                             | Recognise under income from charitable activities/activities for generating funds        |
| Recognise when income recognition criteria have been met. What future conditions are there? | Recognise in line with meeting the performance conditions/obligations under the contract |
| Unspent grants are usually carried forward within funds to be applied in future periods     | Defer or accrue income as appropriate at end of the year                                 |

New Charity SORP 2026 includes some changes to income recognition criteria and terminology



# Restricted vs unrestricted

Grants are a form of donation – possible to be subject to restriction

Contracts by nature are not donations

- Obligation is to deliver activity
- Any surplus could in principle be kept and used for other activities or reserves, and so would be unrestricted funds
- **But** this is not universal – consider the substance of agreement – could it still be restricted?





# Trading and legal issues

## Trading

- Income earned through a contract is likely to qualify as a trade - must consider corporation tax
- Charities are exempt from corporation tax on 'primary purpose'
- Non-exempt income – need to consider need for a trading company

## Legal

- Contracts – subject to contract law
- Grants – subject to trust law

# VAT Principles

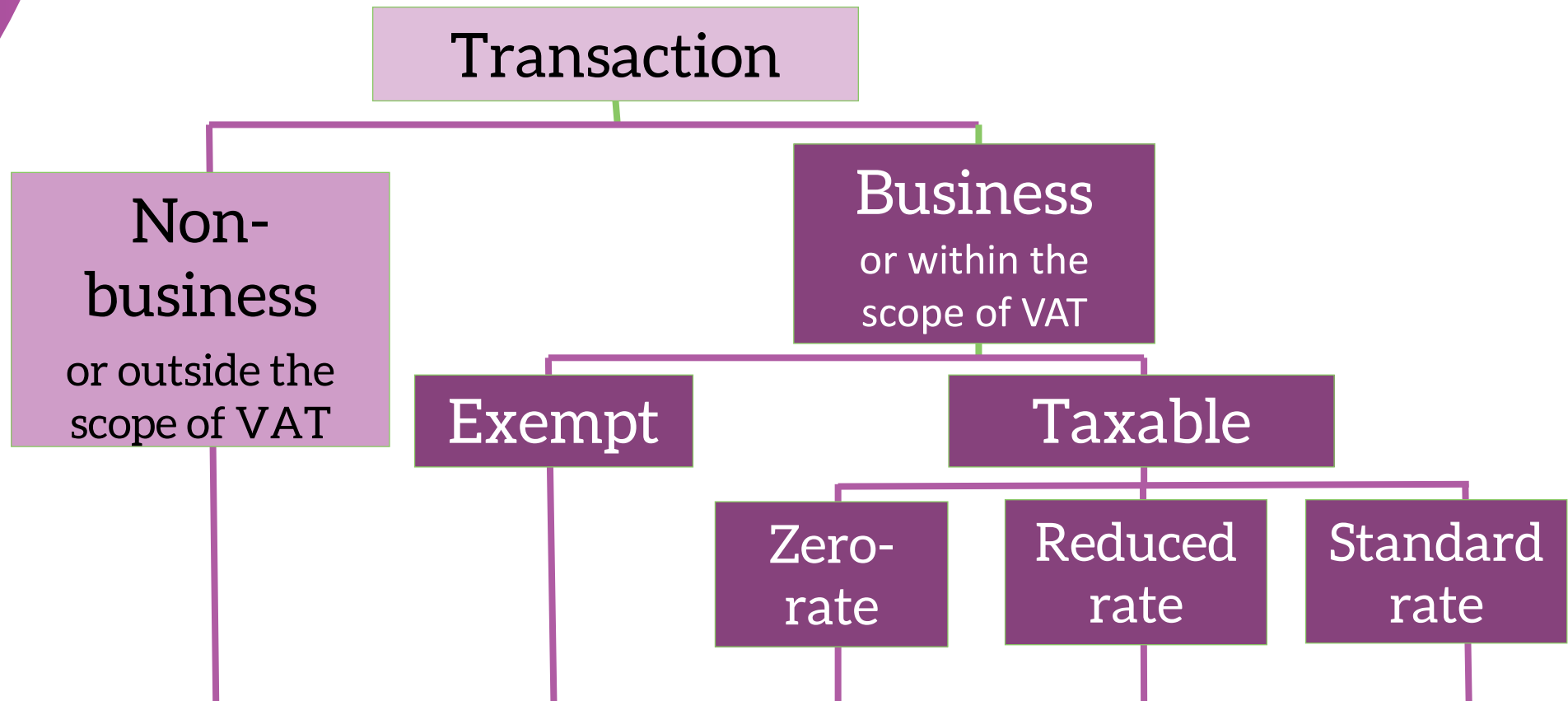
Form of agreement matters in assessing if VAT applies

**Two requirements for a transaction between two parties to be within the scope of VAT:**

- Supply test – there must be a supply of goods or services in return for consideration
- Business test – the supply must be in the course or furtherance of a business activity



# VAT classifications



|                     |                      |                        |     |          |           |
|---------------------|----------------------|------------------------|-----|----------|-----------|
| Output VAT charged? | No                   | No                     | No  | Yes @ 5% | Yes @ 20% |
| Input VAT Recovery  | No – unless s33 body | No – unless de-minimis | Yes | Yes      | Yes       |



# Supply test

Is the funding under the agreement in return for a supply of goods or services?

1

Will there be consideration?

2

Will goods and/or services be supplied?

3

Will the consideration be in return for the supply of goods/services?

## Normally:

- Contract - Consideration is usually in return for a supply of goods or services, so the supply test is met
- Grants are not usually in return for a supply of goods or services, so the supply test fails





## Exceptions - examples

### **Grants can be within the scope of VAT**

- e.g. payment by results
- £x paid per piece of advice provided
- £x paid per blood test conducted

### **Funding under a contract can fail the supply test**

- e.g. no outputs specified, contract only has vague aims, general outcomes – no link to specific service
- HMRC accept this is the case for the standard English NHS contract for hospice care



# HMRC's guidance



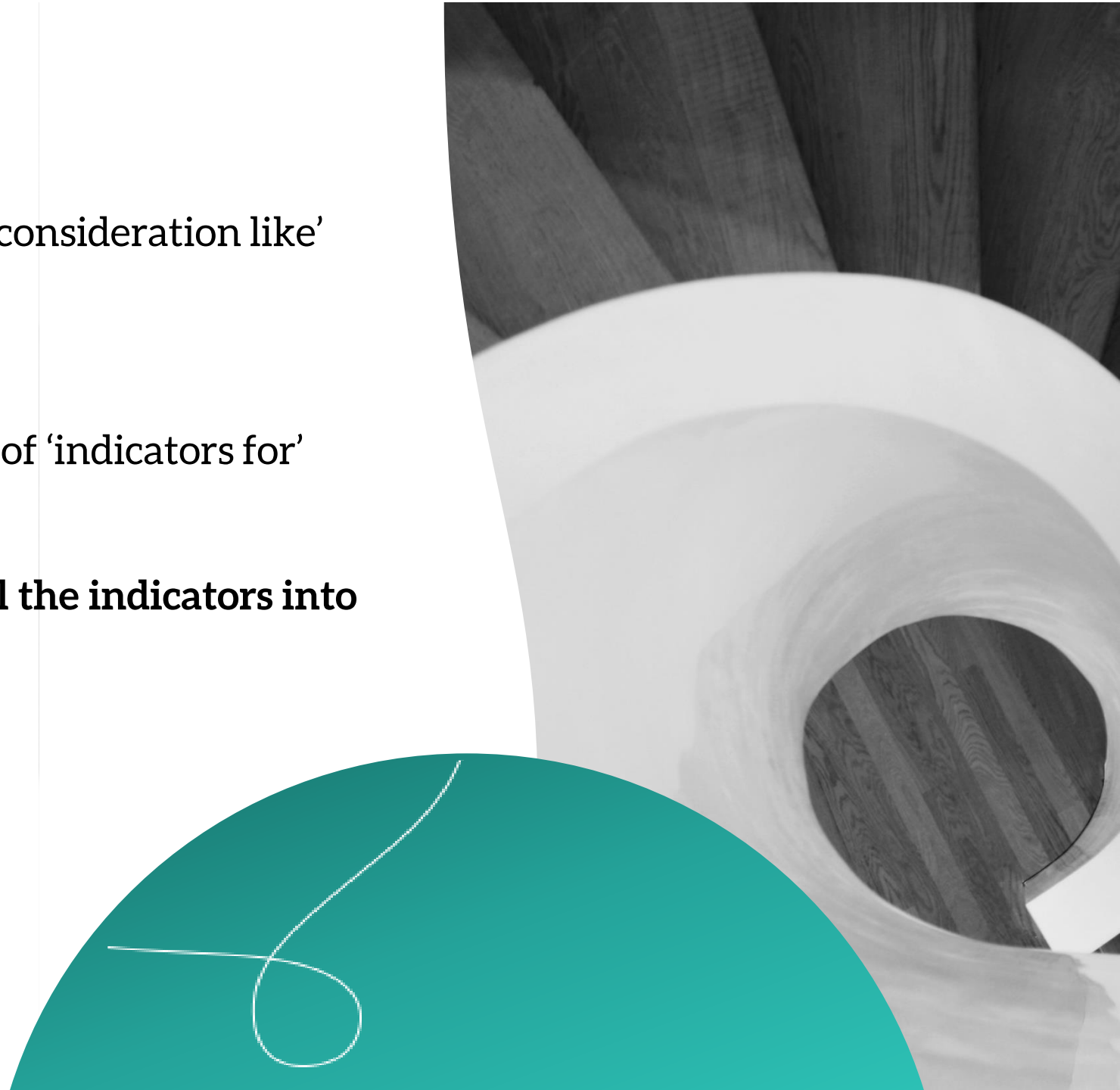
# HMRC's published guidance

- HMRC has published internal guidance on the issue starting at VATSC06300
- HMRC guidance refers to whether a transaction is grant or 'consideration'
- Guidance only covers VAT – no comment on legal or accounting treatment
- Note - the business test must be met for a transaction to be within the scope of VAT
- Dealt with in a separate HMRC manual (the BNB manual)



# HMRC's approach

- The guidance lists 'grant like' and 'consideration like' factors
- All factors need to be considered
- However, it is not simply a matter of 'indicators for' exceeding 'indicators against'
- **Needs a balanced view - taking all the indicators into account**







## The factors

HMRC do not group the factors. However, they can broadly be subdivided:



- **Initiation process** – how was the agreement initiated?
- **Powers** – under what power does the funder provide the funds?
- **Beneficiaries** – who selects the beneficiaries?
- **Control** – who controls how the funds are spent?
- **Payment mechanism** – how are payments triggered?
- **Statutory reporting** – how are the funds reported in the accounts?
- **Failure mechanism** – what happens if either party fails to perform?





## Neutral factors

Some factors do not indicate either way what form a payment takes

- The payment is described as a grant
  - The level of detail within the contract/ agreement does not point in either direction
  - The supplier's activities would be significantly curtailed in the event of a withdrawal or reduction in funding
- 
- 

The background is a solid blue gradient. In the upper left, there are several thin, white, hand-drawn style lines that loop and swirl. Scattered throughout the upper half are small white dots, some in groups of three (horizontal and vertical) and some in pairs (horizontal).

# Reviewing the factors

# Initiation process

## Grant like

The payment was made following a grant application process run by an organisation that regularly provides grants, such as:

- Central or local government
- Lottery funds
- Other grant funder

## Consideration like

Tender for services

Funder is seeking services in return for their payment - if funder is the direct beneficiary of the supplies.

Funder believes they are receiving something in return for the payment.

# Beneficiaries

## Grant like

Charity is carrying out its own aims and objectives. Beneficiaries are chosen by the recipient.

To be outside the scope of VAT a grant should be freely given. Funder should have no expectation of direct benefit in return.

## Consideration like

Funder is direct beneficiary of goods/services

Supplier undertakes outsourced activities on behalf of the funder - the supplier is acting as a subcontractor.

The payments made by the funder to the supplier are made specifically for the supplier to provide particular services to its clients.



# Control

## Grant like

Funder will not attempt to control how the money is spent beyond seeing that the funds are properly managed.

Monitoring is ensuring the payments are appropriately spent.

Supplier will set its own targets for project - as opposed to funder imposing

## Consideration like

Funder will attempt to control how the money is spent, maybe imposing specific targets in terms of quantity, quality, timeframes etc.

Monitoring is to ensure that specific supplies are made

The relationship between the funder and supplier will not be at 'arms length'





# Payment mechanism

## Grant like

Funding is drawn down by the supplier as a reimbursement of expenditure incurred, rather than an advance payment for services.

Alternatively, there may be a 'deficit funding' arrangement whereby the funder agrees to plug any funding gaps

## Consideration like

Each activity carried - gives rise to a specific and identifiable payment. There is probably a detailed recording system for timekeeping, outputs achieved etc.

It is not necessary for the supplier to have a profit motive, but the type of supplies should have **the potential to make a profit**

# Failure mechanism

## Grant like

If the funding is withdrawn there is no legal redress for the supplier to have the payment reinstated

There is a 'clawback' provision within the agreement

## Consideration like

If the funding is withdrawn there is legal redress for the supplier to have the payment reinstated or claim compensation

The solution for reclaiming the payment in any subsequent breach of contract is to sue for damages

## Comments

- Clearly sets out key factors HMRC staff should and should not take into consideration
- Useful as a guide/tool when discussing with funders, advisors or HMRC
- Cannot simply compare the numbers of factors for and against one treatment
- Guidance states that some factors may have more weight in certain situations – but isn't clear which these are!



## Any questions?

**Ross Palmer**

[ross.palmer@sayervincent.co.uk](mailto:ross.palmer@sayervincent.co.uk)

**Jon Williamson**

[jon.williamson@sayervincent.co.uk](mailto:jon.williamson@sayervincent.co.uk)