

haysmacintyre

vision through partnership



charity | briefing

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editorial



Early 2008 will bring the Charity Commission's further consultations on public

benefit involving sub-sectors where the 2006 Charities Act removed the presumption of public benefit – poverty, education and religion – as well as fee-charging charities. We will be following this closely and urge you to do the same and to make your views heard.

We are also pleased to publish details of the 2007-8 programme for our Trustee Training held jointly with Farrer & Co and Rensburg Sheppards. Details are provided on the back page.

Otherwise, this issue features our usual mix of topical and general articles and, as ever, we will be pleased to hear from you if you need further information.

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potential VAT implications of Sempra Metals Limited



A House of Lords decision could have wide ranging implications for the amounts of interest

charities can claim in respect of tax overpaid through a mistake in law in which HMRC was at fault. Following a decision by the European Court of Justice that the United Kingdom's advance corporation tax scheme discriminated against groups of companies with members in other EU States, numerous interest claims were brought. Sempra Metals Limited was a test claim.

In Sempra, the claimant relied on a restitution claim for money paid under a mistake in order to take advantage of the longer limitation period applicable to such claims. This type of claim differs from a claim for damages in that the gain of the defendant is measured rather than the loss to the claimant. This can be a disadvantage where the defendant is the Government, since Government

borrowing rates are inherently low. However, the key issue was whether interest payments should be calculated on the traditional simple basis of calculation, or the more commercially credible compound basis. The House of Lords ruled that compound interest should apply.

Whilst Sempra dealt specifically with corporation tax, there is a reasonable argument that a similar approach could successfully be applied in respect of claims for repayment of VAT overpaid or under claimed under a mistake induced by HMRC error or bad law. The position is as yet untested but could ultimately prove of benefit in a variety of instances, such as Children's Society claims or revisited claims by clubs in respect of the delay in introducing certain exemptions for members' subscriptions in 1994. HMRC's initial stance is that Sempra does not apply to VAT, but this is widely viewed as a desperate attempt to prevent any further erosion of their position.

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the grant versus contract question



The distinction between a grant and a contract is critical to a charity. It often determines

whether the receipt is restricted or unrestricted and may impact on the VAT status of the funding. The forms of wording used in recent times, especially in government and other third sector agreements, have not been always been helpful for determining these points. It is also topical where charities are finding it increasingly difficult to secure funding that covers 100% of the costs of delivering projects and programmes – a deciding factor on whether to accept an agreement or not could be whether the purpose of the funding is to generate a surplus (generally unrestricted) or help to achieve a stated aim or objective of the charity (can be unrestricted or restricted).

The classic scenario is a funding agreement which is drafted with the words 'Service Delivery Contract'. The agreement sets out certain deliverables (apparently indicating a contractual relationship) but when the funding body is asked 'Is this restricted or unrestricted funding?' often they say that it is most definitely restricted i.e. a grant. Funders want to have their cake and eat it – to enforce performance but reclaim any underspend. So what can a charity do? Well, there are a number of recognised indicators for interpreting agreements which may also assist charities in their negotiations with funding bodies and ensure from the outset that they both understand what is on the table. This interpretation will then drive the accounting treatment e.g. whether they

should be accounted for as a restricted or unrestricted project.

There are no hard and fast rules but the following are relevant factors:

Unrestricted projects tend to exhibit the following:

- The funder receives a service i.e. if it doesn't pay the charity to do the work, it will need to pay another body or do it itself. It is contracting out a particular service or deliverable.
- Receipt or draw down of funding is only after satisfactory completion of work or achievement of targets and the service provider has a legally enforceable right to be paid for work performed. The agreement normally establishes a clear link between outputs and funding i.e. provide 1,000 meals at £3 a meal, or train 500 people between 1 January and 30 June.
- Any unspent monies represent a surplus to be retained by the charity. Conversely any overspend must be met by charity reserves.
- Funding is often specifically linked to a stipulated timeframe, often with milestones. This is also important in determining the recognition of income for cut-off at a period end. If the milestone has not been reached, then only a percentage of the income may be recognised.
- The agreement is often the result of a competitive tender – i.e. funders request charities and others to tender for delivering a particular service or programme, rather than the charity approaching the funder.
- Such funding may be trading i.e. not directly related to achieving the objects of the charity, but carried out to generate a surplus. This has VAT and corporation tax implications.

Restricted projects tend to exhibit the following:

- The funder may not receive any direct benefit i.e. a grant giving foundation may fulfil its objects by giving money, but does not receive a service.
- Payment is voluntary. The funder decides that it wishes to fund the charity for a particular project or programme, usually following an approach by the charity.
- Any money unspent may ultimately be repayable to the funder. This is often a clause within the terms and conditions. Conversely any overspend on a project is likely to be met by a transfer from unrestricted funds or specific fundraising activity.
- The documentation may specify how funding is to be spent in line with an overall budget. Terms and conditions often specify the categories of expenditure that can and cannot be claimed from the funder. Claims for funding may require an update of expenditure against the original budgets on a quarterly basis.
- There is unlikely to be a direct linkage between outputs/outcomes and funding receivable. Where outputs/outcomes are specified, these may be indicative targets and a failure to reach targets will not necessarily result in a reduction in funding.

“This interpretation will then drive the accounting treatment e.g. whether they should be accounted for as an restricted or unrestricted project.”

- The funding received may only be part funding where, for example, a charity approaches a number of trusts and other organisations to contribute towards a particular project or programme. This is often termed 'matched funding' where it relates to a condition in a funding agreement, by a principal funder, that the charity also achieves additional funding from other sources.
- There is often more flexibility regarding the period over which the funding may be expended. Where dates are not specified in an agreement,

the accounting treatment generally follows the receipt of funding and can lead to restricted funds carried forward if the funding spans a period end. Where dates are specified, this can lead to accounting adjustments for deferred and accrued income.

- It is generally the result of an application made by the charity on the back of its own ideas and strategy, rather than in response to an invitation to tender.

Although these are indicators rather than rules, they provide a benchmark against

which to assess individual agreements and provide pointers when negotiating with funding bodies. It will also assist fundraisers or other programme leaders who are applying for funding to understand the nature of the agreements that they are trying to secure. Early determination of an agreement also assists the finance team to account for the fund correctly and to report budget and actual information to trustees on a consistent basis.

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salary sacrifice



Salary sacrifice has become popular in recent years as an effective mechanism for providing employees with certain benefits that also reduces the tax liability for the employee and the National Insurance Contributions (NIC) for

the employee and charity. The benefits provided under these arrangements are typically non taxable items such as pension contributions or childcare vouchers. As with most tax arrangements, salary sacrifice arrangements have both advantages and disadvantages which are considered below.

Salary sacrifice is an arrangement whereby an employee gives up the right to future cash, such as part of salary or a bonus, in exchange for a specific benefit. Although such arrangements are used because of the tax and NIC advantages the sacrifice arrangement is an employment law matter. This is because salary sacrifice varies the terms and conditions of the employees' contract of employment.

Tax treatment

For tax purposes it is important to bear in mind that salary sacrifice needs to be effective. There are no specific rules that ensure an arrangement is effective and HMRC will not usually provide any comments on whether an arrangement is effective prior to it actually being put in place.

In general terms a successful salary sacrifice arrangement is one where:

- The right to the salary is given up before it is received, for example, before an employee becomes entitled to a bonus. The terms and conditions of the employee's contract are varied to ensure that the bonus is not paid to the employee and they lose their entitlement to it.
- The outcome of the arrangement is one where the employee is truly entitled to a lower salary as a result of this arrangement.

Once such arrangements have been put in place HMRC will examine the documentation in order to ensure that the arrangement is effective. Such arrangements should not be entered into merely to meet an employees own financial commitments.

No salary sacrifice arrangement should reduce an employee's pay to below the national minimum wage.

Disadvantages

It needs to be borne in mind that the new lower salary, although attracting both the lower PAYE and NIC liabilities will also mean the following:

- Lower pension contributions;
- Reduced entitlement to working and tax credits;

- Reduced entitlement to state pension and benefits; and
- Reduced income level which may affect individuals in their day to day life for example applying for mortgages or loans etc.

Advantages

The advantages are that:

- Employee's overall package generally remains the same;
- The benefit provided to them is one that enhances their

work life balance or planned lifestyle;

- For the charity there is the reduction in NIC costs; and
- The NIC saved could either be reinvested in the employees' chosen benefit or retained as a saving that could be invested in another project.

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in brief



Companies Act 2006 update

Further provisions of the Companies Act 2006 came into force on 1 October 2007.

These include: restricted access to the register of members; the exercise of members' rights to enable a member to nominate another person to enjoy or exercise a specified right; the codification of duties by a company's directors; the introduction of a new statutory derivative procedure enabling shareholders to bring claims against directors; and new provisions dealing with meetings and resolutions.

We have two datasheets with further information downloadable from <http://www.haysmacintyre.com/haysmacintyre/AllPublicationSearchResult.aspx>.

Public benefit

The revised timetable for implementation for the Charity Commission's consultations has now been published. The general guidance will be published in January

2008 and three-month consultations will occur from January/February for certain sub-sectors: charities for the prevention and relief of poverty; charities for the advancement of education; charities for the advancement of religion; and fee charging charities.

It is expected that the public benefit provisions of the Charities Act 2006 will come into force in late March 2008 and that supplementary guidance will follow between July and December 2009. From late March 2009 charities will begin reporting on public benefit as part of their annual reports to the Charity Commission.

It remains to be seen whether the timetable will slip again.

Charity Diploma

The Institute of Chartered Accountants in England and Wales (ICAEW) has developed the Diploma in Charity Accounting (DChA) for those who can demonstrate a high level of charity accounting and charity financial management competence. The Diploma can be obtained either by a study route

or by an experience route. The latter will be feasible for many of those already working in charity finance but this route is only available until July 2008. More details can be obtained from www.icaew.com/charityaccounting.

Charity trading

The Charity and Voluntary Sector group of the ICAEW has issued a new helpsheet on the taxation of charity trading. This can be downloaded from <http://www.icaew.com/index.cfm?route=152388>.

Charity Commission Faith Unit

The Commission launched its Faith and Social Cohesion Unit in November 2007. This follows a series of 15 events last year where the Commission met with representatives of over 800 faith-based organisations. The unit will lead the Commission's work with faith-based charities and will focus initially on Muslim organisations.

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thoughts on the role of trustees



Like many of the haysmacintyre charity team, I am also a charity trustee. Unlike most I have only taken

up this role quite recently and, despite having advised charities for years, was very struck by how different it seems from the other side. What follows are some observations on what I have learned.

Firstly, it should be made clear that the charity I am involved with, Volunteer Centre Westminster, is well run by talented and dedicated management and staff. Secondly, VCW is also a relatively small organisation hence one might suppose it easy for a newcomer to gain an overview of its activities. Furthermore, it does all the right things in inducting its trustees, for example through initial meetings with the chair, other trustees and the Chief Executive, providing access to key documentation such as constitutional documents, accounts and plans, and the opportunity to attend a Board meeting as an observer.

Additionally, we have been able to recruit a diverse Board including representatives of local volunteers, a senior police officer, a retired banker, a HR expert, and a resource management specialist. So what are the challenges for this apparently well resourced board?

Well, for starters getting to understand at least some of the underlying detail takes time and probably cannot be accomplished merely by attending periodic Board and Committee meetings. This is particularly difficult for those Trustees in full time employment or with family commitments but, ultimately,

one must remember that day-to-day detail is down to the management and that, fortunately, there is a mix of Board members with longstanding involvement and newcomers. Also, many of the issues arising at Board level may be entirely beyond the individual expertise of most of the members hence we can find ourselves making decisions on the say-so of the “experts” or, conversely, being cast into the role of the “expert”.

There are inevitable gaps in the skills base. At Trustee level it is all very well doing the highly recommended skills audit but then one still has to find the people. Our main gap at the moment is legal expertise – all offers will be gratefully received! Management often have the same difficulty, of course, as in the smaller charity, the Chief Executive or Finance Manager may well also be Head of HR and/or IT and/or charged with the Company Secretarial work. If they are lucky, they may be able to call on the support on an umbrella body or wider network though any advice they get will no doubt be covered with disclaimers.

“Finally we should all remember for all the emphasis on skills audits and Board diversity that the charitable organisations are above all reliant on people with the time and the will to get involved.”

Larger organisations may have the resources to employ specialist staff or buy in outsourced expertise at a price. Smaller ones may simply not be able to afford that price.

So, on a personal level, I realised being a Trustee is more challenging than I thought which itself is a salutary lesson. Otherwise, my learning points are:

- Accept that you are not an expert on everything or, indeed, most things but be sure there is expertise around
- Remember that help is out there. Many professional firms offer training at nominal cost. Our “Trustee Training” is advertised on the back page of this Charity Briefing. Most of the topics covered are equally pertinent to Chief Executives and Finance Directors too.
- Talk to people. Often Trustee Training sessions are a good opportunity to do just that.
- Beware of being the “expert” as often other people’s common sense is worth as much as expertise.
- Management are employed to manage so let them do it.

Finally we should all remember for all the emphasis on skills audits and Board diversity that the charitable organisations are above all reliant on people with the time and the will to get involved.

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future events

Trustee Training Series

Once again, haysmacintyre will be running a series of Trustee Training Courses in conjunction with Farrer & Co and Rensburg Sheppards. Six sessions have been arranged, as below:

- 5th December - Charity Law update
- 16th January – Accounting for non-accountants
- 23rd January – Market outlook and the thorny issues of VAT and Planning
- 6th February - Investment: Planning for the future
- 14th February - What every trustee should know
- 28th February - The future of the sector

Schools' Conference

– 6 February 2008

Following a record 160 delegates last year we will be holding our 15th annual haysmacintyre independent schools conference with guest speaker Dr Anthony Seldon of Wellington College.

For more information on any of these events, please contact: jtaylor@haysmacintyre.com