



# DRAGONFLY

TAX, ACCOUNTANCY & FINANCIAL MANAGEMENT

## Charity tax - the basics

### Charitable status

You must be recognised by HMRC as a charity for UK tax purposes in order for your charity to benefit from the tax reliefs available to charities (such as, relief from Income Tax, Corporation Tax, or to claim tax repayments). Charitable status is available to entities other than registered charities if they are established for charitable purposes only. Charities already registered with the Charity Commission for England and Wales will meet the charitable purposes condition automatically.

### Tax status of income / gains

Most of the income and gains received by charities are exempt from Income Tax and Corporation Tax provided that the money is then used for charitable purposes only. The main exemptions are summarised below:

- A charity can claim exemption from tax and claim basic rate tax back from HMRC on income received from individuals through Gift Aid donations (see below). It can also claim exemption from tax on donations received from companies. However, because donations from companies don't have tax deducted from them there is nothing to claim back from HMRC. A charity can give donors modest 'benefits' in order to acknowledge a gift – but there are limits on their value.
- A charity is exempt from UK tax on most types of investment income (and can arrange to receive bank or building society interest gross).
- Any profits that a charity makes from trading activities – selling goods and services to customers – may be taxable. However, there are some exemptions which may apply depending on the nature of the trading activities. These include:
  - 'Primary purpose' trading exemption – the trading activities are directly related to the charitable aims and objectives,
  - the 'small trading' exemption, and
  - exemptions from profits on fundraising events and charity lotteries

If these exemptions are not met a charity can conduct all or part of any of its taxable trading activities through a subsidiary trading company, then transfer some or all of the profits of that company back to the charity as a donation.

- A charity is exempt from tax on income received from renting out land or property that it holds for charitable purposes (but there is no exemption from tax for any profits made from developing land or property).
- A charity is exempt from tax on capital gains providing the proceeds of the disposal are used for charitable purposes only.

### Tax compliance

If a charity receives taxable (non-exempt) income or gains, it will need to complete a tax return, either Self Assessment or Company Tax Return, depending on whether it is set up as a charitable trust or company. Most charities will be treated as companies (liable to pay Corporation Tax) for tax purposes (charities will only be treated as a trust if they were set up by a trust deed or a will.)

Your charity will also need to complete a tax return when it uses income for any non-charitable purposes, known as non-charitable expenditure. This has a wide definition and includes not just expenditure outside the charitable objects but also loans and investments which are not charitable, payments made to overseas bodies where the trustees have not taken reasonable steps to ensure that the money will be spent on its charitable purposes and costs to your charity which are not wholly charitable.

### VAT registration

VAT is a sales tax charged by registered businesses on certain goods and services they provide. You have to add VAT to your customer invoices ('output VAT') and pay this VAT over to HM Revenue & Customs ('HMRC'). However, you are allowed to deduct the VAT you incur in making your VATable sales and only pay over the net amount. Deducting VAT charged by suppliers is referred to as 'recovering VAT' and the VAT incurred on business purchases is referred to as 'input VAT'.

You must register for VAT if the turnover on taxable activities exceeds the VAT registration threshold, currently £83,000. You can however voluntarily register for VAT if your current turnover is below this if you want to reclaim VAT on your supplies.

### VAT reliefs

As a charity you don't pay VAT when you buy some goods and services (Community amateur sports clubs (CASCs) don't qualify for the same VAT reliefs as charities). You don't need to be registered for VAT. You must prove to the person who's selling the goods or services to you that you're eligible for relief by providing evidence of your charitable status, such as your Charity Commission registration number or a letter of recognition from HMRC

Items that can be zero-rated include:

- some advertising services
- certain sound recording equipment supplied to charities caring for the blind
- goods donated to charities for sale or export

- certain construction services
- certain supplies of donated medical and scientific goods
- certain land and buildings
- aids for disabled persons
- goods used in connection with collecting monetary donations.

The purchase of fuel and power at the reduced rate (currently 5%) may also be available to charities.

## Gift Aid

Gift Aid is a system of tax relief for donations to charities and Community Amateur Sports Clubs ('CASC').

For donations from companies, the method of obtaining the tax relief is very simple – the company deducts the donation from its taxable profits before calculating its tax liability. The donation is thus made gross of tax and the charity does not claim back any tax from HMRC. There is no need for the company to provide the charity with a Gift Aid declaration, although other rules do apply, such as the donor benefit rules.

For donations from individuals, charities can reclaim the basic rate income or capital gains tax that the individual has paid on the donation, providing the individual supplies the charity with a *Gift Aid declaration*. This boosts the value of the donation to the charity by 25% (assuming the basic rate of income tax is 20%).

Individual Gift Aid is only available for monetary donations. Donations of other assets and gifts in kind do not qualify for Gift Aid, though the *retail Gift Aid scheme* is an HMRC approved way of obtaining Gift Aid on donated goods. Donations made in foreign currencies must be translated at the rate applicable on the date of the donation and there is no need to net off exchange costs.

An individual donor must provide the charity with a declaration that their donation is made under Gift Aid.

Before a charity can claim Gift Aid it must register with HMRC by completing and submitting an online application CHA1. The time limits for claiming Gift Aid depend on whether the charity is a company or a trust. For claims made after 1 April 2010:

**Charitable company** : Four years after the end of the accounting period to which the claim relates.

**Charitable trust**: Four years after the end of the tax year (5 April) to which the claim relates.

Charities must maintain auditable records of declarations and of receipt of donations on which Gift Aid has been claimed.

## Gift Aid Small Donations Scheme

The Gift Aid small donations scheme ("GASDS") started on 6 April 2013. It allows a charity to claim a Gift Aid-like top up payment on small cash donations (notes, coins etc. but not cheques or cards) of £20 or less from individuals without having to obtain and store Gift Aid declarations. The top up is

calculated in the same way as Gift Aid, so with basic rate tax at 20%, the top up payment is worth 25% of the value of the donation.

To be able to make a GASDS claim in any tax year a charity must meet all of the following conditions:

- It must have been established as a charity for tax purposes for at least two whole consecutive years before the start of the tax year of the claim.
- It must make a successful Gift Aid claim in the tax year.
- It must have made a successful Gift Aid claim in at least two out of the previous four tax years. However, if there is a gap of two consecutive tax years in which no Gift Aid claim was made, the claims before that two-year period are disregarded.
- If the charity incurs a penalty in respect of a Gift Aid or GASDS claim, that blocks any GASDS claim in the tax year of the penalty and the following tax year.

A small donation must meet all the following conditions:

- It must be £20 or less in coins or bank notes of any currency. Cheques, credit or debit card donations do not qualify.
- It must be from an individual and must not be made under Gift Aid or payroll giving. However, the individual does not have to be a UK taxpayer.
- It must be banked in a branch of a bank or building society physically located in the UK.
- There must be no benefits associated with the donations, the only exception being a negligible value lapel sticker, badge of similar. Membership subscriptions do not qualify.

The value of small donations on which a claim can be made in any tax year is capped at the lower of the specified amount and ten times the value of donations in the tax year on which Gift Aid has been successfully claimed. The specified amount is £5,000 (£8,000 from 6 April 2016).

**Please contact me if you would like further help or advice.**

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