

Corporation tax implications for charities (Lecture B1399 – 12.15 minutes)

Primary purpose trading

There is no corporation tax on trading which is part of the charity's primary purposes. For example, an independent school charging tuition fees to students, or a care home charging residents for accommodation and care.

There is also no corporation tax chargeable on profit from activities which help the charity's primary purpose. For example, a college selling books to students, a museum running a café for visitors.

Other trading activity

Trading profit that does not fall within the primary purpose rules above will be taxable unless it falls below the 'small trading' exemption limit.

This would cover situations such as a university renting out student accommodation to the public during the summer holiday, or a charity that has a separate shop selling items to raise funds for the charitable work.

If the activity is carried out mainly by workers who are beneficiaries of the charity, it is exempt if the profits are used for the charity's primary purpose, for example students helping to run a farm at an agricultural college or disabled staff of a café run by a charity that helps people with disabilities.

Profits from lotteries or fundraising events are exempt if all of it is used for the primary purpose and the event qualifies for exemption from VAT.

Small trading tax exemption

Any trading profits which are not exempted by the primary purpose rule are exempt if the revenue from them is below the exemption limit.

If the charity's gross income is less than £32,000 p.a., non-primary purpose trading profits are exempt if the revenue from that activity is no more than £8,000.

If the gross income is above £32,000 but no more than £320,000, non-primary purpose trading profits are exempt if the revenue from that activity is no more than 25% of the gross income.

If the gross income is above £320,000, non-primary purpose trading profits are exempt if the revenue from that activity is no more than £80,000.

What if the non-primary purpose trading is not exempt?

If there is the possibility of corporation tax becoming chargeable on the charity, it would be worth considering setting up a trading subsidiary.

A charity might do this for other reasons irrespective of any exposure to corporation tax, for example to protect the charity from any trading losses, or to separate all the trading activities from the charitable ones.

The company's profits can then be gifted under corporate gift aid to the parent charity.

If this is done within 9 months of the end of the accounting period of the subsidiary, the amount gift-aided is deductible from its profits from which the gift was made and in principle would reduce the taxable profits to zero.

For legal purposes, a gift aid donation is a 'distribution' or dividend and can only be paid from net realised profits available for the purpose.

If the charity gift aids unrealised profits by mistake or gifts more than the profit available for distribution, HMRC will treat this as unlawful and disallow it.

This can lead to an unexpected corporation tax liability for the subsidiary and it is therefore essential that the charity takes advice before making the gift aid payment.

Loans to charitable companies waived

Ordinarily, if a lender waives a loan to a company, the company is taxable on the write back of its liability to its profit and loss account under the loan relationship rules, unless the credit falls within one of the exceptions within s.322 CTA 2009.

Charitable companies, however, are exempt from tax on their loan relationship credits (s486 CTA 2010) so any waiver of a loan by the lender will not trigger a corporation tax liability for the charity.

Rental income

Rental income and other receipts from an estate, interest or right over land are exempt from corporation tax for a charity as long as the estate, interest or right is vested in any person for charitable purposes, as long as the income is applied for charitable purposes.

This exemption also covers dividends received from investments in real estate investment trusts (which are taxable as property income, generally), as long as the income is applied for charitable purposes.

There is no need to claim this exemption.

Contributed by Malcolm Greenbaum