



Charity trading and taxation

Charity law allows charities to trade provided that the trading falls into one of the following categories:

- primary purpose trading
- trading ancillary to a primary purpose
- non-primary purpose trading provided it does not involve significant risk to the resources of the charity.

Those responsible for running charities should be aware of the taxation implications of the different categories of trading. Reference to tax here means corporation tax in the case of incorporated charities, or income tax in the case of unincorporated charities.

Primary purpose trading covers trading activities which contribute directly to one or more of the objects of a charity as set out in its governing document. It also includes trading where the work is mainly carried out by beneficiaries of the charity.

The profits from primary purpose trading are exempt from tax provided that the profits are applied solely to the purposes of the charity, which will generally be the case. Applying profits solely to the purposes of the charity does not in itself make a trade a primary purpose one.

Examples of primary purpose trading include the provision of educational services by an educational charity; the running of a theatre by a theatre charity; the sale of Christmas cards by a charity for the disabled if the cards are made by those suffering from the disability supported by the charity.

Ancillary trading is not, on its own, primary purpose trading but is carried out as part of a primary purpose trade. It is treated as part of primary purpose trading for both charity law and tax purposes. An example of ancillary trading is the sale of food and drink in a bar by a theatre charity to members of its audience.

However if the bar is also open to the general public, i.e. non theatre goers, that part of the trade is not ancillary and an appropriate proportion of the trading profits would not be covered by the primary purpose exemption.

Trading is not regarded as ancillary simply because its purpose is to raise funds for the charity.

So far, so good. Where it gets more difficult is **non-primary purpose trading**. Charity law allows charities to carry on a trade which is not primary purpose in order to raise funds, but only if the trading involves no significant risk to the resources of the charity. However there is no general exemption from tax on the profits of non-primary purpose trading and, subject to a small trading exemption (see below), if a non-primary purpose trade makes a profit (after a reasonable apportionment of overheads), tax will be payable on that profit.

You might argue that your non-primary purpose trade makes a loss after apportioning overheads so that removes the tax problem, but there is a catch. This loss will be considered by HM Revenue & Customs to be 'non-charitable expenditure' and under the Finance Act 2006 an equivalent amount of the charity's income will lose its charitable tax exemption and hence become taxable. In some circumstances this taxable income can be offset against the trading loss so there is no net effect, but this is not possible if the trading is not carried out on a commercial basis and there is no reasonable expectation of gain. HMRC deem a loss year after year to be evidence that the trade is not on a commercial basis.



The **small trading exemption** applies to the profits of all trading activities that are not already exempt from tax, provided the total turnover from all such activities does not exceed the annual turnover limit and the profits are used solely for the purposes of the charity. The annual turnover limit is 25% of the charities total gross income from all sources, subject to a minimum of £5,000 and a maximum of £50,000.

The solution adopted by many charities is to carry out non-primary purpose trading activities through a **trading subsidiary**. The subsidiary is a normal commercial company but any profits it makes are paid to the charity under Gift Aid. Use of a trading subsidiary raises several issues, for example if the charity needs to provide permanent funding to the trading subsidiary, or VAT partial exemption, and professional advice is therefore needed.

If you think you may be affected by this and for further information please contact Michael Good on 01865 261100 or mgood@critchleys.co.uk