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"Best overall service award 2011"
Annual *Charity Finance* Survey

not for profit | academies subsidiary trading companies

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Although academies are charities and are largely exempt from direct tax, it is possible for some income (e.g. non-primary purpose trading*) to fail to qualify for any of the wide range of exemptions available.

In such cases, it is common practice to conduct such activities through a trading subsidiary. Although such a company is liable to tax on its profits, it is able to claim relief for any amounts donated to charity under gift aid and effectively shelter the charity's profits from tax. This arrangement can also be useful in protecting a charity's assets where its tax exempt fundraising activities carry a level of commercial risk.

subsidiary trading company advantages

Hiving off certain trading activities into a subsidiary trading company has the following advantages:

- enables activities to be carried out which are outside the charitable objects and when there would otherwise be a significant risk to the charity's assets;
- enables unincorporated charities to use a limited liability company to minimise operating liabilities to trustees;
- avoids corporation tax by gift-aiding the profits to the charity
- keeps the charity and potentially the subsidiary itself below the VAT registration limit so avoiding VAT and related administration costs; and
- may obtain VAT benefits in certain circumstances.

subsidiary trading company disadvantages

The disadvantages of using a subsidiary trading company include:

- additional administrative, company secretarial, setting up and annual compliance costs, such as the preparation and filing with Companies House of the returns and accounts, and requirement for parent charity to prepare consolidated accounts.
- additional accountancy requirements arising from the need to be able to identify which expenses should be allocated to the subsidiary;
- the rates relief available to a charity occupying non-domestic premises may be lost;

- some tax and VAT exemptions available to the charity may be lost if provided through a subsidiary company. (e.g. the VAT exemption for education and for holiday lettings by an academy to another eligible body);
- the charity's ability to finance the trading subsidiary is restricted unless by way of a loan on commercial interest and repayment terms; and
- losses and tax-disallowed expenditure may result in a negative balance sheet.

tax issues

Provided that they are wholly owned by charities, the taxable profits of such companies can be paid out under gift aid: provided the gift aid payment is actually made within nine months less one day of the end of the period of account, it should be effective to reduce taxable profits. Great care needs to be taken in funding such subsidiary trading companies, as it is all too easy to make non-qualifying loans, which give rise to taxable income in the charity. Professional advice needs to be sought when setting up such a company, and when it needs funding.

VAT issues

There may be VAT advantages in using subsidiary companies to change the VAT liability of the activity. It can sometimes be advantageous to carry out a trade which is standard rated for VAT purposes, thus allowing VAT to be reclaimed on expenditure, whereas such an activity might be exempt under the educational exemption if it was carried out by the charity itself. This is attractive where there has been a large capital VAT expenditure such as on buildings, although recent cases have eroded the level of this advantage.

Subsidiary companies can also be used for what one might describe as "VAT avoidance schemes", to use HMRC terminology, where transactions are inserted, and extra companies involved, purely in order to create a high level of VAT reclaim. These plans will need to be considered on their merits, but it should be noted that HMRC has been successful in shooting down such schemes on the basis that they can be very contrived. The arrangements might also have to be disclosed to HMRC, and should not be entered into lightly.

If a subsidiary company is used, in most cases its income and expenditure, where material, should be consolidated in the academy's accounts and should be disclosed in a note to the academy's accounts together with the gift aiding of any surplus.

conclusion

Although the use of a trading subsidiary is a relatively simple tax planning mechanism and is encouraged by HMRC, there are a number of potential pitfalls that can have disastrous consequences. HMRC are strict in applying rules.

These are complex issues and we recommend that you consult your usual engagement partner or Graham Elliott for VAT advice or Anne Gregory-Jones for advice on other tax matters.

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about haysmacintyre

haysmacintyre, Chartered Accountants and business advisers, works with over 550 charities and not for profit organisations in the UK and overseas. Our services include the full range of audit, tax, VAT and comprehensive advisory services. Our multi-disciplinary specialist team has extensive sector experience working for a diverse range of charities. We are based in one location which ensures an integrated and comprehensive approach to our clients' requirements.

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