



Denmark - VAT Compensation Scheme for Charities 2006

In 2004 Danish Charities paid almost MDKK 210 (€28 million) in VAT. Over the years Charities consistently asked the Danish government that they be exempted from this tax as the funds were needed for the work carried out by them. A substantial number of new projects could be launched with that kind of money. In addition, Charities had a hard time explaining to their donors that a proportion of the donations received had to be passed on to the taxman.

All along, various governments were favourably inclined to the idea of returning the VAT money to Charities. The umbrella organization of Charities (ISOBRO) had a number of meetings with the Minister of Finance, Mr. Thor Pedersen. However, the stumbling block was the EU 6th VAT Directive, which the government believed was incompatible with such a refund policy.

A breakthrough was achieved when Mr. László Kovács, the EU Commissioner for Taxation and Customs, clarified the EU position. As long as the government continued collecting VAT from the Charities the requirements of EU legislation would be met. What the government does with the money subsequently, including the implementation of a refund mechanism, is strictly a national budgetary issue, over which the Commission has no say or influence. In a very down to earth approach we repeated the question to the Commissioner's office and once again the above position was confirmed. They even went so far as to say that the refund or compensation scheme could be tied directly to the VAT money - Euro by Euro. As long as the VAT was collected in the first place there would be no EU problems for national governments. This was finally confirmed on February 8th of 2006.

On the basis of this clarification from the EU the government went ahead and included the measure in the preparatory work for the 2007 budget which became law in October 2006 after the third reading. Initially Charities will not get full compensation, but the intention is to gradually increase the size of the refund. An important detail addresses the amount that any Charity may be refunded: The amount of refundable VAT is proportionate to the fundraising capabilities of the Charity. Example: If a Charity receives 30 percent of its budget from the state 30 per cent of the VAT will not be refundable.

Charities fully appreciate the political complexity of the issue faced by the government and the parliament in finding a solution to the VAT problem. Needless to say, Danish Charities are happy with this political breakthrough as new initiatives and projects can now be undertaken with the funds released.

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28th February 2007

The Danish Scheme – Outline of how it works

1. 2004 has been chosen as the threshold year so for each charity the threshold is their audited VAT bill for 2004
2. The compensation scheme applies from 2006 onwards and the amount of VAT to be refunded is proportionate to the fundraising capacity of the charity.
3. To apply for compensation each charity must provide audited details of their VAT expenditure for the year and audited details of the proportion of income sourced from the state and that from private sources. To qualify for a refund the amount paid out on VAT must exceed the 2004 threshold. In addition the amount of VAT that can be reclaimed is in direct proportion to the source of income i.e. if a Charity's income is 60% funded by the state and 40% funded from private sources then only 40% of the VAT can be reclaimed.
4. This is best illustrated by Examples:

Example 1

Charity XYZ paid out a total of €100,000 in VAT in 2004 (audited figure). Their audited VAT bill in 2006 is €150,000 therefore they can potentially reclaim the difference of €50,000. However their audited income figures for 2006 reveal that 50% of the income comes from the state and 50% from private fundraising therefore the charity can only reclaim 50% of that portion of the 2006 VAT bill in excess of the 2004 threshold i.e. €25,000.

Example 2

Charity ABC paid out a total of €35,000 in VAT in 2004 (audited). Their audited VAT bill in 2006 was €34,000 therefore because they have not exceeded the 2004 threshold they cannot reclaim any VAT in 2006.

Example 3

Charity DEF paid out a total of €1m in VAT in 2004 (audited). Their audited VAT bill in 2006 was €1.5m so they are €500k above the 2004 threshold. Their audited income figures reveal that 10% of their income in 2006 came from the state and 90% from private fundraising. They can therefore, reclaim 90% of the €500k VAT above the 2004 threshold i.e. €450k

5. The advantages of the scheme are that it incentivises charities to reduce their dependence on the state through private fundraising; it is simple to administer; applications must be accompanied by audited accounts; it is confined to charities; and control remains with the Revenue Authorities who can carry out a VAT audit of individual charities as they see fit.