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**VAT on grant income after
Colchester**

May 20TH 2026

Introduction

- What does Colchester mean for us?
- Joy and Celebration or Fear and Trepidation?
- To help us answer that question:

TODAY'S SPEAKERS

Our featured panelists



Peter Mantle

Barrister

Monckton Chambers



Gillian McGill

Director

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**Socrates
Socratous**

Partner

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Charity Tax Group Presentation

Colchester Institute Corporation v HMRC The Court of Appeal's 2026 Judgment

Peter Mantle
Barrister
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CIC – The First Test Case

The First Test Case

- HMRC **win** the ‘Consideration Point’ in FTT in 2018
- HMRC **lose** on the ‘Consideration Point’ in UT in 2020
- However, HMRC win in UT on a ‘Set-off Point’ and therefore CIC’s repayment claim is entirely dismissed
- HMRC cannot appeal to Court of Appeal (‘CA’)
- CIC do not seek to appeal to CA on the ‘Set-off Point’
- Revenue and Customs Brief 08/21 addresses *CIC UT 2020* – HMRC policy until CA can adjudicate

CIC – The Second Test Case

The Second Test Case

- The appellant is again CIC
- HMRC reserve their arguments on the Consideration Point in FTT and UT
- HMRC obtain permission to appeal to CA
- CA decide the Consideration Point against HMRC - 27/3
- HMRC do not apply for permission to appeal
- Revenue and Customs Brief 3 (2026): VAT treatment of certain public funds received by further education institutions – initial reaction

The *CIC CA 2026* Judgment (1)

The *Rayon d'Or* point (1)

HMRC v Colchester Institute Corporation

[2026] EWCA Civ 363, [2026] STC 702

- Single judgment of Foxton LJ - both other judges agree

A victory for HMRC en route to defeat

- CJEU judgment in *Rayon d'Or* (Case C-151/13)
- *CIC UT 2020* held that *Rayon d'Or* **bound** it to decide the Consideration Point in favour of CIC
- Peculiar conclusion in context of 'direct link' test for consideration – sensitive to contract terms and facts
- To succeed in CA HMRC had to overturn this conclusion

The *CIC CA 2026* Judgment (2)

The *Rayon d'Or* point (2)

CA overrules CIC UT 2020 on *Rayon d'Or* point

- *Rayon d'Or* did not dictate the outcome of the Consideration Point – see CA at [104]
- *CIC UT 2020* had erred in law – points of distinction existed
- Important as this ***narrows*** the impact of *CIC CA 2026*
- If CA had gone the other way on *Rayon d'Or* there was a question over if a “number of recipients” based funding formula meant that funding must be ‘consideration’ for VAT
- However, CA holds *Rayon d'Or* provides some support to CIC’s case on the Consideration Point.

The *CIC CA 2026* Judgment (3)

A simplified summary of the dispute

- Less a dispute over interpretation of ‘single’ direct link test and more over its application in various scenarios
- All agreed: if there is consideration here it is third party
I.e. supplies by CIC are to students not Funding Agencies
- HMRC rely on “*Kennemer*” type supplies (being available to provide services) being easier to link to lump sums
- HMRC also rely on lack of direct link between annual funding amount and many supplies to individual students
- HMRC also rely on autonomy of FECs in respect of the courses they provide, to how many, and to whom

The *CIC CA 2026* Judgment (4)

Kennemer Type Supplies

CA see distinctions between ‘types’ of services

- CA accepts ([64]) that if services are of a *Kennemer* type:
 - “a direct link may be found between that service and the consideration even if it would be more challenging to establish such a link between the consideration paid and those services actually provided (rather than simply being made available)”
- Also more challenging if services provided for the benefit of a large, indeterminate group, or the interests of a group as whole, rather than individual service recipients

The *CIC CA 2026* Judgment (5)

Third Party Consideration and Apportionment

Stipulation of price necessary but what does that require?

- CA addresses stipulation of price alongside apportionment of a lump sum as a point of law before turning to autonomy of FECs (see [47] – [49])
- No need for price of individual supplies to each student to be agreed
- Lump sum funding amount can be apportioned
- Draws on case law, mainly on multiple supplies to one recipient, possibly questionable, but also on *Rayon d'Or*
- Ultimately difficult to attack CA's analysis on this

The *CIC CA 2026* Judgment (6)

Importance of Funding Agreements

Illustration of importance of contract terms

- CA treats the terms of the funding agreement as the right starting point – the correct approach
- CA gives the terms very great weight
- CA finds strong support for reciprocity and direct link in certain contract terms – see [114] – [115]
- Those terms go far to answer the question: “Is this funding of certain activities of FECs subject to conditions (to protect public money and ensure effective use) or paying for supplies of education?” (see [111])

The *CIC CA 2026* Judgment (7)

Autonomy given to FECs under Funding Agreements

- CA recognises CIC has some autonomy over what it provides under the Funding Agreements
- However, given the agreements and all the circumstances less autonomy than HMRC assert
- Importantly, the nature of the annual funding formula could be seen to reflect the degree of autonomy enjoyed by FECs – a “lagged” student numbers etc. “proxy”
- Nothing to break the necessary direct link

The *CIC CA 2026* Judgment (8)

Questionable points?

Some questionable aspects of *CIC CA 2026*

- CA's reasoning will bind tax tribunals, or if not on the critical path, will probably carry significant weight with tax tribunals
- Should an FEC (a charity) providing the same service to some recipients for direct payment from them carry real weight?
- *Strongly arguably not, especially when the charity is providing most of the services to recipients for free – dog wagging tail?*
- Should the likelihood that the funder will reduce funding for activities in year 2, if there is lower than expected provision in year 1, be relevant to VAT consideration in year 1?
- *Strongly arguably not - no direct link unless contract clawback*

The *CIC CA 2026* Judgment

Impact on earlier case law

Relatively few previous cases at high level

Rayon d'Or

- Remains important and binding. Now to be seen through the lens of *CIC CA 2026*

South African Tourist Board v HMRC [2014] UKUT 0280 (TCC)

- CA follows UT in *SATB* in important respect:
 - In any case there will be a range of factors and no one factor is conclusive
 - Analysis of the entire circumstances of the case is required, weighing the various competing factors

The *CIC CA 2026* Judgment

Matter not covered in judgment

Whether economic activity

- HMRC accepted that if there were supplies by CIC for consideration then CIC was carrying on economic activity – right on the facts
- Some relatively recent CJEU cases on economic activity (i.e. carrying on business) may suggest new grounds in other scenarios for finding no economic activity
- See *Gmina O* (Case C-612/21) [2023] STC 805 and *Gmina L* (Case C-616/21) [2023] STC 835 but also see “*Latvian Information Rights*” case (Case C-87/23)

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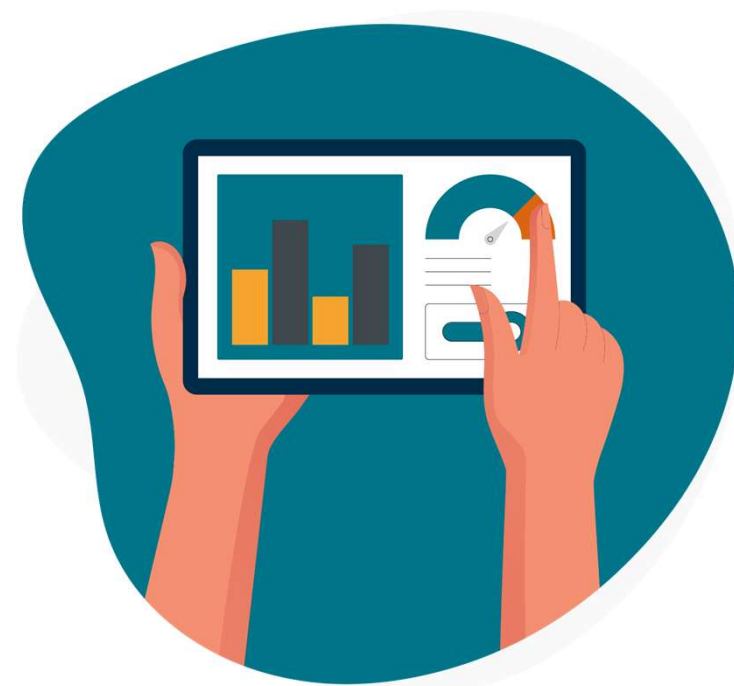


Are all grants now supplies?

Gillian McGill
VAT Director
Larking Gowen

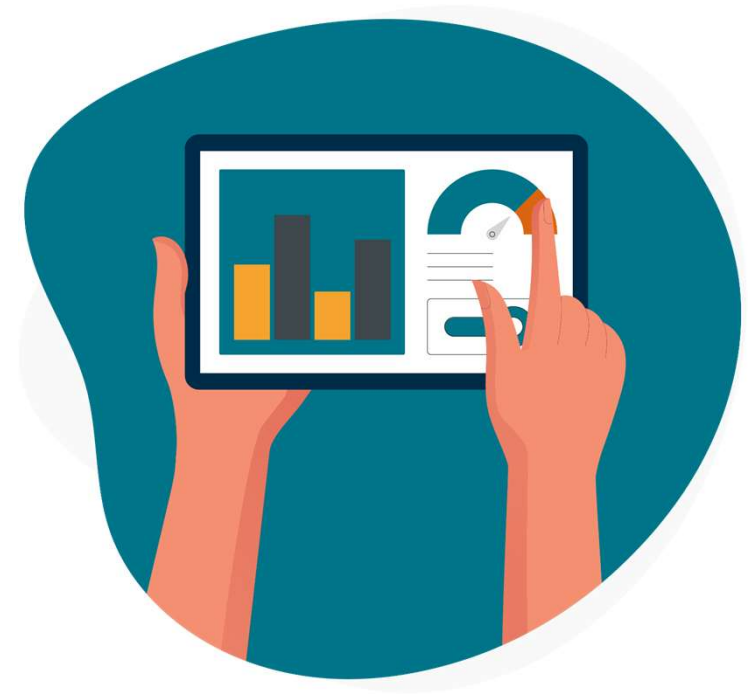
Factors in CIC arrangements

- Funded by EFA and SFA under non-negotiable agreements agreed for the following year
- CIC bound to provide the services in the Funding Agreement and use funding solely for the purpose of delivering the services agreed
- CIC free to spend its funding as it sees fit providing it fulfils the conditions imposed
- CIC required to upload ILR data
- Amount of funding calculated by reference to student numbers with different courses having different funding weighting



Factors in CIC arrangements

- CIC not permitted to charge students that are funded
- Over- and under-payments can be adjusted and funding audits carried out referencing performance of CIC
- CIC not required to provide particular courses but was only funded for approved courses
- Enrolled students provided with a “Receipt” confirming what courses enrolled on



Grant funding post-CIC?

Arts Council funding agreement

- Funding only to be used for specific agreed objectives
- Unspent amounts subject to payback
- Activity information to be uploaded and subject to monitoring checks
- Funds released on milestone reporting

DEFRA funding agreement

- Funding only to be used for specific agreed objectives
- How recipients achieve those objectives is not defined
- Results to be uploaded and subject to audit
- Clawback mechanism in place should conditions not be fulfilled

Academy master funding agreement

- Academies to be conducted in line with Financial Handbook
- Funding only to be used for specified activities
- Requirements on curriculum, school meals, sharing particular data online
- Funding calculated based upon student numbers



HMRC Supply and consideration

VATSC06317 - Grant

- **The payment was made following a grant application process run by an organisation that regularly provides outside the scope grants.**
Such as central or local government.
- **Are the funders the beneficiaries of the project?**
To be outside the scope of VAT a grant should be freely given. In using the payment, the supplier carries out its own charitable aims and objectives with the assistance of the money which is given with no expectation of direct benefit in return
- **The funder will not attempt to control how the money is spent beyond seeing that the funds are properly managed.**
Any monitoring is no more than simply ensuring the payments are appropriately spent.
- **The supplier will set its own targets as opposed to the funder imposing specific targets.**
- The payments are not treated as trading income or expenditure in the accounts of either party.



HMRC Supply and consideration

VATSC06317 - Grant

- If the funding is withdrawn there is no legal redress for the supplier to have the payment reinstated.
- 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.
- **The funding is provided under a statutory provision that empowers the funder to make a grant.**
This would be mainly relevant if the funder is a Government department or local authority.
- **There is a 'clawback' provision within the agreement.**
Funders use this method to reclaim their funding in circumstances such as where not all the money was spent or if the terms of the agreement were not complied with. In contrast, a contract for a supply should not contain a 'clawback' clause as there is no automatic right to reclaim any money. The money is consideration for the supply and the solution for reclaiming the payment in any subsequent breach of contract is to sue for damages.



HMRC Supply and consideration

VATSC06318 - Contract

- **Who initiates the agreement?**

If the funder is seeking services in return for their payment then this indicates the payment is consideration for supplies made to them if the funder is the direct beneficiary of the supplies. The funder believes they are receiving something in return for the payment.

- **The supplier undertakes outsourced activities on behalf of the funder where the services provided are ones ordinarily provided by the funder so the supplier is acting as a subcontractor.**

Examples include the provision of functions ordinarily undertaken by local authorities that they have a statutory duty to perform and would face sanctions if they did not happen

- **The contract is commercial in nature i.e it is a legally binding contract connected to a business activity.**

This means looking for indicators such as penalty clauses being in place if the supplier does not fulfil their responsibilities and so is in breach of contract.

- **The supplies are undertaken as an economic activity.**

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.

- **The relationship between the funder and supplier will not be at 'arm's length'.**

There will be a clear level of control from the funder in the supplier's decision-making process.



HMRC Supply and consideration

VATSC06318 - Contract

- **The payments made by the funder to the supplier are made specifically for the supplier to provide services to its clients.**
The fact that the funder does not know at the time the service is provided the identity of the client or the even the specific service which is being provided is not relevant.
- **Each activity carried out by the supplier gives rise to a specific and identifiable payment.**
This is an agreed sum, either a single payment or a sum per activity i.e the more work done, the greater the payment. For this to happen there is probably a detailed recording system for timekeeping, outputs achieved etc.
- **The funder will attempt to control how the money is spent, maybe imposing specific targets in terms of quantity, quality, timeframes etc.**
Any monitoring is more than simply ensuring the payments are spent properly and is to ensure that specific supplies are made.
- **If the funding is withdrawn there is legal redress for the supplier to have the payment reinstated or claim compensation.**
- **The payments are treated as trading income or expenditure in the accounts of either party.**



HMRC Brief March 2026

In the meantime, the CIC decision is law and applies to any taxpayers with a substantially similar fact pattern although it seems unlikely that HMRC would persist in applying CIC outside the FE sector.

Unless a non-FE organisation wants to apply CIC and HMRC assesses them for doing so, with a case going through the courts, we are stuck in a twilight zone.



Not appealing the Court of Appeal ruling.



Consultation with relevant stakeholders will be undertaken.



Any policy change will be announced by way of brief and guidance.

What happens next?



Review any funding agreements and retain on file evidence supporting your adopted treatment.



Apply HMRC's current guidance in the Supply & Consideration manual and HMRC Brief 10/2022, document the conclusions



For those agreements that are borderline or most at risk of being recategorised as consideration for a supply, model the impact of them being brought into the scope of VAT on both recovery of costs and expenditure.



HMRC non-statutory clearance?



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Buzzacott

CTG –CIC Impact on Charity expenditure

Socrates Socratous

May 2026

Colchester Institute Corporation

Impact on Charity Expenditure

Key Finding of the CoA is that CIC grant funding was 3rd party consideration for a supply

- Many Charity reliefs involving buildings are reliant on the condition that the building is used 'solely' for a 'Relevant Charitable Purpose' - RCP use
- The term RCP has a specific meaning in VAT legislation and requires that a building is used :
 - Otherwise than in the course or furtherance of business, or
 - As a village hall or similarly in providing social or recreational facilities for a local community.

It's the first alternative that could affect charities

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Construction services – new buildings

- Construction services can only be zero rated if the building (or part) is intended to be used solely for a RCP
- Construction services in relation to a ‘charity annexe’
- If acquiring a new building, either the freehold or a lease greater than 21 yrs, the seller can only zero rate the supply if the recipient is intending to use the building solely for RCP

- It is necessary to issue a certificate certifying the building will be used for RCP for a period of 10yrs.
- If there is a change of use within this period, then a self supply charge will arise
- There are penalties for making an incorrect declaration.

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Construction services – new building

- Revenue & Customs Brief 3 is helpful:
- *HMRC is not appealing the ruling of the Court of Appeal and will now consider the terms of the judgment in consultation with relevant stakeholders. Any policy change will be announced by way of a Revenue and Customs Brief (RCB) accompanied by updated guidance*
- *As this appeal has now concluded, for those institutions that have not previously adopted the third-party consideration position, any change to the VAT treatment of this funding will only apply prospectively from a future date yet to be announced.*
- No retrospective action
- Colleges/charities with proposed capital projects intending to rely on Z/R may want to ‘fast track’ projects if funding available

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Fuel and Power

- Charities using a building for at least 60% non business use can receive fuel and power services at the reduced rate
- If the building is used for less than 60% business use, it may be possible to apportion the supply
- As with construction services/buildings, a certificate is required
- Penalties for incorrect certificate

Colchester Institute Corporation

VAT Recovery methods

- VAT recovery method – basis for recovering overhead VAT costs
- Charity may have written agreement for a 2-stage calculation or a combined method
- Income that was treated as grant funding may now be business income
- Will impact on attribution of VAT costs
- Could impact on rate of recovery
- May be necessary to renegotiate agreed method
- Is there any non business activity?
- Current experience, is this will likely be a time-consuming exercise

Q&A

Questions for the panel

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