BWMacfarlane LLP
CHARTERED ACCOUNTANTS

Charity

Charity Taxation

If you are involved with running a charity, you should be aware of the special accounting and tax provisions that relate to charities.

A charity must usually be registered with the Charity Commission (or Scottish Charity Regulator in Scotland). To register, a charity must meet certain objectives such as to have only charitable causes that are for the public benefit. Some community sports bodies may also be taxed on the same basis as charities.

In addition, the charity must be formally constituted. The commonest forms are as a trust or a limited company. There are also Charity Incorporated Organisations, which report only to the Charity Commission. Each of these has its own requirements. For example, a limited company must make annual returns to Companies House.

Charities may make a charge for primary purpose trading**,** such as when an art gallery or museum charges for admission. However, a charity may not itself conduct commercial trading, such as selling ordinary goods. In practice, charities establish separate trading companies whose profits are then applied to the charity. These trading companies are not themselves charities.

Accounting

In addition to the accounting standards that apply to all entities, there is a Statement of Recommended Practice (SORP) that applies just for charities. For some charities, such as further education or for registered social landlords, there are more specialised SORPS. There are also statutory regulations on charity accounts.

Charity expenditure must be within the objects of the charity. There must also be a published statement of policy regarding reserves.

The funds of the charity must usually be clearly distinguished between:

- restricted;
- designated; and
- general.

Restricted funds

These may only be used for the purpose for which they were given. For example, if you collect funds to repair a church roof, you may not use the funds to repair the boiler. If you collect funds to send food to Ethiopia, you cannot use the funds to send food to Somalia. So if you make an appeal for a specific purpose, you must be clear what you will do if you collect excess funds or not enough funds.

Designated funds

These are funds that you have set aside for a particular purpose. They are not restricted, so you may use them for another purpose but you may need the consent of your members or governing body to do so.

General funds
These are free of any restriction and may be used for any purpose, including the payment of expenses and overheads.

Charities often build up significant reserves. This is fine, provided funds are still being applied for charitable purposes. There are restrictions on how a charity may invest its funds.

Charities must usually produce annual accounts. Often these must be examined or audited. There is other information that must be published with the accounts.

Taxation
It is not strictly true that charities have tax advantages that commercial businesses do not. For example, most businesses may claim back VAT input tax on purchases whereas charities usually cannot. So £100 worth of stationery for a commercial business can cost a charity £120.

Gift aid and payroll giving
Donations to a charity may be made by Gift Aid. This is a scheme that allows the charity to claim back the donor's income tax at the basic rate. So if a donor earns £100 and pays £20 tax, he or she may donate £80 to the charity which can then claim back the £20 tax. Thus Gift Aid can increase the value of donations by 25 per cent.

These claims must be made by the charity to HMRC. They can now only be made online and we can do this for you.

If the donor is a higher rate taxpayer, he or she will receive a refund of tax at the higher rates. Although this does not benefit the charity directly, it may be used to persuade the donor to donate a further sum equal to this extra tax rebate.

There is now a separate scheme that provides the equivalent to Gift Aid tax refunds for up to £5,000 a year in donations from unknown donors. This can provide the charity with an additional £1,250 in tax income in respect of collections in tins, buckets and charity boxes. This is subject to certain restrictions and conditions that we can explain to you.

There are other tax-advantaged schemes such as **payroll giving** where an employer and employee may agree that part of a person's wages may be passed to a charity.

Income tax
Charities do not pay income tax or corporation tax on donations but can be liable to tax on **trading income,** such as selling goods. If a charity has investments it is liable to pay income tax or corporation tax on the interest or other investment income.

Legacies

Legacies in wills are free from inheritance tax. In addition, if the deceased leaves at least 10 per cent of his or her estate to charity, the rest of the estate is taxed at 36 per cent instead of the usual 40 per cent. So, if someone already plans to leave a significant sum to charity, it is possible that increasing the sum will not only give the charity a bigger legacy but will reduce the tax payable and thus increase the amount inherited by other beneficiaries.

Charities often have draft clauses available for supporters to use in their wills. We can ensure that you have suitable wording available.

Value added tax (VAT)

VAT is payable by charities who do not enjoy any general relief. If a charity has established a trading body that generates sufficient income, it must register for VAT and charge output tax on its supplies. The trading body may claim back input VAT that it has incurred but it cannot claim input tax incurred by the parent charity.

A charity is not allowed to register for VAT as it does not conduct a business activity. In some cases, the distinction between charity and business can be marginal. We can advise you based on case law.

Businesses and individuals that make donations of goods or money to a charity do not pay VAT on such donations. There is a specific category of zero-rating for goods donated to a charity shop.

Some charitable goods are specifically zero-rated. These include aids for disabled people, lifeboats and talking books for the blind. It should be noted, however, that the scope of these categories are closely defined. For example, an automatic curtain closer is not zero-rated as an aid for disabled people as it may also be used by those without disability.

There are also many specific tax provisions that relate to:

- fundraising activities
- sponsorship
- village halls
- charity buildings
- secondment of staff to charities
- charity advertising
- lapel badges
- medical equipment
- adapted vehicles
- welfare services
- fuel for charitable buildings.

BWMacfarlane LLP
CHARTERED ACCOUNTANTS

Charity

FOR GENERAL INFORMATION ONLY
Please note that this guide is not intended to give specific technical advice and it should not be construed as doing so. It is designed to alert clients to some of the issues. It is not intended to give exhaustive coverage of the topic.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.

About Us
Professional, Personal, Affordable.
We are one of the leading, independent chartered accountancy practices in Liverpool. At BWMacfarlane we provide a wide range of accountancy and business support services to organisations and individuals throughout the North of England and beyond. Our experienced and skilled partners and their teams are ready to support you with high quality, individual yet affordable services however complex your personal or business needs.

For more details of how we can help you transform your business, please visit www.bwm.co.uk or call us on 0151 236 1494