Spring 2015

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ARTS & CULTURE BRIEFING

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LETTER FROM THE EDITOR

Welcome to the second edition of the haysmacintyre arts and culture briefing.

In this edition, we report on updates from the Charity Commission, including a summary of their review into the quality of charity accounts, the introduction of the Arts Impact Fund, the use of Gift Aid on distributable reserves and a brief budget update on matters relevant to arts organisations.

The increase in the audit thresholds to £1million of annual income has been approved with effect for 31 March 2014 year ends. This will benefit many smaller arts and culture organisations.

The Serpentine Gallery case of 2014 has clarified a finer point of VAT regulation relating to membership type arrangements and we include an article on the impact of this decision. The finer detail is becoming even finer.

Theatre Tax Relief continues to be of interest; whilst this is not new, HMRC have yet to release any guidance to organisations on how this tax relief will work in practice and what they expect to see both within the tax returns and in the supporting information. In conjunction with Bates Wells Braithwaite, we explain the practical considerations of this tax relief.

We hope you enjoy reading this edition and if you have further queries on any of the articles, please do contact one of our specialist charity and not for profit advisers.

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Governance and Financial Reporting

INTRODUCTION OF THE ARTS IMPACT FUND

Following the Arts Council's 10 year framework, 'Great Art and Culture for Everyone', it sought to identify methods of accessing funding for arts organisations that placed less reliance on grant income, the aim being to ensure sustainability by other financing means.

The Arts Impact Fund offers repayable finance to arts organisations working in England that can show how they are sustainable, have great artistic ambition and have a positive impact on society. The fund has been created by Bank of America Merrill Lynch, Esmee Fairbairn Foundation and Nesta.

It will provide repayable loan finance of between £150,000 and £600,000. Examples of funding bids that would be considered include finance to acquire or refurbish a building, purchase of equipment, or paying salaries of buy in additional services that will help generate additional income. Applicants will need to explain what their future plans entail and how the funds would help build and grow their organisation.

More information is available from www.artsimpactfund.org

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COMMISSION RELEASE REPORT ON THE QUALITY OF CHARITY ACCOUNTS

In March 2015, The Charity Commission published a review on the quality of filed charity accounts. They selected 215 charities of various sizes split between reporting periods 31 March 2012 and 2013. Their results were based on their own 'acceptable quality' criteria rather than strict compliance with the charity SORP. Of their sample, they found that the 'acceptability' criteria were met by 54% of charities for the reporting period 2011/12, increasing to 68% for 2012/13. This in itself was encouraging, showing an improvement between periods. However, further analysis shows that only 70% of those sampled had a statement of both their purposes and their activities to carry out those purposes and only 69% included a reserves policy.

They also found that only 38% of accounts explained levels of unacceptably low charitable expenditure, only 61% explained deemed insolvency issues and 70% explained significant loans to or made by the charity.

Given the recent increase in audit thresholds, of specific interest was 89% of those sampled, which were above the audit threshold, had accounts of an acceptable quality. Only 65% passed the test where the accounts were between £250-500,000 of income, reducing to 53% for those charities below £250,000 of income.

With the vast majority of charities falling into these later classifications, it must be a concern that the quality of charity accounts decreases when they are not subject to statutory audit.

Time will tell whether the increases in disclosures in the new charity SORP will encourage better quality in charity reporting and if the removal of the need to be audited will result in an increase in non-compliance.

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CHANGES TO THE AUDIT THRESHOLD FOR CHARITIES

Published on 19 February 2015, was the Cabinet Office's response to its consultation on the statutory audit thresholds for charities. The conclusion reached, following the consultation, is that the income threshold for audit will increase from £500,000 to £1million, but both the asset component and the income component of the asset threshold will remain unchanged at £3.26million and £250,000 respectively. The threshold for preparing accruals accounts will remain unchanged at £250,000. Charities that choose to take advantage of the audit exemption will still require an Independent Examination, which, for charities with income above £250,000, will still need to be conducted by a suitably qualified professional.

These changes have been approved by Statutory Instrument and are effective for accounting periods ending on or after 31 March 2015.

The Cabinet Office publication is available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/405587/Government_Response_charity_audit_and_independent_examination.pdf

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TAX

MEMBERSHIP BENEFITS – SERPENTINE GALLERY CASE

The case concerned a Supporters or Patrons scheme with a number of different tiers of benefits. HMRC took the view that the income was all standard-rated, and this was supported by the Judge. HMRC took the position that VAT was due on the entirety of the amount paid because their view was that it was consideration for the benefits up until some changes were made to their membership scheme in 2013.

It is important when identifying the benefits of a scheme that a specified amount should be set for the value of the benefits and the balance can then be treated as a donation. The Judge commented "If the Trust had offered benefits for a fixed price and specified anything additional was a donation, then clearly the element of the donation would not be paid "for" the benefits".

The judge acknowledged surprise that such a simple change in wording is sufficient to change matters, but without this clarification it was absolutely clear that VAT would be due on the amount donated because it is payment for the benefits provided.

For charities with membership schemes with benefits, it is important to review the documentation and literature to ensure that it meets these requirements and avoids any potential over-claim.

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GIFT AID ON DISTRIBUTABLE RESERVES

Both HMRC and the ICAEW have been looking into the use of Gift Aid in companies, in particular when the company does not have 'distributable reserves'.

Distributable reserves are the available reserves of the company to distribute, usually its profit and loss reserve. For Gift Aid purposes, a trading subsidiary of a charity can only relieve its liability to corporation tax if it makes a Gift Aid payment within nine months of the year end to which the profits relate. Often adjustments in the corporation tax computation can result in a Gift Aid payment that exceeds the accounting profits (and hence profit and loss account balance) for that year. For accounting purposes, the Gift Aid provision can only be the accounting profits of that year.

Where these adjustments are a timing difference i.e. difference between depreciation v. capital allowances, the differences will reverse over time, but for permanent timing differences this poses a real issue that directors of the trading subsidiary need to deal with as they will always be making payments out of future profits which is not sustainable indefinitely. The Charity Commission advice is currently being updated.

There are effective ways in which to reduce the occurrence of such 'permanent' timing differences and these should be explored to reduce and hopefully prevent them occurring in future. We still await the guidance from HMRC on their stance to such issues; it is unknown to what extent they may require trading subsidiaries to unravel the past in order to correct their individual positions, or whether their position will solely look to the future. A watching brief as ever.

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2015 BUDGET - ELEMENTS OF PROMISE

The latest Budget, delivered by George Osborne on 18 March, showed elements of promise for the Arts and Culture sector. He emphasised the importance of the sector in securing Britain's place as a 'culture sector of the world'. Few would disagree with that statement, but please George (and or his successor), the words need to be followed by two critical actions; effective policies and adequate funding for the sector.

That said, there were specific commitments to include an extra £9m to support culture and tourism, a 25% tax relief on qualifying expenditure from April 2016 for orchestras (along the same lines as the recent theatre tax relief), an increase in film tax relief to 25% and a new children's TV tax relief from April 2015.

There was also an increase in the small donations threshold for claiming Gift Aid from the current £5,000 to £8,000, with effect from April 2016.

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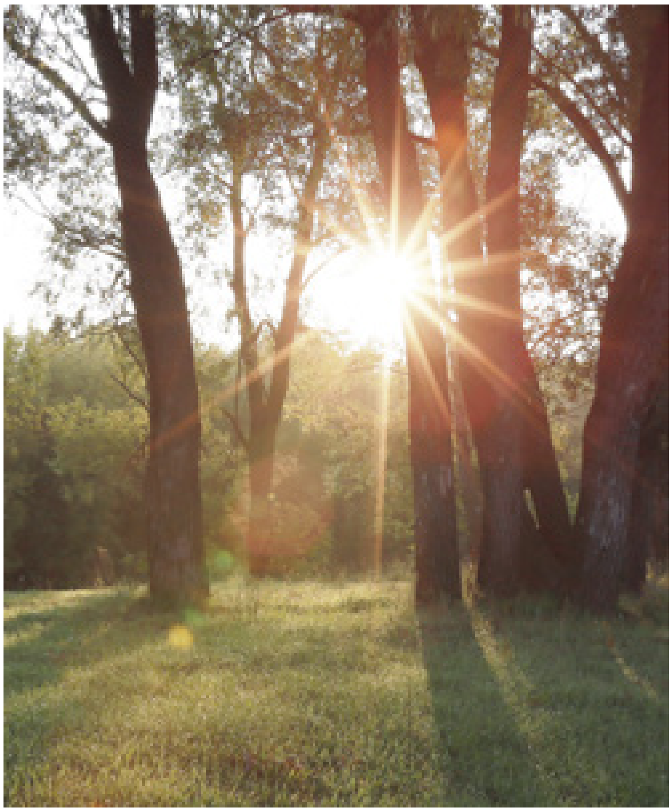

THEATRE TAX RELIEF AND THE REPAYABLE TAX CREDIT FOR CHARITIES

More than six months following the introduction of Theatre Tax Relief on 1 September 2014, wherefore art the promised comprehensive guidance from HMRC? Although potentially valuable, it is clear that the relief was not originally designed with charities in mind. Moreover, without the promised guidance, the sector is left to rely on the broad representation that the not for profit sector will be able to access the relief without significant additional administrative burdens. This, together with the other information made available to date, implies that implementing arrangements wholly to enable access to the relief will be "acceptable tax planning", much the same as the simple use of a subsidiary to carry out commercial activities.

Notwithstanding the present relaxed attitude, the legislation is prescriptive in terms of who can qualify for the relief, their involvement in the production and the type of production that can be claimed for. Care is needed to ensure that the relief can be accessed as planned and HMRC have been helpful in clarifying some of the practicalities of how they would expect things to work. We have outlined some of the main benefits of the relief and how it might work in practice below.

WHAT IS THEATRE TAX RELIEF?

Eligible entities can claim a repayable tax credit at the effective rate of up to 20% (for a touring production) or 16% (for a non-touring production) of their eligible costs. The eligible costs are broadly the core costs of producing (but not the ordinary running of) the production and closing the production. Core costs do not include indirect expenditure such as financing, marketing, legal services or storage.

OUR CHARITY DOES NOT PAY ANY TAX - CAN IT CLAIM THE RELIEF?

The charity does not need to pay tax to claim relief but it does need to be a body corporate to claim the relief directly. Although HMRC are unable to advise on tax planning, they envisage that charities would generally use a separately incorporated Special Purpose Vehicle (UK limited company) to act as a production company. The charity would pay the company a production services fee and the company would carry out the qualifying production services, making the appropriate Theatre Tax relief claim. Charitable Trusts should also be able to access the relief in this way.

IF A CORPORATE CHARITY CAN CLAIM DIRECTLY, WHY USE A TRADING SUBSIDIARY?

The way in which the relief is calculated takes the claimant company's income into account. The maximum potential claim can be made for a production if it does no more than break-even but, if the production makes a profit, the relief is reduced. Using a production company means that the income that is taken into account can be controlled – the ticket sales would belong to the charity and the production company would only receive the production services fee. The production company would break-even regardless of how many tickets were sold, ensuring maximum relief.

THIS ALL SEEMS STRAIGHT FORWARD – WE SHOULD DO THIS, RIGHT?

All the indications are that HMRC want this to happen for charities and they are going to be helpful, but some care is needed as there is a recurring trend of simple tax breaks becoming seen as unacceptable avoidance, or light touch regimes becoming much more highly regulated than initially expected. Proceed with caution, look to the detail and consider applying for HMRC clearance in advance for your own arrangements.

NOW I'M WORRIED, WHAT THINGS DO I NEED TO CONSIDER BEFORE SETTING UP A SEPARATE COMPANY?

Will the claim generate enough to justify the additional work and associated costs of making and supporting a claim? To claim the relief, each production is treated as a separate trade and will need to be accounted for as such, with the costs fairly apportioned between the subsidiary and the charity. The charge by the production company will need to be calculated based on the costs allocated to it and making allowances for the amount of these costs that will be funded by the relief. The costs of claiming will include: determining what lines of expenditure qualify for each production; determining a fair method of apportionment between qualifying production costs and excluded (ordinary running) costs; and ongoing calculation and monitoring of the methodology, all of which need to be supported by adequate documentation to defend each claim should HMRC enquire. There are also costs associated with setting up and maintaining a subsidiary company, which are arguably costs of that entity and should be borne by the subsidiary and recharged as a management cost by the parent to further evidence a clear separation in management of the entity. A direct claim by the charity may be less efficient in terms of the quantum of the relief but better in terms of total costs.

How will this impact on VAT? Are we currently registered and will the intercompany transactions result in irrecoverable VAT? Should we consider group registration? How will this impact on administrative costs? Each organisation should produce their own forecasts of the additional costs, potential relief and additional time it will take to administer the relief to determine whether or not it is worthwhile. Each organisation will have a different threshold depending on the size of the production(s), the costs available for relief and the group structure and VAT structure that is in place.

Who will employ the staff? Do we need joint contracts of employment?

How will we finance the company and minimise the risk of direct tax liabilities in connection with any funding by the charity?

There must be a real separation of the responsibilities of the production company and the charity so that the production company can be shown to meet the conditions for the relief in its own right. Each entity will need to minute its key decisions. Ideally these should be documented through the year and not just as a one off event at year end to help validate the segregation and independence of the subsidiary.

Who will we appoint as directors of the subsidiary production company – the decision making process is not simply a case of documentation and there should be at least one director that is not conflicted when making decisions affecting both the charity and the subsidiary. Do they have the expertise necessary to make the key production decisions such as appointing creative talent and approving budgets/overruns?

To what extent do we need to protect ourselves from a change in view by HMRC?

The answers to these questions will very much depend on your organisation's particular circumstances. Whilst they could be a bar for some or potentially erode the benefit for others, they are intended to encourage a robust decision making process rather than present insurmountable obstacles for the many charities for which a trading subsidiary will be of great benefit (and the right way to go!).

THE BORING BIT – HOW DO I CALCULATE THE RELIEF AND WHAT ARE THE MAIN CONDITIONS?

The relief is available to production companies for Theatrical Productions (broadly one that is performed by the playing of roles before a live audience) and is calculated at a rate of 25% of the surrenderable loss for a touring production and 20% of the surrenderable loss for a non-touring production.

The surrenderable loss is calculated by taking the total income (I) in connection with making or exploiting the production and deducting: -

- the costs of developing, producing, running and closing the production (P);
- the costs of activities undertaken with a view to exploiting the production (E);
- an additional amount equal to 80% of the "qualifying expenditure" (80% uplift) but limited to the amount of qualifying expenditure that is EEA expenditure.

The surrenderable loss cannot exceed the 80% uplift but otherwise = I - (P + E + 80% uplift).

So the surrenderable loss for a break-even production would be 80% of the qualifying expenditure (QE) and the repayable credit would therefore be (25% of 80% =) 20% of QE for a touring production and (20% of 80% =) 16% of QE for a non-touring production.

"Qualifying expenditure" is the cost of producing and closing the production but does not include the costs of actually running the production or costs not directly involved in actually producing the production (such as finance, marketing, legal fees or storage).

The production company must be responsible for producing, running and closing the production; be actively engaged in the decision making process, making an effective creative, technical and artistic contribution; and directly negotiate, contract, and pay for rights, good and services in relation to the production.

A touring production is intended to be performed in 6 or more separate premises or will be presented in at least 2 separate premises with at least 14 performances. (Note that there are additional reporting requirements and complexities in terms of calculating the relief if the production tours or runs over a year end.)

The production must meet the commercial purpose condition. Broadly, the performances need to be made to paying audiences or for educational purposes. Determining whether the first condition is met should be relatively straight forward, but care is needed for the second as having a general object such as "education in the arts" is not enough to meet the second leg of the condition. This is aimed at particular circumstances such as educational performances in schools and prisons and HMRC have recommended that clearance is sought in this area.

At least 25% of the core expenditure must be incurred in the EEA.

The amount of state aid cannot exceed 100% of costs for the production (and both the repayable credit and grants from the Arts Council would count as state aid for these purposes). We are advised that breaching this limit is unlikely as most productions will be at least part funded by ticket sales but this would be a serious matter and must be monitored and disclosed with any excess state funding repaid should it happen.

Please contact Sarah Campbell or James Cameron for further details and assistance.

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Future events

Civil Society Trustee Exchange*	21 April 2015
P11Ds: Reporting Expenses and Benefits (Webinar)	27 April 2015
Trustee Training Masterclass - Charity fundraising and raising of finance	5 May 2015
Trustee Training Masterclass - Owning, managing and occupying property assets	12 May 2015
CFG Annual Conference*	13 May 2015
What every trustee should know - Refresher	19 May 2015
haysmacintyre VAT Exchange	24 Spetember
Network of Women Chairs	Multiple dates available on our website

*haysmacintyre will be speaking and exhibiting at these events

For further information on these events please visit www.haysmacintyre.com/events or contact Charlotte Gibbons on 020 7969 5521, cgibbons@haysmacintyre.com

Should you wish to receive an electronic version of our briefing going forward please email Charlotte Gibbons on cgibbons@haysmacintyre.com

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