# Charities and trading

## Time for a rethink

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# Foreword

Some years ago ACEVO and CFG joined forces with Pesh Framjee to produce a publication on charities and trading. This was commissioned by HM Treasury and was needed as a result of the mostly unnecessary complexity of the rules. When it comes to raising income, charities invest a lot of resource into ensuring that they comply with the law; but having to set up trading subsidiaries for fundraising activities that do not involve significant risk simply because of tax risk is money and time that could be better spent, without adverse effect on the public finances.

The ideas contained in this paper have much to commend them and few, if any, noticeable draw backs. ACEVO and CFG have always been in favour of reducing unnecessary burdens on charities, yet often critics will complain that charities are looking for handouts or special treatment. These proposals could alleviate the burden not just on charities but also HMRC, which currently has to process tax returns for which there is invariably no benefit or income to the public purse.

We believe the principles underpinning this paper may open up other areas of discussion about the role and nature of tax in the context of charity and the need to simplify the ever increasing complexity of charity tax rules.

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# Preface

The current tax regime means that much of the normal fundraising activity of a charity is treated as trading and can lead to a tax liability. The tax rules are difficult to apply in practice and many charities default to putting such activity through a trading company.

Very few charity trading companies pay tax as they Gift Aid their profits to the charity so the present system does not lead to any increased tax revenue. What this does do is lead to increased costs and administrative burdens for the charity including professional fees paid to accountants and lawyers to understand the complexities, prepare agreements and carry out audits.

Defaulting to the use of a trading company can also lead to a charity accepting undue risk as there is sometimes a view that this risk is acceptable as it is not being carried out in the charity. In addition, Trustees may be abdicating their oversight responsibilities once an activity is not carried out by a charity as they believe that their responsibilities do not extend beyond the charity.

The last review of this structure was carried out by the Cabinet Office some years ago. The review recommended a change but it was not implemented. As charities work for increased efficiencies and strive to improve their effectiveness and governance I believe that it is time for a rethink.

This paper explains the background, considers the issues, discusses the concerns and highlights some of the complexities of the existing regime.

The recommendation for change is to allow charities to undertake all trading within the charity, without the need for a trading company. In effect, extending the exemption that allows charities to carry out primary purpose trades to all trades. A compromise would be to remove the fixed monetary caps and allow charities to trade if their trading income did not exceed 25% of all their income.

This proposal is for an option not to use a trading company, rather than preventing the use of one, so charities could and should continue to use a subsidiary trading company when the situation merited it.

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Charities are faced with the increased demand for their services and as expenditure outpaces income there is a constant need to look for innovative means of income generation. Charities are trying to increase their slice of the 'fundraising cake' as well as increase the size of the cake itself. However, many charities have also recognised that they need to generate income through some form of exchange transaction. Hence charity shops, commercial sponsorship, affinity card schemes and other sources of charity income generation that arise from earning income.

Earned income is a significant proportion of the income of the UK charity sector. Charities are providing products and services for a fee on a regular basis and these arrangements often lead to the dreaded 'trading' with its consequent charity law and tax implications. As charities widen the range of their income generation efforts, the incidence of 'trading' increases and income generation activities come under close scrutiny.

## What is trading?

What then is trading? My dictionary refers to, *"the practice of some occupation, business, or profession habitually carried on especially when practised as a means to a livelihood e.g. shop keeping, commerce, buying and selling"*. However, our everyday understanding is considerably widened by tax law which states that a trade includes *"every trade, manufacture, adventure or concern in the nature of trade"*. It does not cease to amaze me how unhelpful this circular definition is which originated almost 200 years ago. Consequently, the courts have on several occasions had to scrutinise activities to decide whether they fall within the definition of trade.

Some of the income generation activities of charities are easily recognisable as traditional charity trading - the purchase and sale of goods, Christmas cards and such. In addition, more and more charities are being entangled in the trading net for activities that they had thought were part of their normal fundraising efforts. For example, commercial sponsorships, certain fundraising events, affinity card schemes, lotteries and conference income.

The Charity Commission's guidance on trading (CC35) explains *"the fact that the sale of goods, services and property furthers the objects of the charity, or that the trading profits are to be used for the furtherance of those objects, does not prevent an activity from being regarded as 'trading'."*

## The position at present

Tax rules provide exemption on the profits of a trade in certain circumstances. The most common is the primary purpose trading exemption. A primary purpose trade is one which is carried out as part of the charity's primary charitable purpose or purposes. For example, a social care charity charging fees for a care home. Similar to this is an exemption for a trade carried out by the beneficiaries. This encompasses trades, which are non-primary purpose but are carried out mainly by beneficiaries. For example, the manufacture and sale of items by blind people by a charity supporting blind people.

In some cases a trade may be ancillary to the carrying out of a primary purpose. An ancillary trade is one that by itself would not be primary purpose but one that a charity would be expected to or obliged to carry out as part of carrying out its primary purpose. This trading can still be said to be exercised in the course of carrying out a primary purpose. It is therefore part of the primary purpose trade and will be exempt from direct tax. For example, the sale of food and drink in an art gallery or museum cafeteria to visitors of its exhibits.

All other trades are taxable unless they fall within the de minimis exemption for small trades. This applies when the turnover is below either £5,000, or 25% of the charity's total incoming resources, with an overall upper limit, recently increased to, £80,000.

The reality is that most charities do not pay tax on trading profits even if they are large and fall outside the primary purpose trading exemptions as they trade through a subsidiary trading company that uses Gift Aid to transfer its profits to the charity. This route to reduce taxable profits is available to any company. So the present rules do not really lead to an increase in the tax take.

## The problem in a nutshell

In 2002 the Cabinet Office carried out a detailed review of the charity sector and published *Private Action, Public Benefit A Review of Charities and the Wider Not-For-Profit Sector*. This made a number of recommendations and said, *"Currently charities are only permitted to undertake substantial trading that is directly connected to their charitable purpose, with all other trading done through a subsidiary. Allowing charities, subject to a specific statutory duty of care, to undertake all trading within the charity would remove much of the burdensome complexity in the current system."* An extract of the Cabinet Office's thinking and their recommendation is presented in Appendix 1. This summarises the issues well.

In essence, it can often be quite difficult to decide when an activity will be treated as trading and how it will be treated for tax purposes. This means that many charities either do not carry out useful income generation activities which do not have significant risk because they do not want to set up trading subsidiaries, or they do set up trading subsidiaries with all the attendant administrative and third party costs. These include cost sharing agreements, audit fees, legal fees, managing separate accounting records and bank accounts etc.

Many years ago Helen Verney, a Trustee of the Charity Finance Directors Group (as it then was), and I provided oral evidence to the all party committee that was considering matters for the Charities Bill that became the charities Act 2006. In our evidence we highlighted the costs and unnecessary bureaucracy. Cost escalations mean that the position has worsened and charities are having to incur even more unnecessary costs and effort to jump through hoops and loops and it really is time for a rethink.

The main reason that many charities set up a trading company is because they could incur a tax liability if a non tax exempt trade is carried out through the charity. Since most trading subsidiaries use Gift Aid to profit shed there is ultimately no tax paid and it seems that the current regime only benefits accountants and lawyers.

This is because the tax rules are often difficult to apply, so much so that some years ago HM Treasury commissioned a book on the *Tax Implications of Charities and Trading* which I authored with members of the Crowe tax team. This was published by ACEVO and CFG. This book highlights the many challenges that charities face. Some of the complexities and anomalies of the current tax rules are highlighted in Appendix 2 to this paper.

There are many more such examples where charities have to use trading subsidiaries for no other reason than to meet tax rules. If not for the tax rules such activities would be considered as part of the normal fund raising activities of a charity and would be treated as such. There is no charity law reason for a non charitable subsidiary to be used in most of the situations that lead to the use of trading subsidiaries but charities have to go over hurdles to manage the tax risk.

I also have a concern based on a number of cases that the use of trading subsidiaries can lead to charities carrying out inappropriate activity and/or not exercising proper oversight as the activity is seen to be within a separate non charitable company, which is often not subject to the same regulatory regime as a charity.

## HMRC guidance

HMRC has provided extensive guidance on trading and this explains:

*"Your charity will not pay tax on profits it makes from trade if:*

- *you are making money to help your charity's aims and objectives, known as 'primary purpose trading'*
- *your level of trade that is not primary purpose falls below the charity's small trading tax exemption limit*
- *you trade through a subsidiary trading company.*

*Your charity must pay tax on any other profits."*

## Charity Commission perspective

The Charity Commission has explained that a trading subsidiary must be used in any case where there would be a significant risk to the assets of the charity. The proposed change to the tax rules would not change this. In their guidance on Charity Trading (CC35) the Commission has said:

*"Where trading (other than trading in pursuit of its charitable objects) involves significant risk to a charity's assets, it must be undertaken by a trading subsidiary. But even where it is not essential for the trading to be undertaken by a trading subsidiary, the use of trading subsidiaries may produce benefits, for example in reducing tax liabilities. In particular, trading subsidiaries may make donations to their parent charity as 'Gift Aid'*, *so reducing or eliminating the profits of the subsidiary which are liable to tax.*

*But the use of trading subsidiaries where it is not essential to do so is not always beneficial, since it may involve additional management and other costs. And there may be fiscal drawbacks to balance against the advantages to be obtained, although direct financial considerations may not be the only ones which are relevant. Trading operations may benefit from using a trading subsidiary due to the organisational and financial clarity conferred by distinguishing a trading operation from the charity's main work."*

The recommended change to the tax rules advocated in this paper would adhere to these principles but would also bring significant advantages by changing the fiscal regime which requires fundraising activities to be carried out through a non charity simply because of the tax risk rather than any inherent financial or reputational risk. The recommendation would in no way compel charities to undertake risky trading within the charitable structure. The recommendation would, however, enable charities to undertake well-established trading activity more efficiently and with proper oversight by bringing it within the charitable structure.

The Charity Commission, provided written evidence on this matter to the Joint Committee and they supported the recommendation to extend the right of charities to trade saying:

*"The proposal is in the same liberalising spirit as other recent better regulation developments, such as the changes to investment rules made by the Trustee Act 2000. The Commission has taken an active part in these developments, for example in our approach to Trustee remuneration where we look at what is expedient in the interests of the charity.*

*These changes are all designed to give Trustees greater freedom – balanced with a duty of care – in deciding how to deploy resources to best advantage. The present proposal would put trading, as a form of income generation, on the same footing as fund-raising – an area where the great majority of charities have a record of proportionate and successful investment. The new freedom would emphasise charities' ability to identify and control risk. Many charities would need advice and guidance from specialist advisers on how best to structure their trading activities so as both to minimise bureaucracy and mitigate risks to their assets. Measures that charities took to mitigate risk would have their own costs attached. Trustees of unincorporated charities would need to consider the risks of direct trading very carefully indeed, given the personal liabilities involved.*

*Should the proposal be implemented the Commission would work with charities to build better understanding of the issues and to increase transparency of such trading activities."*

At the time, with support from the Charity Commission, a draft of what could be included in the Charities Bill was produced for the Joint Committee (See Appendix 3). However, without a change to the tax law any change to charity law would have been ineffective. The tax regime would have to change by extending the primary purpose trades exemption to all trades.

An example of where the tax and charity rules do not align, is provided in CC35 which says:

*"The provision by a charity of advertising and other promotional services in return for business sponsorship is an example of trading which is unlikely to present significant risk to the assets of the charity, since the outgoings which a charity faces in the course of such trading are likely to be minimal. So there may be no charity law imperative to hive off this type of trading to a trading subsidiary but there may be a tax benefit from so doing, if the profits would not qualify for any charity exemption. This is because the charity would be liable to tax on the trading profits, if it were to carry on the trade itself, whereas if the trading were to be conducted by a trading subsidiary, the profits of the trading subsidiary could be transferred to the charity as a Gift Aid donation, and thus restrict or eliminate any tax liability."*

The extract above from CC35 shows that there are areas where the Commission would accept that the 'trade' could be carried out by the charity if not for the potential tax liability. This is made clear in CC35 which states, *"Charity law permits charities to carry on non-primary purpose trading in order to raise funds, provided that the trading involves no significant risk to the assets of the charity. The 'significant risk' to be avoided here is that the turnover is insufficient to meet the costs of carrying on the trade, and the difference has to be financed out of the assets of the charity."*

All the examples provided in Appendix 2 are cases without significant risk where there is no *"charity law imperative to hive off this type of trading to a trading subsidiary"* but charities do this and incur unnecessary costs simply because of the tax rules.

The Commission has recently issued much guidance on charities working with non charities (including their trading subsidiaries) and it is evident from this and their published casework that many of the problems stem from activities carried out within trading companies without properly thinking through the issues. If HMRC extends the primary purpose tax exemption to all trades the Charity Commission could decide if and how it wanted to provide further guidance and/or impose a statutory duty of care. This should help in making Trustees consider these matters more carefully.

## The proposal

The recommendation for change is to allow charities to undertake all trading within the charity, without the need for a trading company. In effect, extending the exemption that allows charities to carry out primary purpose trades to all trades. A compromise position would be to remove the fixed quantum caps on the small trades' exemption and allow charities to trade as long as the trading income did not exceed 25% of their total income.

## Addressing concerns

There have been a number of concerns expressed as reasons not to support the proposal to change the tax regime. Many of the umbrella groups such as Association of Chief Executives of Voluntary Organisations ACEVO, the Charity Finance Group (CFG, the Charity Tax Group (CTG) and the National Council for Voluntary Organisations (NCVO) have over the years explained how some are unfounded and how others can be managed.

**Risk management**

There is rightly an overarching concern that Trustees should not enter into activities that put their charity's assets or reputation at risk. There may be a belief that because Trustees are not allowed to carry out non primary purpose trades in the charity they will think hard before they set up a subsidiary to do so. I do not subscribe to this view, many charities have set up trading companies and a number have done so without proper thought as to whether they really need them and more importantly how they will use them.

The reality is that sometimes the use of a trading subsidiary can lull the Trustees into believing that by carrying out the activity in a trading company it is okay to take risks that they might otherwise have avoided. Trustees often believe that since the activity is outside the charity it does not need the same level of scrutiny and oversight as it would do if carried out within the charity. They think that taking risk is okay because it is 'ring fenced' within the trading subsidiary.

Crowe runs free helplines for umbrella bodies such as ACEVO, CFG, CTG, and we see many incidents, a number of which do not hit the regulatory radar, where inappropriate activities or poor oversight of trading exists simply because it is carried out "outside" the charity.

The use of trading companies in this way does not mitigate risk to the charity but exacerbates it by allowing an approach that fosters the mistaken belief that 'it's okay to take the risk as it's not in the charity'. The requirement for the application of a proper duty of care as advocated in the Cabinet Office Report (See Appendix 1) would be a better approach to managing risk.

In any case, most of the typical fundraising activities that charities set up subsidiaries for are not risky but the complexity of the tax requirements mean that they have to be channelled through a non charity. (See Appendix 2 for examples).

**Unfair competition**

References to unfair competition are often made citing the fact that charities would not have to pay tax on their trading profits. The argument that charities would gain an unfair advantage against the private sector needs to be considered carefully. This is something of a red herring in this context as having to channel the trade through a subsidiary or carry it out within a charity should not impact as the trading company rarely if ever has a tax burden.

Furthermore, many charities derive most of their income from trading so it could be said that a charity providing residential care is competing with private sector providers as would an arts charity selling theatre tickets. These trades are primary purpose trades and can be carried out within a charity in any case. So allowing a charity to carry out fundraising or letting for example should not increase any perception of unfair competition.

**Trustee skills**

At the time when the Cabinet Office proposal was being discussed there was a concern that the boards of many charities lack Trustees with the commercial experience and acumen to establish and conduct trading operations. It is important to consider this in the context of charity trading. Most of the charity trading that this proposal is trying to address is of the type that would be carried out within a charity if not for the tax rules. For example, merchandising, fundraising events and cafeterias.

Both ACEVO and CFG responded to the concerns about skill sets explaining that the Charity Commission recommends that Trustees *"be selected on the basis of their relevant experience and skills".* The Charity Commission has provided guidance and information on selecting Trustees, skills audits, decision making and conflicts of interest for charity Trustees. There are also reporting requirements in the Charity SORP on how Trustees are recruited, inducted and trained. However, there are no such reporting requirements for non charity trading companies. In many cases the trading subsidiary is simply a ‘shell organisation’ set up to manage the tax exposure and the Trustees or senior managers of the charity are also directors of the subsidiary.

It is difficult to see how the existing tax rules that predicate towards using a trading subsidiary in any way lead to better governance or the application of greater skills.

**Public perception**

There was also a view that if charities were allowed to trade it would confuse members of the public by blurring what is done by a charity and its trading arm.

The reality is that the public do not see the sometimes artificial segregation of these activities. When a customer uses a charity shop they do not know or care that when they buy donated goods the income belongs to the charity, but when they buy new goods it belongs to the trading company that will then Gift Aid the profits to the charity. Similarly, if they use a café run by a charity they do not know that the income may have to be routed through a non charitable trading company. More likely, there would be concern if the public knew that the tax rules mean that the charity has to set up a trading subsidiary to deal with the new good sales and the café proceeds and the funds that could be used by the charity are reduced by costs that only arise because the trade has to be channelled through a subsidiary.

**Loss making trades**

There was a view that having to channel trades through a trading company meant that a loss making trade could be identified. The reality is that, since profitable fundraising activities of the type mentioned in Appendix 2 of this paper are often channelled through the same trading company as other trades, any other loss making trade is masked by the profitable fundraising. The Charity SORP’s requirements to analyse income and expenditure by function would in fact provide the transparency to be able to see the results of the different activity.

## In conclusion

Much of the ground work has already been done. The extensive consultation that the Cabinet Office carried out shows that the change recommended in this paper has wide spread support. A simple amendment to the tax law to extend the primary purpose trading exemption to all trades or to remove the fixed quantum cap for the small trades' exemption will benefit many charities without any real reduction in the tax take.

It is time for a rethink.

# Appendix 1 - Extract from Private Action Public Benefit

**The law on trading**

4.44 Currently, charity law permits charities to undertake trading that is directly connected to charitable purposes. Examples might be a theatre which charges for tickets, or a care charity charging the local authority for providing services under contract. It is also permissible for a charity to undertake a small amount of trading for fundraising.

4.45 However, any charity that wishes to undertake substantial trading for the purpose of generating income, rather than in direct pursuit of its purposes, has to set up a trading company to do so. An example of this type of trading would be a theatre which opens a restaurant that caters for both audiences and the general public. The charity can receive any surpluses on this trading activity tax-free by using Gift Aid to transfer them back.

4.46 In practice, this means that a charity can undertake any trading activity it likes and can be exempt from most taxes, so long as it sets up a separate organisation to do so. The rationale for this is to isolate assets from risk and making financial flows between the charity and the trading activities transparent. The difficulty with the system is that it is administratively complex, expensive for individual charities, and can inhibit them from diversifying their income streams. Deregulating the system would allow charities to continue to trade as they currently do, but remove the need for a separate trading company.

4.47 This will not mean that it is right for every charity to undertake substantial trading; the decision will be for the individual Trustees with professional advice, if necessary. Specific statutory duties of care will apply to Trustees who take the decision to trade. These duties are designed to mirror existing good practice, and most Trustees will be used to taking these points into account already when considering new activities.

## Recommendation

**To amend charity law to allow charities to undertake all trading within the charity, without the need for a trading company. The power to undertake trade would be subject to a specific statutory duty of care *(see Box 4.3).***

4.48 This change would be largely tax neutral, but would remove an unnecessary administrative burden.

*Box 4.3: Proposed Trustee duties in relation to trading*

The following new duties would apply to Trustees of charities involved in trading:

- A duty of care along the lines of that in the Trustee Act 2000.
- A duty to give proper consideration to the need to structure the trade in a way which does not expose the assets of the charity to significant risk
- A duty to take proper (professional) advice in connection with the establishment, exercise and discontinuance of the trade.
- A duty to consider the suitability to the charity of trading as a form of income generation, and to consider the suitability for that purpose of the particular trade or proposed trade.
- A duty to compare the economic benefits of the trade or proposed trade with other forms of income generation open to the charity

# Appendix 2 - Some examples of the difficulties with the present regime

**1. Corporate donations and sponsorship**

Charities often receive funding from corporate supporters. When looking at a transaction of this sort HMRC will examine the transaction and may conclude that the charity may be selling advertising services or providing a marketing benefit to the sponsor. HMRC looks carefully at this and have stated that references to a sponsor which amount to advertisements will cause the payments to be treated as trading income. HMRC will regard a reference to a sponsor as an advertisement if it incorporates any of the following:

- large and prominent displays of the sponsor's logo,
- large and prominent displays the sponsor's corporate colours, or
- a description of the sponsor's products or services.

There is no definitive rulings on what is 'large and prominent' and as a consequence charities either channel all corporate donations through a subsidiary or have to spend time and effort, including taking professional advice, on deciding how to treat such income.

**2. Letting**

It has been emphasised that a charity should as far as possible utilise all its property and where charities are not using their facilities all the time they often hire out space to other organisations or individuals. This may include conference hire, letting of unused accommodation etc.

Where no additional services are provided this is treated as income from property which is exempt from direct tax. However, where a charity provides services other than just the bare letting of rooms then it is likely that a trade is being carried on, which would usually be non-charitable. For example, HMRC have re-emphasised that the use of student residential accommodation and other university and school owned premises by non-students and the associated income generation activities such as the provision of food and drink, external catering, and conferences, also to non-students, may be a non-primary purpose trading activity.

Accordingly, this has to be channelled through a non charitable trading company. HMRC has explained that when allocating between the charity and the trading company where student accommodation is let to tourists out of term, the costs should be split on the basis of the number of days in the year when the premises are allocated to the trade, and actively marketed. So if the holiday lets are available for 4 months of the year the trading company should bear 4/12 of the costs even if the actual letting is only done for one month. This is regardless of the fact that if there was no out of term letting the charity would have to bear the costs for all 12 months.

HMRC's view that the costs should be allocated on this basis between periods when the buildings are in use by students (generally in term time) and when they are available for external (non charitable) letting (out of term) causes problems. If the buildings are available for letting but not in practice fully let out of term, the costs for these periods would fall under the heading of non-charitable trading. This means that there is a high likelihood of the non-charitable trading activity making a loss. This approach seems unreasonable, given that the fixed costs would be incurred in any case and if no non charitable trading took place, all these costs would be regarded as charitable.

CC35 explains *"If a charity incurs losses in non-primary purpose trading which it has carried on, the charity's tax exemptions on other income may be at risk, and the Trustees may be liable for breach of trust."*

As a result of the tax rules charities often find it easier not utilise spare capacity, leave the property empty and absorb all the costs in the charity.

**3. Use of a charity's logo**

Charities often enter into cause related marketing and use their logo for fundraising purposes. The tax treatment of this is complicated.

If the charity is a Trust, or if the logo came into existence before 1 April 2002, the payment is taxable in the charity's hands unless it is structured as an annual payment. To be treated as an annual payment the payment must be:

- applied solely for charitable purposes; and
- made under a legal obligation; and
- recurring (the payments must be capable of recurring each year but the obligation may be contingent); and
- treated as pure income profit in the hands of the charity. (A sum is 'pure income profit' if it comes to the charity without the charity having to do anything or incur any expenses in return).

If the charity is a company and the logo came into existence on or after 1 April 2002, then the logo is treated as an intangible asset, and the tax treatment depends on whether it is regarded as a *"trading intangible asset"* or a *"non-trading intangible asset".*

Receipts from non-trading intangible assets are exempt if applied to charitable purposes. Whether or not the logo is regarded as a trading asset or a non-trading asset will depend on the relationship with the sponsor. If the charity is passively receiving income, the logo is likely to be a non-trading asset, and the income exempt. If the charity is carrying out activities in return for the income, then exploiting the logo is more likely to be a trading activity, and the logo will be a trading asset.

The sorts of activities that the charity might undertake may seem innocuous but can lead to a tax liability:

- Providing support for the company's publicity activities such as photo shoots, by sending staff
- and/or volunteers to participate in them
- Sending mailings to its own supporters encouraging them to buy the products or visit the company's website
- Putting links on its own website

Due to the complex nature of the tax rules the charities default position is often to simply use a non charitable trading company and in cases this has led to seemingly inappropriate endorsement by the charity.

**4. Mixed and ancillary trades**

HMRC explains:

*"Under general case law charities will have only 1 trade. For some charities the trade will be a combination of a charitable trade (primary purpose or carried out by beneficiaries) and partly non-charitable trade (non-primary purpose and not carried out by beneficiaries). For example, the trade might deal in a range of goods or services only some of which are within, or ancillary to, a primary purpose. Or the trade might deal with some customers who cannot properly be regarded as beneficiaries of the charity. Examples of such trading include:*

- *If an art gallery or museum has a shop which sells a range of goods, some of which are related to a primary purpose of the charity (direct reproductions of exhibits with no other function, (therefore excluding for example, mugs and postcards), catalogues, etc), and some of which are not (promotional pens, mugs, tea towels, stamps, all postcards, etc)*
- *the letting of serviced accommodation for students in term-time (primary purpose), and for tourists out of term (non-primary purpose), by a school or college*
- *the sale of food and drink in a theatre restaurant or bar both to members of the audience (beneficiaries of the charity - ancillary) and the general public (non-beneficiaries - not ancillary)*
- *the operation of a café by a 'relief of the disabled' charity where only 50% of the staff are disabled (beneficiaries) and the other 50% are not charitable beneficiaries."*

In these cases the receipts or expenses relating to the overall trade need to be apportioned to the separate trades and a trading subsidiary is used to channel the elements of the trade that are not within the exemptions.

Therefore, if an art gallery charity has a café that can be accessed after entering the art gallery then it is okay for the café income to be treated as part of the charity but if it also has an entrance on the street then a trading company needs to be used with all the attendant complexity of cost allocations, cross charges, separate audits etc.

**5. Affinity Credit Cards**

Typically a card provider will pay an agreed amount to the charity (or its trading subsidiary) on the issue of each new card. Thereafter the card provider pays the charity a percentage of the turnover (value of purchases) on the card. HMRC has explained tax treatment "payments by card providers to a charity, made solely in respect of the use of the charity's name and logo, can be treated as contributions for which the charity is not obliged to do anything in return.

*"To benefit from this treatment there must be 2 separate agreements:"*

*"one agreement, between the charity (or its trading subsidiary) and the card provider should provide for the supply by the charity (or its trading subsidiary) of the necessary marketing and publicity services, access to membership lists and other promotional activity for the card (marketing services) and these supplies are taxable at the standard rate"*

*"a second and separate agreement between the charity and the card provider should provide for contributions to be made by the card provider in respect of the use only of the charity's name or logo, or both, contributions made under this agreement can be treated as outside the scope."*

The way the scheme works is that part (at least 20%) of the initial payment can be treated as taxable consideration and is channelled through the subsidiary. The remaining 80% or less of the initial payment, and all subsequent payments based on turnover can be channelled through the charity.

Similar issues can arise with other cause related marketing initiatives.

All this complexity leads to additional costs.

## Appendix 3 – What the legislation for a general power to trade might look like

The general power to trade where all the profits of the trade are applied for the charities' purposes.

1. Subject to sub-sections (2), (3) and (5), a charity has the power to undertake all types of trade. This power is called 'the general power to trade'.

2. Before exercising the general power to trade [or discontinuing its exercise], except where the trade is exercised in the course of the actual carrying out of a primary purpose of the charity, the charity Trustees must:

    a. give proper consideration to the need to structure the trade in a way which does not expose the assets of the charity to significant risk
    b. take appropriate professional written advice in connection with the establishment, exercise and discontinuance of the trade
    c. consider the suitability to the charity of trading as a form of income generation and to consider the suitability, to that purpose, of the particular trade or proposed trade
    d. compare the economic benefits of the trade or the proposed trade with other forms of income generation open to the charity.

3. The statutory duty of care contained in Section 1 of the Trustee Act 2000 applies to all charity Trustees (regardless of the constitutional form of the charity concerned) when exercising the general power to trade and when carrying out the associated duties in sub section 2.

4. The duty in sub section 2 includes but is not limited to a duty to consider whether the trade ought in the best interests of the charity to be undertaken by a separate non-charitable body.

5. A restriction on the general power to trade, contained in the governing document of a charity, is void if the said restriction was created before these sections come into force but is otherwise valid.

6. Appropriate professional written advice is the advice of a person who is reasonably believed by the Trustees to be qualified to give it by his/her ability in and practical experience of financial and other matters.

## Start the conversation

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## About us

Crowe UK is a national audit, tax, advisory and risk firm with global reach and local expertise. We are an independent member of Crowe Global, the eighth largest accounting network in the world. With exceptional knowledge of the business environment, our professionals share one commitment, to deliver excellence.

Independent surveys have listed us as the lead provider of audit services to charities for 11 consecutive years.