

Trading by charities

Tax issues

December 2009

Trading by charities - tax issues

Any commercial enterprise carried on by a charity may be a potentially taxable trade regardless of its charitable motive or the charitable application of its proceeds.

Trade

"Trade" itself is a varied and relatively vague concept, which is not comprehensively defined in the tax legislation. Whether a charity is trading will depend on a number of different factors, including whether the charity seeks to make a profit from the activity and how often it undertakes it. Any commercial enterprise may qualify, including running a school, arranging festivals and organising certain fundraising events.

Tax consequences

The most significant consequence of trading by a charity is that the profits of the trade are potentially liable to tax. This is because, contrary to popular belief, charities do not have a blanket exemption from tax but rather have to rely on a complicated "patchwork" of exemptions and reliefs that will not apply in every case. This is particularly true of trading profits, where there are six tax exemptions. Two of these relate specifically to lotteries and agricultural shows. The remaining four are more helpful generally and are summarised below. Profits from trading outside the exemptions are taxable.

Primary purpose trade

This exemption applies to the profits of a trade which is carried out in the course of actually carrying out a charity's charitable objects. So it would include, for example, profits made by an independent school supplying education to its pupils or on the sale of tickets by a theatre charity.

The exemption also extends to trades which are not primary purpose but are ancillary or incidental to a primary purpose trade. This would involve, for example, the sale of food and drink to visitors to an art gallery and the provision of a crèche for the children of students by a college or university.

Some trades are not wholly primary purpose (for example, the letting of accommodation for students in term time, but for conferences out of term time, by a university). If a trade comprises both primary purpose and non primary purpose elements, the trade must be treated for tax purposes as two separate trades and the rules relating to each different types of trading will apply. There must be a reasonable apportionment of expenses and receipts between the separate trades.

Beneficiary trades

This exemption applies where the work done in connection with the trade is mainly carried out by the charity's beneficiaries.

Such trades are relatively rare, but would include a farm operated by students of an agricultural college and the sale of goods manufactured by people with a disability working for a charity for the disabled.

Small trades

This is an exemption for the income from non-primary purpose small trades where the gross trading income (i.e. before deduction of any expense) during the financial year is less than the smaller of £50,000 and 25% of all of the charity's income from all sources (including donations) during the year.

So for a charity with an annual income from all sources of £100,000, the limit on gross trading income is £25,000. However if it has income of £300,000, the limit on gross trading income is capped at £50,000.

If the limit is exceeded the exemption cannot apply at all and all of the profits will be taxed, unless the charity had (at the beginning of the relevant financial year) a reasonable expectation that its gross trading income would not exceed the limits.

Fundraising events

Fundraising events, such as dinners and dances etc, which a charity organises on an infrequent or irregular basis, will not usually mean that it is carrying on a trade.

Where fundraising events do constitute a trade, profits from the event may fall within an exemption provided by HMRC by way of extra-statutory concession. The concession applies to events organised by a charity whose primary purpose is the raising of money and that are promoted as being primarily for the raising of money.

Many different kinds of events are covered provided they are not of a semi-regular or continuous nature (e.g. balls, festivals, shows dances and exhibitions) and that no more than 15 events of the same kind are held in the same location within a financial year. Fundraising holidays, challenge events or day-trips (and any event where accommodation is provided for more than two nights) do not generally fall within the exemption.

Where the exemption does apply, it covers all admission charges, the proceeds of sale of brochures and other items sold at the event, the sale of advertising space at the event, and sponsorship payments for the event.

Tax planning

If a trade would otherwise generate taxable profits, it may be possible to structure it in a way that will minimise the charge to tax. A strategy often used is for the charity to carry on the trade through a subsidiary company. The subsidiary can pass any profits back to the charity tax-effectively using gift aid.

There are a number of issues that need to be considered in relation to setting up a subsidiary company, not least how it should be financed. This route also involves greater administrative costs so should only be adopted if other strategies are not suitable.

VAT

VAT should be borne firmly in mind. If a charity is carrying out a trade (whether or not within any of the exemptions mentioned) it will almost certainly also be carrying out a "business" for VAT purposes. If the value of the charity's VATable supplies is in excess of the relevant VAT registration threshold, which is currently £68,000, then it will be obliged to register and account for VAT. In appropriate cases, a charity may consider voluntarily registering for VAT so that it can recover the VAT that it pays on supplies of goods and services made to it.

Further information

HMRC has produced some helpful guidance for charities:

<http://www.hmrc.gov.uk/charities/index.htm>

Further advice

This note provides general guidance only. You should not rely or act upon it without taking advice on your specific circumstances.

For further information please contact Con Alexander (calexander@vwv.co.uk / 0117 314 5214) or your usual contact at Veale Wasbrough Vizards.

To see our other publications visit our website at www.vwv.co.uk.