Implications of Charity Trading

Funding your organisation's work can be tough at the moment, with less grant funding available and more people using the services provided. Therefore, understanding the Income Spectrum and which types of income your organisation could have access to, is key to a sustainable future.

One option on the Income Spectrum is trading. But what exactly is trading? Can charities trade? What are the legal implications for a charity trading? What are the tax implications of a charity trading?

This factsheet has been written to separate the facts from the myths and help your organisation understand how it can trade.

Please note: *This information is for guidance and is not a statement of the law. It is intended to offer assistance and provide information where appropriate and Community Southwark is not liable for action taken, or not taken, as a result of reading this briefing.*

What is trading?

Definitions:
1. Buying and selling securities or commodities on a short-term basis, hoping to make quick profits.
2. More generally, any buying and selling of securities, commodities, goods, or services.

The definitions above describe trading, which is generally thought of as a profit making activity. Charities and other not-for-profit organisations often take part in trading activities, to raise money for projects and for their main aims but there are rules around the types of trading a charity can take part in.

The main difference between charity trading and commercial trading is that charities reinvest any profit made back into the organisation, rather than distributing them to individuals or external shareholders. Profit is therefore often known as 'Surplus' in the charity sector.

The most common reason that charities undertake trading activities is to further their primary purpose/objectives and does not require the implementation of additional governance procedures; however, if you intend to trade solely to generate income in order to reinvest back in to the organisation – i.e. to make a profit – then you will need to be mindful of additional governance and accounting processes.

It is not unusual to trade in the voluntary and community sector, but does your organisation know when it is trading and why?

‘*If you want to sell goods or services, you will need to find out whether your activities are considered trading, and if they are, what type of trading you will be doing. Profits from some types of trading may be liable for tax. Whether you are trading or not can depend on the number and frequency of transactions you make, among other factors. Selling donated goods, for example in a charity shop, is not considered trading so any profits would not be subject to tax*.’ (Charity Commission)

‘Where a charity is trading, the trading profits are, in principle, subject to corporation tax (or income tax in the case of charitable trusts), other than as specifically exempted’ (Charity Commission Guidance). However, there are considerable tax advantages for charities compared to ordinary commercial companies such as VAT and tax exemption. For example, only if your charity’s trading income is above the VAT registration threshold of £82,000, must it register for VAT.

Do Charities Trade?

Yes!

A charity can:

- Charge beneficiaries for goods and services;
- Deliver services under contract with public bodies;
- Raise funds through sales and events;
- Corporate fundraising;
- Lotteries.

BUT there are a number of questions to consider:

- Is this primary purpose trading? Or is it secondary purpose (i.e. specifically to make profit but not related to your objects)
- Do we have power in our governing document to undertake trading?
- What are the tax – both VAT and corporate - implications?

Whether the sale of goods and services by a charity is ‘trading’ depends on a number of factors, including:

- the number and frequency of transactions;
- the nature of the goods or services being sold;
- the intention of the charity in acquiring the goods which are to be sold;
- whether the goods are capable of being used and enjoyed by the charity selling them;
- the nature and mechanics of the sales; and
- the presence or absence of a profit motive.

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’.

There are however some activities that may appear to be trading at first glance but are not regarded as trading and therefore the income generated through these activities would not be considered as ‘trading profits’:

- the sale or letting of goods donated to a charity for the purpose of sale or letting;
- the sale of investments;
- the sale of assets which the charity uses, or has used, for its charitable purposes; and
- the letting of land and buildings where no services are provided to the user.

(Adapted from Charity Commission Guidance)

Primary Purpose Trading

Definition:

- the trade is carried out of a primary purpose of the charity, i.e. is directly related to the aims of the charity; OR
- the work of the trade is mainly carried out by the beneficiaries of the charity.

For example:

- a charity charging for a training session or selling a religious publication;
- sale of goods manufactured by disabled people who are beneficiaries of a charity for the disabled;
- sale of tickets for a show put on by a charitable theatre, or for an art exhibition held in a charitable art gallery.
- an independent school charging students tuition fees for their education
- a care home charging residents for accommodation and care

What you need to know about primary purpose trading:

- the profits of primary purpose trading are exempt from tax
- there is no blanket exemption from VAT
- public benefit implications of fee charging, i.e. do they pass the public benefit test as defined in the Charities Act 2006

Ancillary trading

Definition:

Ancillary trading is trading which is in some way complementary (or ancillary) to a charity's primary purpose. It is therefore legally part of the charity's 'primary purpose trading'

For example:

- a museum cafe, selling goods to visitors of the museum'
- a gallery selling goods to visitors;
- a theatre restaurant selling meals to members of the audience;
- a college selling students text books

What you need to know about ancillary trading:

- Treated as primary purpose trading but the lines can be blurred so make sure you can show how it is directly related to the aims of the organisation. For example a school charging fees – the fees are primary purpose, but selling text books to the students would be ancillary so still considered primary purpose as this supports the main aims.

Non-Primary Purpose Trading or Secondary Purpose

Definition: trading intended to raise funds for the charity, rather than trading which in itself furthers the charity's objects.

For example:

- a theatre restaurant selling meals to members of the public who have not bought tickets to the theatre production;
- a charity buying pre-made Christmas cards then selling them for a profit;
- some fundraising events and corporate sponsorship

What you need to know about non-primary purpose trading:

- Charity law allows the activity if it doesn't involve significant risk to the resources of the charity.
- The profits will probably be taxable with limited exemption for:

- Sale of donated goods = The sale of donated good does not constitute trading for tax or charity law purposes. The sale of donated goods by charity law is zero rated for VAT purposes. The entitlement to rate relief is not affected if the trade is carried out by the charity.
- Small scale trading: the total turnover from all the charity's non-exempt trading activity must not exceed the annual turnover limit. The annual turnover limit for non-primary purpose trading is £5,000 if your charities total annual income is less than £20,000. If the annual income is above £20,000, the limit is either 25% of the charity's total incoming resources up to a maximum of £50,000.
- Certain fundraising events: a range of fundraising activities may involve trading for example lotteries, marketing and corporate sponsorship. In that case, there is a tax and a VAT exemption for one off fundraising events and a tax exemption for lottery income.

Exemptions can only go so far and depending on how your organisation would like to trade, you may need to consider a trading subsidiary.

Trading Subsidiary

Establishing a trading subsidiary is necessary if you intend to undertake non-primary purpose trading which exceeds the small scale trading. This creates a clear structure to manage the trading activity and provides a 'ring-fence' around the trading activity which limits the risk to the main charity if things were to go wrong.

Definition: Any non-charitable trading company owned by a charity or charities to carry on a trade on behalf of the charity (or charities).

For example:

- The Depaul Box Company sells boxes for moving, profits go to Depaul UK, a youth homelessness charity.
- Charity shops selling donated goods and giving the money raised to the charity such as Oxfam, Red Cross, Cancer Research etc.

What you need to know about trading subsidiaries:

- If a charity wants to carry out non-charitable trading beyond the limits above, it will need to set up a trading subsidiary so it does not become liable for income and corporation tax
- Runs separately form the charity but feeds its profits into the charity
- The charity must have the powers in its governing document to set up a trading subsidiary
- Can take any appropriate legal form such as a Company, Community Interest Company or Industrial & Provident Society
- Must be a clear line between the parent charity and the trading subsidiary i.e. the charity trustees should not all be the same as the trading subsidiary directors
- Can donate its profits to its parent charity and claim Gift Aid tax relief on the donation, if it is liable for corporation tax

** new legislation has updated the Charities Act 2006 to fall in line with Company Law which means that trading subsidiaries can longer give the parent company more than 50% of their profits. Previously this was advisable – in iorder to ensure the trading company can cover its costs, try new things and invest in growth; but now it is a legal requirement.

For a full rundown of the updates please see the Russell-Cooke LLP Charity Law Update

Resources

- Charity Commission Guidance: Setting up and running a charity – guidance Charities and trading (updated April 2016)
- Charity Commission Guidance: Trustees, trading and tax - How charities may lawfully trade (2007)
- Charity Commission Guidance: Charity trading: selling goods and services (2013)
- Gov.UK: Charities and trading: Cabinet Office (2014)
- Debbie Jennings: Expert advice - Trading subsidiaries: Civil Society (2013)
- DIY Committee Guide: Charities trading, tax & subsidiaries: Volunteer Now
- Gov.UK: Guidance - Annex iv: trading and business activities - basic principles: HMRC (2013)
- Gov.UK: VAT for Charities: (2014)
- Institute of Fundraising: Guidance about Fundraising - Trading and VAT
- Get Legal: Trading
- The Guardian, Voluntary Sector Network: Q&A: Charities and trading: (2009)
- The Guardian, Voluntary Sector Network: Ask the expert: How do small charities set up trading subsidiaries?: (2012)
- The Guardian, Voluntary Sector Network: How charities can trade successfully: (2013)
- Red Ochre: Charity Trading: Business Link (2009)
- Charity Finance Group: Trading – A Survivor's Guide: Deloitte Not for Profit Unit: 2007
- The Russell-Cooke Voluntary Sector Legal Handbook, Third Edition
- Ruth Hayes and Jacki Reason: 'Voluntary but not Amateur – A guide to the law for the voluntary organisations and community groups': 8th Edition: Directory of Social Change (2012).
- Cecile Gillard: 'Charity Checklists': Institute of Chartered Secretaries and Administrators (ICSA) (2014)

Support

If you would like any support with income generation, charity trading or any other issues facing your organisation, please contact the Development Team at Community Southwark: development@communitysouthwark.org.uk or 020 7358 7020.