Briefing Papers

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CHARITY CORPORATION TAX: THE 10 RULES YOU NEED TO KNOW

HMRC enjoys a useful income stream from charities that get a Corporation Tax return out of the blue and bin it because we all know that 'charities are exempt from paying tax!'

This simply isn't true. What is true is that there are a number of tax exemptions available to charities – income from primary purpose trading, property, investments, fundraising and gifts are usually exempt. However, because charities are used to operating tax free they often forget that corporation tax is still payable on many sources of income.

HERE ARE THE MAIN AREAS WHERE TAX MIGHT BE PAYABLE:

1. Charities often forget that the trading tax exemption only applies to income from their primary charitable activities. Any other trading they carry out is not always tax exempt. There are 3 types of charity trading: primary, non-primary, and ancillary. An example of primary trading is a museum charging entrance fees; an example of non-primary is selling on goods which have been bought in to raise funds for the work of the charity; ancillary is where the museum operates a tea shop for people coming to view the museum. (This last can be a bit of a grey area see 3 below, so take advice if there's any doubt)

2. If your objects involve the care of the elderly, your income from care of children will be liable to tax on its profits even though they are both charitable activities. This is because the tax exemption only applies to income from your objects, and does not apply to income from wider charitable activity. It is always worth examining your objects before undertaking a new source of charitable activity to ensure you can undertake it tax free. Some charities have very wide objects in part for this reason. If there's been mission drift over the years you might benefit from a review of your governing document to see if the objects need updating to reflect new charitable activities. (You'll need Charity Commission approval to change the objects.)

3. While trading that is ancillary to the primary purpose trading is also tax exempt, wider more loosely connected trading is not. For example, a theatre bar only available to paying attendees at a play is tax exempt. A theatre bar open to anyone whether attending a performance or not is not tax exempt.

4. Not all fundraising is tax exempt fundraising. There are specific limits in the rules governing the number and type of events that can be held (no more than 15 events of the same type in the same location per year). So a monthly event should work, but a fortnightly event may not)

5. Note that when making grants overseas the law says you need to take the steps that HM Revenue & Customs deem as reasonable in the circumstances to ensure that a payment is spent charitably. Fail to take those steps and corporation tax can be charged on the value of the grant paid! I've been involved in situations where the audit trail of overseas donations has been a bit loose and HMRC has challenged the charity. This can also impact Gift Aid. Take advice if necessary. Be proportionate.

6. A donation that requires you to give recognition of the donor is generally not a donation but is a sponsorship fee subject to tax. Instead negotiate a separate payment for sponsorship rights ensuring that the bulk of the payment received is still a donation. This can impact VAT if it's a big sum; it might also impact Gift Aid.

7. Similarly, a payment from a corporate supporter that allows them to display and use your logo and brand is regarded as taxable non-charitable trading.

8. Overage payments are not exempt from tax. If you sell land and use the proceeds charitably the proceeds are exempt from tax. However, if you are entitled to additional overage payments, i.e. bonuses following the successful development of the land, then this is taxable. This shouldn't be a problem provided your advisers and accountants have good understanding of charities.

9. Development of a tax exempt income stream into something else can cause problems. So, for example, while hiring rooms can be income from property exempt from tax, the provision of catering, equipment and overnight accommodation is not exempt from tax. Take care when you are supplying other services.

10. The sale of goods donated to a charity is tax exempt fundraising. The sale of new goods, often in the same charity shop, is not. Careful monitoring of sales is required to differentiate between the two.

If all this is beginning to daunt you remember the good news: There's a general trading tax exemption worth up to 25% of your total income up to a maximum of £50,000 of non-charitable trading income.

This is very helpful for smaller charities; it can take a long time to build up to this threshold, but if you decide to set up something like a cafe, or a shop, do remember to take advice before you go too far down the road.

Once you start to get near to this 25% or £50,000 whichever is the lower, you need to start to think about setting up a trading company. This company can be wholly owned (a CIC?), and will gift its profits to the charity. (In practise there may be some small liabilities for CT if profits have to be kept back for cash flow needs.

I took the bones of this briefing from www.charityfinancials.com, but I have significantly added to it.

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www.afvs.org.uk