haysmacintyre

"OVERALL AUDIT SERVICE AWARD" - WINNER 2009
Annual *Charity Finance* survey

not for profit | trading by charities

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A common misconception is that charities are exempt from all taxation. This is unfortunately not the case. The main tax exemptions for charities are in respect of Rental income, Investment income, certain Lottery income and only certain categories of trading income.

As the trading income of a charity is not wholly exempt from taxation it is important to identify the nature of the trading activities undertaken and the extent to which the exemption may apply.

what is trading?

Tax legislation gives a wide and rather unhelpful definition of a trade and states that "trade includes every trade, manufacture, adventure or concern in the nature of trade". This means that not only do activities that are readily recognisable as trades come within the definition but so can some less obvious activities such as sponsorship, charity shops, Christmas cards, conference centres, holiday facilities, certain affinity card schemes, fundraising events and theatrical or artistic ventures.

reliefs available for trading by charities

Provided that the profits are applied solely for the purposes of the charity, the following categories of trading income can either be exempt or treated as being non-taxable:

- primary purpose trading: where the trade is exercised in the course of the actual carrying out of a primary purpose of the charity

- trades ancillary to the primary purpose: where activities do not fall within the strict primary purpose exemption, but are so closely linked to that purpose that they can be treated as falling within the exemption (for example the sale of text books for students by a school or college, or the sale of food and drink by a theatre in a restaurant or bar to members of the audience)

- small trading: where the total turnover from non-primary purpose trading does not exceed the greater of:

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- £5,000, and

- the lesser of £50,000 and 25% of all incoming resources (i.e. total receipts from all sources such as grants, donations, investment income and trading receipts) of the charity for the year

• certain fundraising events: Broadly speaking, provided that no more than 15 events are held at the same location during a year, and each event is arranged by a charity and held out as being for fundraising purposes, the profits may not be taxable. In the case of smaller events (takings less than £1,000), each such event can be held on a weekly basis

• work done by beneficiaries: where the work in connection with the trade is mainly carried out by the beneficiaries of the charity

• other: Certain lotteries and exhibitions or shows held by agricultural societies are exempt

If a charity conducts a trade that is not covered by either the statutory or the concessional exemptions, any profits will be taxable and any loss is likely to be treated as non-charitable expenditure. As a result, some of the charity's other income could become chargeable to tax.

There have been significant changes in this area and charities that have previously been able to conduct loss making trades without incurring a tax liability should review their position.

using a trading company

In order to avoid the income from certain activities being taxable the answer may be to form a subsidiary company. The company could carry out the activities in question and any taxable profits could be donated to the charity under Gift Aid. Provided the profits are donated within nine months after the company's year-end, no corporation tax should arise.

Regardless of whether a charity already has a trading subsidiary or not, it is best practice for the situation to be periodically re-examined, as circumstances may not always remain static. Even in circumstances where a trading subsidiary exists and remains necessary, savings can sometimes be made by restructuring the activities between the Charity and its subsidiary.

When assessing, either, the appropriateness of a trading subsidiary, or, the way in which an existing subsidiary is operated, consideration should be given to the following points:

• investment powers: do the charity's investment powers permit the making of an investment in a subsidiary trading company.

- comparative costs: where taxable profits are relatively low, the costs of administering a trading subsidiary could outweigh the tax savings made by transferring the activity.

- funding: subscription for shares other than in nominal amounts will need to be agreed by the Charity Commission. In the absence of this agreement, it is recommended that any significant funding by the charity be made available by way of formal interest bearing loans on commercial terms, and preferably secured on the assets of the subsidiary. It is not advisable for the charity to make permanent loans that are never reduced and informal loans can result in a loss of tax relief for the charity.

Cash flow problems can arise where the entire profit of the company is donated to the charity and loans need to be serviced. This can be mitigated by delaying the company's profit-shedding Gift Aid donation to the latest date possible, giving the company at least nine months profit to use as working capital. If this is not sufficient, the company may need to obtain a more permanent form of finance from a commercial source, or look to retain an element of profit as working capital (even though this may involve a corporation tax liability).

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.

haysmacintyre is a founding member of MSI Global Alliance (MSI), an international alliance of independent legal and accounting firms, with 250 members in 100 countries.

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