Charities Can Trade!
(November 2014)

You have to be a social enterprise to trade don't you?
With all the hype and promotion about social enterprise many people have got the impression that charities cannot trade. This information sheet will show that this is a myth and that charities have a lot of freedom to trade and indeed there is a long history of charities trading (think about all those charities running community centres, village halls, playgroups and nurseries!). Charities can use a social enterprise way of working just as much as a CIC. Generally charities can trade if:

- Your constitution allows it, and
- It's within charity and tax law.

So what is trade?
Trading is the exchange of goods or services for a fee. Someone pays (cash or in kind) in the expectation they will receive something in return, which may not be 'valued' at the same amount, i.e. it is subsidised and/or discounted. Therefore there is a legally binding 'contract' between the buyer and seller, with recourse to the law if anything goes wrong. So for instance funding received by way of a contract counts as trading. This is different from donated income when a donor gives the money without expecting something in return for themselves. Remember though that the donor is giving this on trust to a charity and so the trustees have a duty to use that money in the ways that the donor expected.

Most of the time it is clear that trading is taking place. You advertise that a cup of tea is 50p, someone gives you 50p and so you give them a cup. However for other cases it might be a grey area but ultimately it's HMRC, and lots of case law, who decides (see http://www.hmrc.gov.uk/guidance/selling/badges.htm). 'Evidence' of trade may have some or all of the following:

- repetitive i.e. not one off
- intended to make a profit (even if it actually makes a loss!)
- a mechanism for selling e.g. a catalogue, a price list, a shop or display, etc.
- acquiring items for re-sale rather than to be used by the organisation

An illustration of the subtleties that exist is that if you offer refreshments for free this is not trading, as would be a notice saying 'donations accepted' and even 'suggested donation' BUT a sign saying 'minimum donation' is classed as trading (i.e. you are advertising a product, the tea, in exchange for a minimum 'price').

It's important to identify what activities are trading because trade income is subject to corporation tax and VAT (see below). If you are unsure if an activity would be classed as trading then it's best to seek professional advice.

But I thought that charities did not pay tax?
Charities do not pay corporation tax (a tax on profits and surpluses) on their donated income (gifts, donations, grants) as long as it is all used for charitable purposes. Nor are

they liable for trading that helps the charity fulfil its charitable objects. This is called primary purpose trading. Examples would be a child care charity charging fees from parents, a community centre letting out rooms, an educational charity charging for its training courses. Charities can undertake as much primary purpose trading as they like without incurring tax. However trustees must be satisfied about any risk element involved to protect the charity assets (see below on trading subsidiaries).

Any trading that does not directly help the charity to fulfil its charitable objects is called non-primary purpose trading (i.e. its intention is to raise money for the charity) and is liable to tax. So for instance if a childcare charity whose objects were the education of school aged children outside of school hours were to start running crèches for under 5s, this would be classed as non-primary purpose. However there is an exemption for small scale trading as set out below as long as the profits are used for charitable purposes:

Annual Income	**Maximum contribution from non-primary purpose trading**
Up to £20,000	£5,000
£20,000-£200,000	25%
Over £200,000	£50,000

Much of fundraising that involves ‘selling’ (e.g. charity Christmas cards) is in fact non-primary purpose trading but as long as the income raised fits within the small scale exemption there is no problem. Fundraising events are taxable e.g. selling tickets for a disco, entrance to a fund day, etc. However fund raising events are exempted as long as there are no more than 15 similar events in the same place per year and that weekly gross takings are no more than £1,000 e.g. a weekly fundraising disco held in the same community centre could all be subject to tax. Remember that if a charity’s objects were the appreciation and encouragement of music and dance then discos could be classed as primary purpose, but you would have to prove to HMRC that the primary reason was not to raise money but to carry out the charitable objects.

The sale of donated goods would seem to be trading (i.e. the exchange of a product for a fee) **BUT** very importantly HMRC do not consider it trading so any income is exempt.

Some trade will be mixed because it both involves primary and non-primary, for instance if the childcare charity ran sessions at the same time for under 5s and for over 5s this is called mixed trading and generally you have to keep separate records so you can account for them to HMRC. Also if a trade is carried out by at least 50% of charity beneficiaries then this is exempted. So for the childcare charity the selling of craftwork made by the children would be exempted. Another exemption exists for ancillary trading, where the trade is undertaken in the course of carrying out a primary purpose. So for instance the selling of refreshments to the audience attending a performance put on by a drama charity (however if the refreshments were on sale to the general public not just the audience this would not be exempt!).

Cor blimey, that’s complicated!

Once you get your head around primary and non-primary it’s quite easy and the freedom to raise potentially up to £50,000 a year from any old trading can be a good way to raise money for a charity.

However the other, and potentially much more complicated matter, is VAT! Any activity that is deemed to be ‘trade’ (including contracts) is subject to VAT (donated income is not VATable). Any organisation that receives £81,000 (threshold for 2014-15) in VATable income must register for VAT and then charge VAT (although they can then claim VAT back on purchases made). Much of the income for charities, particularly those delivering education and social welfare, is exempt from VAT and so does not count towards the threshold, including:

- educational training and courses by educational charities
- care or protection of children including nurseries, after school and fostering
- care and treatment that promotes physical and mental welfare of those in need
- conferences (but not letting of stand space)
- research if paid for by educational establishments, government and charities (but not private companies)
- sponsorship if the sponsor gets only a brief acknowledgement
- letting/renting of property
- admission charges to museum, gallery, art exhibition, drama/music/dance events
- sale of donated goods
- membership if it does not provide a service

Remember you only have to worry about VAT if your annual trading income is more than £81,000 and so have to register. If you do have to register you may need professional advice about what is VATable and what you can claim back.

So can our charity trade?

Yes you can as long as

- Your constitution allows it, and
- It's within charity and tax law.

Check your constitution (memorandum and articles if a charitable company) to see if you are allowed to trade. Some constitutions use phrases such as 'not substantial permanent trading activities'. More recent model constitutions say 'taxable permanent trading activity'. Case law interprets any actual phrase as if it included the word 'taxable', i.e. non-primary purpose trading above the small scale exemption. A catch all power such as 'any lawful activity to further the objects' will also cover you. If there are no such clauses then it would be best to change your constitution to include one of them.

Also fully understand your charitable objects so you can clearly define your trading as either primary or non-primary purpose. It might even be worthwhile changing your objects to make them wider so you can include more trading activities as primary purpose (e.g. the childcare charity could change the age range from 'school age' to 'under 18s' and so be able to class crèches as primary purpose).

So if you can fulfil the two requirements above your charity could undertake unlimited trading. However trustees have a legal duty to protect the assets of the charity. Therefore undertaking any risky venture, not just trading, needs to be undertaken with care and the Charity Commission will expect to see good forward planning/robust business plan and any mitigation put into place regarding substantial trading. If non-primary purpose trading makes a loss then the Charity Commission may see this as a breach of trust (and possibly expect trustees to make up the loss if trustees had been irresponsible) but HMRC will definitely see this as non-charitable expenditure and could seek corporation tax on this amount.

Do we need a subsidiary trading arm?
If the trade is primary purpose or if it is non-primary but fits into the small scale exemption then there is no need. However you will have no choice if you want to carry out more than small scale non-primary purpose trading. Setting up a subsidiary will have cost implications as it is a completely separate organisation and so will have its own insurance, book-keeping (possible audit), advice, governance and other costs. Also if not a charity it will lose some of the financial benefits such as rate relief. You might want to set up a subsidiary for other reasons:

- Reduce VAT liability. If a charity's VATable income is more than the threshold for VAT registration then the whole organisation is registered, not just the trading activity. This may be advantageous or not. By being registered you will have to add VAT to all your 'sales' which might make you uncompetitive. VAT means more paper work. So hiving off some of the trading to a subsidiary might save the charity time and money.
- Reduce the risk to the parent charity. Some trading activities may be very financially risky and if it goes horribly wrong then the entire assets of the charity may be at risk. Undertaking the activities through a trading company will help limit that risk, although at a cost (see above). Indeed the Charity Commission may consider this a prudent thing to do for some risky ventures.

If you are considering setting up a subsidiary it is best to seek advice to explore your individual circumstances and the pros and cons.

Is it worth all this hassle?
Yes it is! NCVO estimates that in the sector just under half of all income comes from trading. Remember that trading income is unrestricted and can have less strings. Many small charities such as childcare organisations and community venues have quite happily traded for years so don't be put off. The much more important question is have you something that others want to buy at a price that covers your cost to deliver?

Where can I find out more?
Trustees trading and tax. How charities may lawfully trade, Charity Commission, www.gov.uk/government/publications/trustees-trading-and-tax-how-charities-may-lawfully-trade-cc35/trustees-trading-and-tax-how-charities-may-lawfully-trade

HMRC, www.hmrc.gov.uk/charities/tax/trading/basics.htm

Trading Issues made Simple, Sayer Vincent

Subsidiaries made Simple, Sayer Vincent

VAT made Simple, Sayer Vincent
www.sayervincent.co.uk/publications/made_simple_guides#.T6001FJnpUE

The Good Guide to Trading, NCVO, 2009

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