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Not for Profit eNews

August 2021

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Welcome to the latest edition of MHA Not for Profit eNews.

In this edition, we look at the Charity Commission 2021/22 business plan, annual return extensions, and the Governments impending review over the Charities Act 2021 financial reporting thresholds.

We also report on how the COVID-19 pandemic has increased society's trust for charities, but has also increased society's expectations on the services, exposure, and impact on their overall objectives.

Best Regards,

MHA Not for Profit team

Charity Commission Business Plan 2021 to 2022

The Charity Commission have announced their 2021/22 business plan, marking the third year of their five year strategy. The plan reemphasizes their aim to become a more effective and efficient regulator, while investing in new approaches to data and intelligence to support evidence-based regulatory and operational decisions. The Charity Commission have set out five key objectives including, holding charities to account, dealing with wrongdoing and harm, and informing public choice. In order to move further towards this in year three of the strategy, the four priorities below have been established:

1. They will help charity to deliver impact, as the country recovers from the pandemic, by improving its services to trustees and building stronger relationships with them. There is also an aim to improve engagement through more effective communication channels.
2. They will continue to deliver a step change in their robust approach to regulation, this will involve making greater use of intelligence gathering and data analysis.
3. They will improve how they use data collected through statutory returns. They will also look at ways in which to improve the reporting of impact that charities make to the public.
4. They will create the right environment to enable their people to be more efficient and to help make the Commission a great place to work. This will involve a 'lessons learnt' exercise from remote working and a review of what the culture and ethos of the Commission should be.

The Charity Commission will report performance against their business plan and annual report in the following financial year. The 2020 to 2021 Charities annual account was published on 15 July 2021.

Rise in trust, but public expectations remain high

The Charity Commission have reported that there is "No room for complacency" after new research suggests that after a decade-long decline in people's perception of charities' importance in society, charities are beginning to recover with a 6-year high.

This has been linked in part to COVID-19 pandemic where charities role has been more visible with direct response to the national lockdown, specifically reacting to poverty and support for NHS and other key workers.

However, researchers have confirmed that key drivers of trust in charities have not changed and people still expect charities to show the positive difference made, spend high proportion of funds on the end cause, and also to truly live by their values.

The uneven impact of the pandemic on charities

In a piece of independent research, – 'Trust in charities post-COVID' - Yonder asked how charities have been impacted by the pandemic in the short term.

A survey of over 2,700 trustees finds that COVID-19 has had an uneven impact on the sector, with smaller charities much more likely to have halted services. A quarter of charities with incomes of less than £10,000 say they were forced to cease all their services, compared to only 3% of charities with incomes of £500,000 or more.

In contrast, those largest charities were more likely to have moved their existing services online (63%) and to have helped directly with the pandemic (36%).

As fundraising events were curtailed, over a quarter of the largest charities (> £500,000) were able to find alternative sources of income, compared to only 5% of the smallest (<£10,000). Around half of the largest charities used furlough or emergency Government support, and 17% of them accessed the Government's £750m fund set up specifically for the voluntary sector.

Smaller charities were less likely to have accessed either.

Researchers conclude that there is "no room for complacency", with people from diverse walks of life sharing consistently high expectations of charities. The findings confirm that the key drivers of trust in charities have not changed during the pandemic, and that people expect charities to:

1. show that they make a positive difference
2. spend a high proportion of funds on the end cause, and
3. live their values, showing charity not just in what they do, but how they behave along the way

Filing Extensions with Charity Commission set to end

Under normal circumstances charities registered in England or Wales must submit an Annual Return to the Charity Commission within 10 months of the end of the financial year.

The coronavirus meant that the Charity Commission had implemented filing extensions for those that needed it. As restrictions are gradually easing, they have reviewed the approach to said extensions. From 1 July 2021 to 30 September 2021, if you have an imminent filing date and you are unable to meet your filing obligation for a COVID-19 related reason, you can still apply for a new filing extension. The Charity Commission will allow a fixed three-month extension from the date of application.

Formal alert to overseas aid Charities

A formal regulatory alert has been issued from the Charity Commission addressing the need for international aid charities to enforce better prevention over exploitation and abuse.

It is noted that significant improvement has been made since 2018, but more work is needed for a significant impact over the safeguarding of those in receipt of aid. This alert comes following a 40% increase of serious incident reporting on safeguarding matters by charities, showing improvements in reporting and complaint processes.

These reports identified further risks and weaknesses around safeguarding across the sector, reiterating that all charities must be constantly alert to the risk of harassment and abuse.

The Charity Commission recommends the following considerations:

1. Joining the Misconduct Disclosure Scheme
2. Giving those in need a safe means to report concerns and complaints
3. Designing reporting processes that reflect local context
4. Implementing a survivor-centered approach
5. Clearly communicating the support available.

Charities Act 2011 reporting threshold review

The Government made an announcement that they aim to review financial reporting thresholds next year which could lessen the reporting burden for some charities.

Currently the Charities Act 2011 increase financial reporting requirements as charities' income and/or assets increase.

The Law Commission recommended that the Government should "periodically review all financial thresholds in the Charities Act 2011 with a view to increasing them, by secondary legislation, in line with inflation". The Government agreed with this and said that they will aim review at least once every ten years. The review in 2022 will include the thresholds for permanent endowments and failed fundraising appeals.

According to the Bank of England's tool, between 2011 and 2020 inflation averaged 2.5% per year. If the suggested change is implemented then thresholds will increase significantly, resulting in many charities being able to apply lower reporting and external scrutiny requirements.

Unfurling after the Furlough Scheme

With the Government easing the country out of lockdown, organisations need to start planning for the tapering of the Government contributions to the Scheme and its ultimate closure.

The Furlough Scheme is due to end on 30 September 2021, which mean organisations contemplating redundancies of 100 or more employees would need to commence collective consultation no later than 16 August in order to conclude by this date.

In order to prepare for this, organisations should review current staffing levels against estimated demand, considering whether temporary reductions are possible, or whether permanent redundancies are deemed necessary.

Further information and advice surrounding this topic can be **found** on MHA MacIntyre Hudson website.

VAT: update

Brexit issues:

From 1st January 2021 all movements of goods between the UK and EU became exports and imports, with simplified Intra-EU trade rules disappear for UK businesses. The trade deal between UK and EU secured 0% duty tariffs, however customs declarations and VAT issues remain. Charities who may be affected should consider using Postponed Import VAT Accounting (PIVA). This enables import VAT to be paid and recovered on the same VAT return.

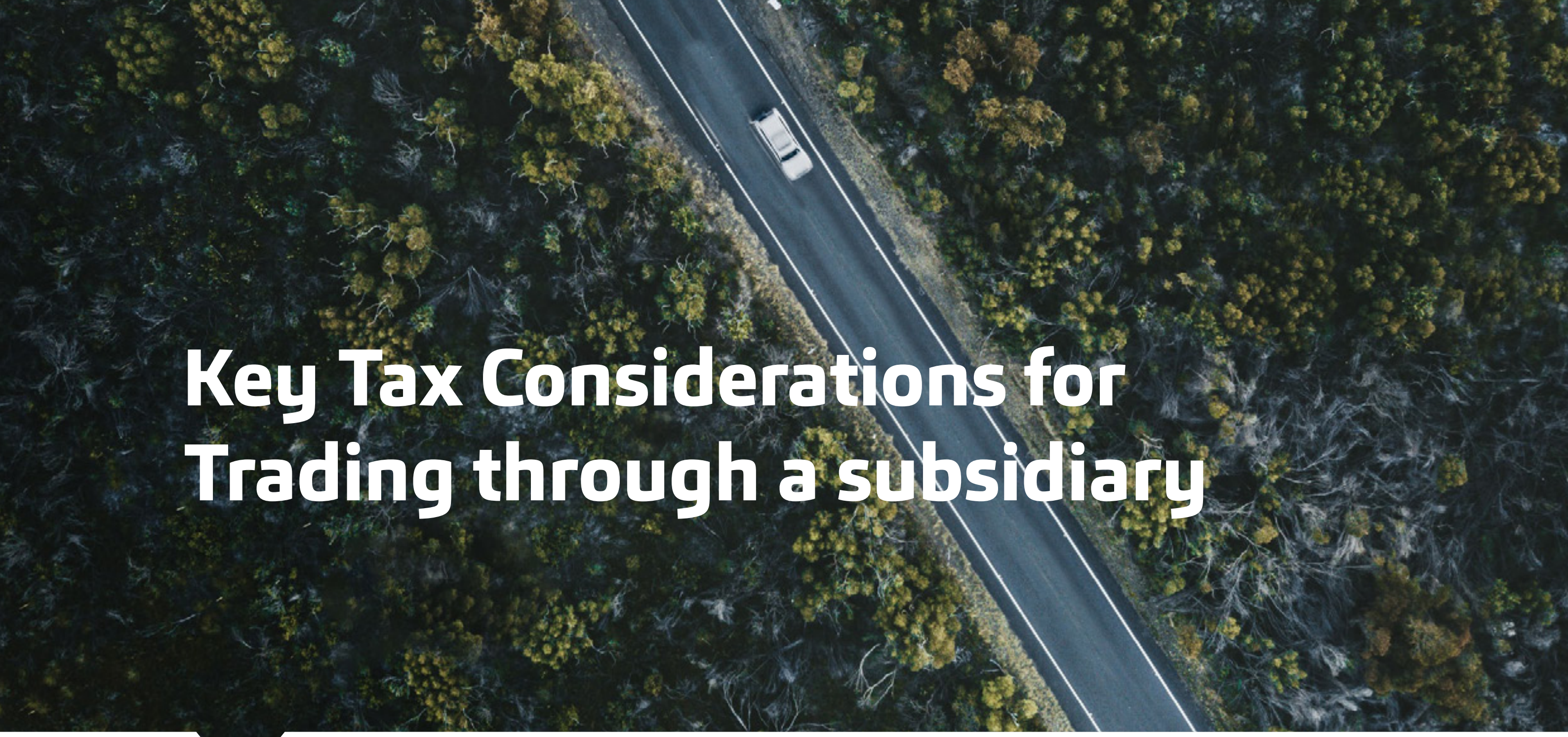
Selling goods B2C into the EU:

The aim is for all goods to be taxed in the country of the purchaser and sellers to collect VAT at the rate of the country of each purchaser. For all sales of 150 euros or less; organisations should register for IOSS and pay VAT via an IOSS registration in the EU. Any sale of more than 150 euros; organisations will need to register for VAT in every EU country where they make sales.

If marketplaces or platforms facilitate either, B2C sales within the EU by businesses not established in the EU and/ or facilitate B2C sales of goods imported into the EU with value not exceeding 150 euros, the marketplaces or platforms will be liable to pay the VAT amounts due in the EU country of the customer.

Making Tax Digital:

The initial soft-landing period, 1 April 2020, was extended to April 2021, as part of the Government measures to support businesses during the COVID crisis. This gave businesses until 1 April 2021 to fully meet MTD VAT digital link requirements. MTD VAT will be extended to all VAT registered entities (including charities) with taxable turnover below the VAT registration threshold to 1 April 2022.



Key Tax Considerations for Trading through a subsidiary

Recently we have seen a lot of our charity clients ask for tax advice around their expansion plans.

This article, whilst not an exhaustive list of issues to consider, looks as some of the key tax matters to consider when looking to commence trade through a subsidiary company.

Making the decision to trade through a subsidiary

There are a number of reasons why you might consider incorporating a trading arm, these include:

- To perform an activity outside the charity's primary purpose (which may otherwise become subject to tax if the charity carried these out and exceeded the Non-Primary Purpose limit)
- To perform an activity not in the public benefit (e.g.: it may exclude people due to price)
- Legal/contractual reasons
- Risk reduction – the limited liability status of a separate trading company may protect charitable funds in the event of an accident

However, to incorporate a subsidiary company, the Trustees of the charity must ensure that they are happy that the subsidiary will be financially viable as soon as possible. It is therefore important that a business plan is produced which clearly shows when the subsidiary is forecast to become profitable and to assess progress against the business plan. Where the subsidiary is not forecast to be profitable within 2 years consideration should be given to the appropriateness of the planned activity.

This is because in most cases it will be the charity which is funding the operations of the subsidiary. Trustees must ensure that charity funds are used appropriately, furthermore should the charity make a non-qualifying investment, a Corporation Tax charge can arise on the value of the investment.

In practice it is not common to see non-qualifying investment charges arise, and a number of factors are considered in relation to them. However, we would stress the importance of having clear business plans in place before the subsidiary commences trade, so that the basis of the decision to incorporate a subsidiary is well documented. Furthermore, should the charity be funding the subsidiary via a loan, a proper loan agreement should be drawn up with commercial rates of interest charged (and paid over).

Corporation tax

A key driver of trading through a subsidiary is the ability to reduce Corporation Tax to nil by making "Gift Aid" donations to the parent charity within 9 months of the year end.

However, for this to work in the long term there needs to be no difference between accounting profits and taxable profits. Examples of where differences can arise:

- Fixed assets – if the subsidiary holds fixed assets, there might be disallowable depreciation charged on assets where no tax relief is available from Capital Allowances
- Disallowed expenses – the subsidiary may incur expenditure which is disallowable e.g.: third party entertaining, legal fees which are capital in nature

Gift Aid donations are akin to dividends, and therefore must be made out of distributable profits. In simple terms, should the taxable profits exceed the accounting profits then it would not be possible to cover the whole taxable profit with a Gift Aid payment.

However, like most things, it isn't always that simple. It may be that the subsidiary has distributable reserves brought forward, or that within 9 months of the year end additional profits have been made which enable the distribution to be made.

VAT

Trading through a subsidiary can have VAT implications, positive or negative depending upon the fact pattern. Therefore, we would always recommend taking advice specific to your circumstances to consider issues such as:

- Will the subsidiary be required to be VAT registered? If not, would it still be beneficial to register?
- Will the transactions between the charity and the subsidiary be VAT-able?
- Should the charity and the subsidiary be VAT grouped?
- Are there any implications for the VAT recovery rate within the charity?
- Could there be implications on the VAT recovered on capital items through the Capital Goods Scheme?

Employment taxes

There are a number of ways in which staff might be employed:

- Through the charity
- Directly through the subsidiary
- Joint contracts of employment with the charity and the subsidiary

Depending upon how you structure this you may need to make recharges for staff time between the charity and the subsidiary and/or set up a separate payroll for the subsidiary company.

We would always recommend that you take legal advice around contracts of employment.

Other issues to consider

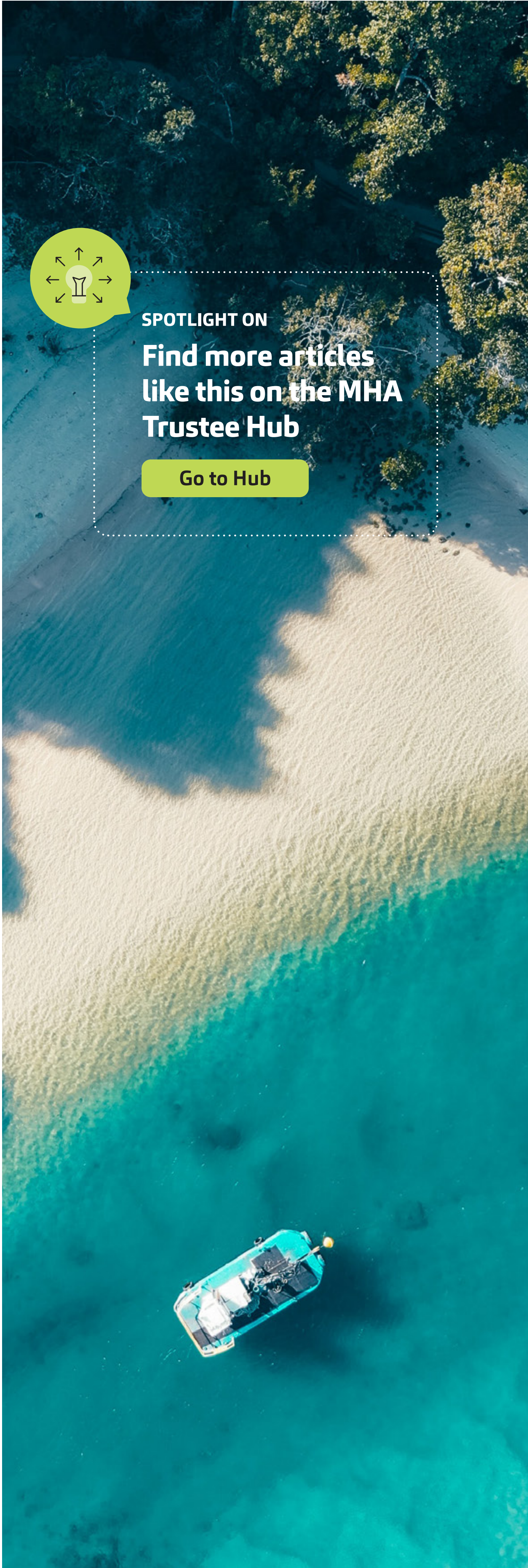
Some addition items to take into account when considering setting up a subsidiary company include:

- It will create a more complex structure with additional costs (e.g.: audit, professional fees, additional accounting software licenses etc.)
- Possible loss of rate relief for the subsidiary's activities
- Staff time will be spent administering the subsidiary
- The subsidiary must operate at an "arms-length" to the charity (i.e.: recharges should be made at a commercial rate for services provided between the two).

Conclusion

For many charities setting up a trading subsidiary company, it is the correct course of action as it enables them to achieve objectives which are not possible or are more costly/risky through the charity.

However, we strongly recommend taking the time to carefully document the reasons for incorporating a subsidiary company, and to look in detail at the wider and long-term implications.



Charity Commission consultation on responsible investment

Responsible investment is becoming increasingly important to charities, investors, businesses and regulators alike.

The Commission's focus on this area recognises that many charities are already investing in this way and there are many others that are considering doing so. In 2020 we updated our research, **Intentional Investing,** which surveyed 295 long-term charity investors about their approach to investments. We found that 77% have chosen to adopt a policy to link their investments to their charitable mission, which compares to 59% five years ago and 23% 10 years ago.

This shows the significant change in charities' approach to responsible investment and highlights the need for updated guidance from the Charity Commission.

Our research also found that the main barrier to charities investing responsibly is a concern that this could mean sacrificing financial returns. This view is somewhat of a myth - evidence shows that integrating environmental, social and governance (ESG) factors into investment decisions can actually reduce risk and even enhance returns. Unfortunately, the draft guidance doesn't quite hit the mark in terms of making this clear. Instead, the guidance talks about 'financial investment' as opposed to 'responsible investment,' suggesting that the two are mutually exclusive. In fact, stronger ESG scores correlate to lower price declines for companies [1].

There are also significant opportunities in this space; it is estimated that $120 trillion needs to be invested across the value chain to fund the energy transition which presents an exciting investment opportunity. What's more, investing 'irresponsibly' and ignoring ESG factors could result in much worse financial outcomes – for example, when Volkswagen was revealed to be cheating on their emissions tests in 2015, their stock price fell almost 40%.

Overall, the Charity Commission's focus on this topic is welcome and the guidance does lay out the circumstances in which charities can take a responsible investment approach. However, our concern is that the false dichotomy presented between financial investment and responsible investment could mean some trustees remain hesitant.

[1] Based on average of Environmental, Social and Governance scores applied to the universe of ESG-ranked stocks in the BofAML US coverage universe. Source Lipper – based on peak to trough price declines over 5 year period

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