

## Contract versus Grants

### Overview

This overview guidance seeks to provide clarification on the differences between grant and contract funding arrangements, the key considerations to be made in deciding upon which funding route to take and a summary showing the difference between them for the recipient organisation.

### Context

The term 'grant funding' has been used both across the Council and strategic partners to describe a large number of funding agreements predominantly with third sector organisations. In reviewing the data behind payments to the third sector it is clear that decisions to grant fund have been made that should actually be registered as 'contract' arrangements. Prior to entering any sort of agreement with a third party organisation, careful thought must be given as to what the true relationship is. It is irrelevant, for legal and VAT purposes if any signed agreement surrounding the funding states 'grant' when by definition it should have been a contract.

To illustrate this crucial element, a recent VAT Tribunal determined that certain payments made by a public organisation to Hope in the Community, a Kent-based umbrella body for religious organisations, pursuant to "grant" agreements, were in fact contractual payments upon which VAT should have been paid. In the ruling it was made clear that the true nature of the relationship was contractual due to a service being provided in return for the funds. In addition to the charity having to pay the VAT owed, the funding body were left open to challenge under procurement regulations for not using a competitive process.

### Purpose

Each funding arrangement has different over-arching purposes, these include:

Grant Funding	Contracts
<ul style="list-style-type: none"> <li>• Generally made to benefit a section of the public</li> <li>• Usually specified to be for a very specific purpose</li> <li>• Outside the scope of VAT as the agreement does not equate to the provision of a service</li> <li>• Will require all unspent funds to be returned.</li> <li>• Falls outside of EU procurement rules</li> </ul>	<ul style="list-style-type: none"> <li>• Defines the responsibilities of both the purchaser and the provider.</li> <li>• Includes specification of the service provided.</li> <li>• Required to comply with EU procurement and relevant national legislation.</li> <li>• Surpluses made through the contract may be retained and utilised by the provider (unless specifically excluded in the contract).</li> </ul>



Grants are widely used to fund a short/medium term programme that is specific in its objective. They may also be used to fund an organisation that is locally unique, has narrow objectives and is working in partnership with the funding body.

It is worthy of note that grant arrangements by their very nature fall outside of the procurement process and therefore the EU Procurement rules do not apply to them.

### Grant or Contract, what's the difference?

Truthfully, it can sometimes be hard to distinguish the difference, especially as many grants are developed into contracts over time. The line between the two can sometimes be hard to distinguish.

In law it is not the formal description that counts but the content of the agreement. As such, it is important that we recognise and understand the differences between grants and contracts. The distinction is hugely important: for example, VAT is chargeable on the supply of services which occurs under a contract, under a grant there is no supply of services to be taxed.

- **Grants** are subsidies for the operation of the third sector organisation in meeting its purpose and objectives and are subject to the European State Aid regime and its regulation of competition law.
- **Service level agreements** set standards and specify levels of service without any commitment to use the agreement. These are not legally binding.
- **Contracts** specify service requirements and make clear what and how a service is to be delivered and for what payment.

When the intended outcomes are relatively specific and there are indicators available to evaluate the quality and quantity of those outcomes, a procurement process open to competition and leading to a conventional trading relationship under contract is more likely to be the most appropriate option.

Grants are hugely valuable to the VCS for a number of reasons and the National Council for Voluntary Organisations, among others, have been very vocal in calling for their continued use in the delivery of public services.

The value of grants is that:

- they offer the opportunity to undertake activity which cannot generate enough income to cover its costs e.g. research and development;
- they are helpful start-up funds to trial new ideas and provide initial capital;
- the process of applying for grants and managing grants is easily accessible to organisations;
- Statutory commissioning authorities can convert them into contracts to continue them over the longer term



The decision as to whether a funding agreement can be fulfilled by a grant arrangement must be clear. In general terms:

Grant Funding Applies:	Grant Funding does not Apply:
<ul style="list-style-type: none"> <li>• Where the Council is not purchasing specified services in return for the payment</li> <li>• Where the service is not one that the Council would consider itself responsible for providing</li> <li>• When the funding is supporting a local organisation whose purpose and objectives are specific and not expansive.</li> </ul>	<ul style="list-style-type: none"> <li>• When a pre-determined specification, which may include performance targets is in place defining the service.</li> <li>• When a commissioning process that leads to a service being provided has been undertaken.</li> <li>• When the service proposed is a statutory duty for the Council to provide, or one which the Council would consider itself responsible for providing if the organisation ceased to exist</li> <li>• When the service delivered is perceived by the recipient(s) to be provided by the Council.</li> </ul>

Although grants fall outside of the scope of public procurement regulations, this exemption can be challenged, especially if the use of a contract can be perceived as more appropriate for the type of service being funded. There must be care and clarity within the funding arrangement to ensure this does not happen. Public bodies must also ensure their arrangement with the grant recipient does not offend the rules against state aid which prohibit public bodies from favouring certain undertakings and distorting competition. The rules apply to any aid provided to a single organisation which exceeds the published EU thresholds over any rolling three year period where certain conditions are met.

Any decision to fund an organisation through grants must be taken within the understanding that grants are fundamentally ‘donations’. As a consequence, there are occasions when the use of a grant arrangement would be appropriate. This should only include low level funding of a service or activity provided by an organisation that has specific organisational objectives and the activity sits within these. Any activity that extends these objectives should be funded through contract arrangements.

It is preferred that contract arrangements are used to fund services provided. This gives greater safeguards for both the funding body and the provider of service.

### Charity Accounting

There are technical and tax issues that need to be recognised in regards to the difference between ‘grant’ agreements and ‘contract’ agreements.



Generally, grant agreements are exempt from VAT for the organisation receiving the funds although there are exceptions to this.

To address the issue of VAT from a technical perspective, charities have to account for their incoming and outgoing resources as different types of funds. Unrestricted funds are funds the charity receives to further its objectives. These can be donations, grants or fees received. Restricted funds have to be used for the purpose for which they were given.

If a charity has narrowly defined objectives, then a grant it receives may be a perfect fit and so be unrestricted. Where this is not the case, a funder may specify that they wish a grant to be used to help a specific group of beneficiaries, or support a particular project. In these situations, the grant would be treated as restricted income and therefore funds not spent on the specific purpose must be returned.

Contracts by their nature are not donations and therefore cannot be treated as restricted funds. Contract income should be treated as unrestricted income. The recipient charity is obliged to meet the terms of the contract but is not required to spend all of the contract fees on the specified activity.

To summarise:

<b>Grant Funds</b>	<b>Contract Income</b>
<ul style="list-style-type: none"> <li>• Are treated as donations / aid</li> <li>• Restricted funds</li> <li>• VAT exempt</li> <li>• Used as specified and under spends returned.</li> </ul>	<ul style="list-style-type: none"> <li>• Unrestricted funds</li> <li>• VAT applies</li> <li>• Obligated to meet terms of the contract</li> <li>• Under spends can be retained</li> </ul>

