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THE TAX TREATMENT OF CHARITIES



If your organisation is a registered charity it may qualify for some potentially valuable tax reliefs and exemptions. HMRC has recently updated its guidance on the tax treatment of charities, and this factsheet provides an overview of the current rules.

QUALIFYING CONDITIONS

To be defined as a charity for tax purposes, an organisation must meet four qualifying conditions. These stipulate that the organisation should be:

1. Established for charitable purposes only
2. Subject to the control of a court in the relevant country
3. Registered with the relevant regulator, if required in that country
4. Managed by fit and proper persons.

The first condition means that the charity is restricted to using all of its income and assets for its stated charitable purposes.

If a body is required to register with a charity regulator, as set out in condition three, it must do so before applying to HMRC for recognition as a charity for tax purposes. The Charities Commission is responsible for regulating charities in England and Wales, while organisations wishing to act as a charity in Scotland must register with the Office of the Scottish Charity Regulator (OSCR). Charities in Northern Ireland must register with the Charity Commission for Northern Ireland (CCNI).

Once the four conditions are met, the charity can then apply to HMRC to be registered as a charity for tax purposes. In addition, if the charity is to take advantage of the Gift Aid Scheme and charitable tax exemptions, it must register for an HMRC online account. This will also allow the charity to receive tax repayments.

TAX EXEMPTIONS AND RELIEFS

Trading profits

A charity's trading profits are exempt from tax as long as the activities contribute directly to the furtherance of its charitable objectives. There

are two forms of charitable trading – primary purpose trading and trading mainly carried out by the beneficiaries. Primary purpose trading is trade undertaken whilst carrying out the purpose of the charity, e.g. a charitable school providing education for fees. In addition, any profits from ancillary services which contribute indirectly to the purposes of the charity are exempt from tax. This could include the sale of food and drink to the audience by a charitable theatre. Trade mainly carried out by the beneficiaries is where the activities are performed by the beneficiaries of the charity, e.g. the manufacture of goods by disabled people.

The overriding condition for tax exemption is that the profits from these activities are only applied for charitable purposes.

Any income received by the charity from the sale of goods that have been donated is not regarded as trading profit but just the realisation of the value of a gift.

Activities which do fall within the above categories of charitable trade will be treated as 'non-charitable trading' and the profits may be subject to tax (see later).

Other profits

Subject to certain restrictions, other activities which are exempt from tax include fundraising events such as discos or fairs, and also lotteries.

The profits of a property business carried on by a charity are also exempt from tax, although the exemption does not apply to the profits from buying and selling land or the development of land. If a charity sells land that has been held as an asset there is an exemption from capital gains tax.

In addition, all interest, dividends and Gift Aid donations are exempt from tax, while capital gains also avoid tax.

In all cases the income or gains are only exempt if applied for charitable purposes.

COMMUNITY AMATEUR SPORTS CLUBS

Registered Community Amateur Sports Clubs (CASCs) are also entitled to certain tax benefits, including Gift Aid (see later). To qualify as a CASC for tax purposes, the club must broadly:

- be open to the whole community
- be organised on an amateur basis
- have, as its main purpose, the provision of facilities for, and the promotion of participation in, one or more eligible sports
- not exceed the income limit.

Further details of the criteria can be found at:
www.gov.uk/register-a-community-amateur-sports-club.

In order to be eligible for tax reliefs, the CASC must use all of its income and gains to promote participation and provide facilities for their eligible sport.

Where this condition is met, the club will not pay tax on:

- interest received
- chargeable gains
- trading profits where turnover is less than £50,000 a year
- income from property if the total property income is less than £30,000 a year.

It should be noted that if trading turnover exceeds £50,000, all the trading profit is assessable to corporation tax.

In addition, the CASC can benefit from Gift Aid and the Gift Aid Small Donations Scheme (GASDS) for qualifying donations – details of these are set out below.

WHEN YOU NEED TO PAY TAX

Non-charitable trading

Activities which are not treated as charitable trading, as described earlier, will be treated as non-charitable trading and the profits will be taxable. There is, however, a small scale exemption for non-charitable trading. This is the case even if the activities raise funds for the charity. A common example of this would be a charity which is an art gallery selling promotional pens, mugs, etc which are not related to the main purpose of the charity.

Where a charity has both charitable trading and non-charitable trading it will need to apportion income and expenses between the two types of activities. One way of dealing with the tax charge on non-charitable trading profit is to set up a trading subsidiary of the charity which carries out the activities which are not tax exempt. This subsidiary then donates its profits to the charity under Gift Aid, thereby reducing taxable profits.

Non-charitable expenditure

Tax exemptions are restricted where the charity has incurred non-charitable expenditure and has an amount of income or gains that are eligible for tax relief or exemption (attributable income and gains). Attributable income and gains would include Gift Aid donations, rental income, interest received, profits from charitable trading activities and capital gains. Non-charitable expenditure would include any expenditure which is not for the charitable purpose only. Where non-charitable expenditure is incurred, the charity will lose tax exemption on an equivalent amount of their attributable income and gains. The rules in this area are complex.

VAT

For VAT purposes there is no distinction between charitable and non-charitable trading. Even though an activity is carried out for the benefit of the community or in the furtherance of charitable objects, it can still be a business activity for VAT purposes and VAT may be due on the income.

If the charity is VAT registered it may be possible to reclaim some VAT under the normal VAT rules and there are additional VAT reliefs available for charities. It should be noted that these reliefs are not available to CASCs.

The rules governing VAT and charities are complex, so please talk to us for further information and advice.

Tax returns

Where tax is owed, the charity must complete a tax return and the appropriate Charity Supplementary pages and send them to HMRC. A charity may also be asked by HMRC to complete a tax return.

CLAIMING GIFT AID

The Gift Aid scheme allows registered charities and CASCs to maximise the value of monetary donations by reclaiming the basic rate of tax paid by the donor (so an additional 25p can be claimed for every £1 donated).

The donor will need to have completed a Gift Aid declaration and have paid enough tax in that tax year to cover the amount that is being claimed in Gift Aid.

The Charities Online service allows Gift Aid repayments to be claimed online. The system is designed to speed up and simplify the process of making a repayment claim, saving valuable time for charities and CASCs. Alternatively, claims can be made by post using a form ChR1.

THE GIFT AID SMALL DONATIONS SCHEME

Charities and CASCs can also claim a top-up payment on cash donations of £20 or less without the need to collect Gift Aid declarations. Charities will generally be able to claim on small donations totalling up to £8,000 per annum from April 2016, an increase on the previous limit of £5,000. Claiming GASDS on £8,000 of small donations will result in a repayment of £2,000 for the charity or CASC.

The GASDS is ideal for small cash donations received in collection boxes, bucket collections and during religious services. Charities and CASCs wishing to claim under the GASDS will still need to make Gift Aid claims in respect of other donations for which they have a Gift Aid declaration in the same tax year: for example, on regular donations received from supporters. This is called the 'matching rule': every £10 of donations claimed under the GASDS must be matched with £1 of donations claimed under Gift Aid in the same tax year.

We can provide further advice on the tax rules governing charities and CASCs. Please contact us to find out more.

