Trading and Tax

It is often thought that a typical charity is an organisation that asks for donations and spends the funds on charitable activities.

In fact, donations and legacies make up just over 34% of total income for charities (Feb 2022, Charity Commission Register), with over 57% coming from trading to raise funds or fees for charitable activities. So charities have almost twice as much earned income as donations. This article provides information for trustees on how to trade safely.

Trading and Tax

UK charities have preferential tax status (derived from the Elizabethan principle that socially beneficial activity should not be subject to tax). Many involved with the charity sector would suggest that this principle has been lost over time, however HMRC report that the value of benefits to the sector was £5.7bn in 2020/21. In practice there are some taxes that charities pay in full such as National Insurance; some where there are exemptions such as VAT; and others where tax is rarely paid such as corporation tax. The primary guidance from the Charity Commission is set out in Trustees, trading and tax – how charities may safely trade (CC35), alternatively HMRC also provides valuable guidance and most charities will need to consider both.

The Nature of Trading

Donations are not a trade, because nothing is received in return (technically, a non–exchange transaction). Any exchange of goods or services for money is a trade. However, there are complexities and the following issues all need to be considered:

- The number and frequency of transactions.
- The nature of the goods being sold.
- The intention of the charity in acquiring the goods to be sold.
- Whether the goods can be used and enjoyed by the charity.
- The nature and mechanics of the sales.
- The presence or absence of a profit motive.

What Trades are Lawful for Charities

The main aspect is trading that contributes directly to the provision of charitable activity, known as primary purpose trading. A related aspect is ancillary trading, where a secondary activity is provided in support of the primary activity. A third aspect is where the purpose is to raise funds for the charity and the activity does not involve significant risk. Risk is limited by the small-scale exemption.

Primary Purpose Trading

This covers the majority of charitable activity and where fees are charged for goods or a service.

Specific examples include:

- Course fees at a charitable school or college
- Sale of goods manufactured by disabled people at a sheltered workshop
- Residential care and accommodation at a residential care charity
- Sale of tickets for a performance by a theatre charity
- Entrance to a charitable museum or art gallery.

Ancillary Trading

Ancillary trading is where a service is provided that supports the primary activity, such as a café in a theatre for the audience. It must be closely aligned with the primary activity and the purpose of raising funds for the charity is not sufficient to qualify.

Non-Primary Purpose Trading

Charities can undertake non primary purpose trading, but the principle is that they are liable for corporation tax (or income tax if they are a charitable trust) unless the activities fall within specific exemptions:

- Lotteries
- Small scale
- Fundraising.

If these exemptions do not apply, charities are advised to establish a trading subsidiary. This trading subsidiary would normally be limited by guarantee and if it became insolvent, the charities assets would be protected.

Small Scale Exemption

The small scale has a threshold calculated with reference to the overall income of the charity and the income from the trading activity. For small charities with overall income of less than £32,000, the threshold is £8,000 with a sliding scale at 25% of overall income to a maximum permitted turnover from trading of £80,000.

Fundraising and Lotteries

Most fundraising events are exempt from corporation tax, but they cannot be a trade and therefore provide unfair competition with commercial companies. Therefore, charities need to consider the detailed guidance available in "Charities and Fundraising CC20" and in the OSCR publication "Benevolent Fundraising". Lotteries are trading, but there is a specific tax exemption for charities as Lotteries are governed by the Lotteries Act 1976 and this limits the risk.

Trading Subsidiaries

Trading subsidiaries are a commercial company, normally fully owned by a charity, although it is possible to have other shareholders if that route is chosen. The company requires directors and to be administered according to company and tax law. The charity will have to demonstrate why they are investing in a trading company and how this investment is an appropriate use of charitable funds. A trading company should protect the charity's funds from risk and could bring some tax advantages. However, it will involve higher costs of administration.

Funding the Trading Subsidiary

As the owner, the charity will normally be responsible for providing the funding for the subsidiary to operate. Any loan must include properly set out terms of repayment and interest payable in writing and approved by both the trustees of the charity and the directors of the subsidiary.

Donating to the Charity From the Trading Subsidiary

Companies can make donations and treat them as expenses, therefore reducing any taxable profits. However, this is normally limited to small amounts. Trading subsidiaries will donate all unretained profits at the year end. This transaction is treated as a distribution of profit, but a gift aid declaration is still made and recognised by HMRC. A trading subsidiary cannot donate under gift aid more than the profit it has available for distribution.

How do I know if I am doing a good job?

- Make sure the charitable activities of the charity are within those set out in the governing document.
- Make sure any ancillary trading has not, over time, developed its own distinct customers.
- Check that fundraising activities are clear in setting out what is a donation and what is a payment in exchange for a good or service.
- Review the basis of the ownership of a trading subsidiary to make sure that it remains a good investment of charity funds.
- Commission a charity tax review by your specialist charity accountant.

Did you know?

- Charities have almost twice as much earned income as donations (CC Register Feb 2022).

How we can help

When a charity is not solely funded through donations, the trustees should make sure they understand their tax position. If in any doubt, please do not hesitate to get in touch with your local MHA member firm for assistance.

If you would like to discuss any matter arising from this article please contact MHA on info@mha-uk.com or your usual MHA contact.