

No. 86

Issued: July 2002

This information sheet aims to clarify the types and extent of trading that may be conducted by community associations without infringing their charitable status or incurring a tax liability.

Trading and Community Associations

1. Introduction

As managers of a community organisation, the Main Committee must consider its liabilities to pay rates and taxes to one or more public bodies: the Inland Revenue, Customs and Excise and the local authority; and also to the privatised suppliers of fuel, power and water. The rates, taxes and other charges that you may have to pay go under the headings of corporation tax, income tax, capital gains tax, value added tax, the climate change levy, business rates, fuel, power and water and sewerage charges. If you have paid employees you will also have to make payments to the Inland Revenue for their income tax and national insurance.

In addition, if the organisation engages in trading activities, questions may arise not only in relation to rates, tax and utility charge requirements, but also in relation to charity law.

This Information Sheet is one of a series that deal with concerns around trading by community associations and around taxes, rates and utility charges, particularly in relation to the management of community buildings. There is inevitable overlap in coverage, and the different sheets in the series need to be read in conjunction with each other. As far as possible, cross-referencing has been included in each sheet.

The complete series consists of:

- Information Sheet No. 15 Rates
- Information Sheet No. 62 Community Buildings and Taxation
- Information Sheet No. 66 Community Buildings and Utility Charges
- Information Sheet No. 86 Trading and Community Associations

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While every effort has been made to ensure the accuracy of information in these information sheets, it is not possible to cover every circumstance. In cases of doubt, further advice should be obtained since, as ever, ignorance of the law is no excuse for making a mistake.

The following information is particularly related to trading on the part of Community Associations.

Community associations as charities can only engage in trading if they have the power to do so and providing there are no restrictive covenants in their terms of occupation or ownership of their premises. Furthermore, the trustees must be sure that the trading activity is in the interests of the association.

The profits from trades relating to an association's primary purpose are not taxable as long as various requirements are met. The profits of trades undertaken for fund-raising purposes will be taxable above defined limits unless they benefit from various statutory exemptions or concessions allowed by the Inland Revenue and Customs and Excise. Generally speaking, associations that want to engage in regular trading to raise funds above the concessionary levels must set up a separated trading company to do so. In cases of doubt, contact should be made with the local office of Inland Revenue and/or Customs and Excise.

Associations wishing to run a regular bar for fund-raising purposes will almost always have to devolve the running of the bar to a trading organisation. For more on this point see Community Matters Information Sheet No. 37, *Alcohol in Community Premises*.

2. What is Trading?

Normally trading involves the sale of goods or services to customers as part of a commercial transaction. Trading can be a regular, occasional or one-off activity, the profits of which are normally taxable. Whether an activity is or is not trading for the purposes of taxation depends on the facts in

each case, as decided by the Inland Revenue. When deciding whether an activity amounts to a trade it is irrelevant whether or not the profits are intended to be used for charitable purposes.

3. Trading by Community Associations

Trading by charitable community associations can take a number of different forms, but in general there are two categories:

- Primary purpose trading (which includes 'ancillary trading' - see Section 3.2 below)
- Non-charitable trading for fund-raising purposes

A mixed trade is a single trade which contains elements of both categories of trading.

The distinction between different types of trading is important for the purposes of taxation and for compliance with charity law.

3.1 Primary Purpose Trading

Primary purpose trading is conducted in the course of the actual carrying out of a primary purpose of the charity. The primary purpose of a community association will be defined in its governing document.

Community associations with similar objects to those in the Community Matters Model Constitution have a special status in law, which derives from the Recreational Charities Act 1958. The Act specifically mentions community associations, village halls and women's institutes as organisations whose charitable status derives from the provision of -

'facilities for recreation or other leisure-time occupation, if the facilities are provided in the interests of social welfare ...'

But the Act goes further and extends this to the -

‘provision and maintenance of grounds and buildings to be used for purposes of recreation or leisure time occupation, and extends to the provision of facilities for those purposes by the organising of any activity.’

In short this means that primary purpose trading for community associations will include hall lettings to anyone, or any organisation, and the organising of any activity which furthers these aims for leisure or recreation, provided that it is in the interests of social welfare.

No amount of primary purpose trading will affect an association’s charitable status or cause it to incur a tax liability, as long as the profits from the trade are used solely for the charitable purposes of the association.

3.2 Ancillary Trading

Ancillary trading is treated in the same way as primary purpose trading by both the Charity Commission and Inland Revenue. Ancillary trading occurs where the trade carried out is not of itself a primary purpose trade but where it is conducted in the course of the carrying out of a primary purpose activity. Much of any trading conducted by community associations is likely to fall into the category of ancillary trading. The letting of premises for use by other organisations is a case where special conditions apply: for more information on this, see Section 4 below.

An ancillary activity for a community organisation could be cafeteria services to provide refreshments to people using the building for charitable purposes. It would not matter that a profit was made by the café, as long as the café was aimed solely at providing refreshments to people taking part in the charitable activities of the association. A café set up to serve people other than charitable users of the building, meanwhile, would not be conducting an ‘ancillary trade’ but would be conducting a ‘fundraising trade’ for which there are tax implications - see Section 3.4 below.

Before undertaking any ancillary trading, community associations should check that they have the powers in their constitution to do so. If they have, then they can undertake ancillary trading knowing that it will be treated in exactly the same way as primary purpose trading. This means that it will not incur a tax liability or affect an association’s charitable status, providing that the proceeds are used to support the association’s charitable work. If an association does not have the appropriate power to conduct an ancillary trade, but wants to, it will need to amend its constitution in consultation with the Charity Commission.

3.3 Mixed Trading

Mixed trading is where the trade being carried out is partly but not wholly a primary purpose trade. In the case of a mixed trade the Inland Revenue will treat the profits as being exempt from tax as long as the turnover of the non-primary purpose element is less than £50,000 and less than 10% of the turnover of the whole trade. This is known as a *de minimis* allowance. If either one of these requirements is not met the whole of the profits of the trade will be subject to tax.

To take the example of a café again, if the café is partly for the benefit of people using the building for charitable purposes and partly for others engaged in non-charitable activities (e.g. breakfasts for local builders or passers-by dropping in off the street), the café would be conducting a mixed trade. If the total turnover of all trading conducted by the café was £15,000, as long as the turnover of the non-primary purpose element (e.g. sales to builders and passers by) was less than £1,500 (i.e. just less than 10% of the whole turnover), the Inland Revenue would disregard the profits and no tax would be payable.

3.4 Non-charitable Trading for Fundraising Purposes

This is trading which is not a primary purpose trade, nor treated as a primary purpose trade. The profits from this type of

trading are liable to tax but in some cases may still be relieved *via* a series of statutory exemptions and concessions granted by the Inland Revenue and Customs and Excise.

There are three important exemptions or concessions for non-charitable trading and they relate to:

- Major fundraising events and frequent small-scale events (see 3.4.1 below);
- Small scale trading;
- Lawful lotteries

When assessing the extent of allowable non-charitable trading, an association should calculate the extent of any trading which might be relieved from tax under the fundraising events concessions first. The 'small scale trading' exemption can then be applied to the remaining trading which does not benefit from any of the other exemptions or concessions. The 'small scale trading' exemption is like a catch-all to relieve the profits of small amounts of non-charitable trading which are not relieved from tax by any of the major concessions or exemptions.

3.4.1 Fundraising Events

The direct tax concession and VAT exemption for fundraising events is in two parts. The first relates to a limited number of large-scale events as long as they do not distort competition with local traders. The second relates to small-scale events that take place more frequently. In both cases the people attending the event must realise that the event is intended primarily for fund-raising purposes.

1(a) Major Events and the 15-Event Rule

The exemption for large-scale fundraising events is restricted to 15 events in a year at any one location. Location refers to the geographical area within which the fund-raising activity takes place. Similar kinds of event held in different locations will not be aggregated for the purposes of the 15-event rule. However, where an event such as a concert is repeated on successive evenings, each performance is a separate event and

counts toward the maximum number of 15 events allowed by the exemption.

The event must be an incident with an outcome or a result: '*activities of a semi-regular or continuous nature such as the frequent operation of a shop or bar cannot therefore be an event*'. Social events which '*incidentally make a profit*' do not fall within the exemption. Events that form part of a social calendar for members do not qualify for exemption. In the case of VAT the exemption is mandatory for any event that fulfils all the conditions.

If an association wants an event to qualify as one of its large-scale events it is advisable to keep minutes of meetings, costs, examples of publicity and other paperwork to show that the main purpose for holding the event was to raise funds.

The list below, which is not exhaustive, includes some of the qualifying events that may be held for fund-raising purposes under the concession.

- Ball, dinner dance, disco or barn dance;
- Performances: for example concerts, stage productions, and other events which have a paying audience;
- Film showing;
- Fête, fair or festival;
- Horticultural show;
- Exhibition - including art, history, science etc;
- Bazaar, jumble sale, car boot sale;
- Sporting participation (including spectators);
- Sporting performance;
- Games of skill / contests / quiz;
- Endurance participation;
- Fireworks displays;
- Dinner, lunch, barbecue;
- Auction;
- Raffle, lottery;

Car boot sales and events where an association charges an entrance fee to people wishing to sell their own goods at the event will fall within the concession provided the

other necessary conditions are satisfied. Community associations can organise fund-raising events in conjunction with other charities, but only if all the charities (including their trading subsidiaries) have organised, whether individually or with others, less than 15 exempt events of that type, in that location, in their financial year.

The selling of goods does not in itself constitute an 'event' unless it is an organised bazaar or something similar. The sale of goods through retail outlets - i.e. charity shops or similar regular rather than occasional outlets - is not eligible for relief under these provisions, even where all the proceeds are received by a charity. **If the 15-event limit is exceeded, all profits from all the events will be taxable, not just the profits from those events over the 15, and all supplies will attract the normal VAT treatment.**

Events arranged by a professional fundraiser/fundraisers may qualify for exemption if the association or its trading subsidiary is the principal partner and the professional fundraiser merely an agent. If the agent charges or retains any part of the gross receipts, this is consideration for agency services and will be subject to VAT. This applies even if the amount is less than or equal to the cost of arranging the event. Any VAT the association incurs in connection with the event will not be recoverable, any more than if it had made all the arrangements for the event itself.

All the income from the supply of goods and services in connection with an event is exempt from tax, for example:

- all admission charges;
- the sale of commemorative brochures;
- the sale of advertising space in those brochures;
- other items sold by the charity at the event such as T-shirts, auctioned goods etc. Where items are normally supplied zero rated such as children's T-shirts then zero rating rather than exemption can be applied;

- sponsorship payments directly connected with a qualifying event.

The main beneficiaries of the VAT relief on fundraising events will be those groups that organise very large one-off events, where the size of one or more of their events would otherwise require them to register for VAT. This is unlikely to be the case for many community associations. The concession does not mean that the group organising the event can reclaim the VAT that it pays out when buying goods and services that are part of the event.

1(b) Avoiding VAT on admission charges

Community associations that are VAT registered can reduce their liability to VAT in respect of entrance to events that do not qualify for exemption, if they set a basic minimum charge that will be standard-rated, and invite those attending the event to supplement this with a voluntary donation. These extra contributions will be outside the scope of VAT if all the following conditions are met:

- it is clearly stated on all publicity material, including tickets, that anyone paying only the minimum charge will be admitted without further payment;
- the extra payment does not give any particular benefit (for example admission to a better position in the hall or auditorium);
- the extent of further contributions is ultimately left to ticket holders to decide, even if the organiser indicates a desired level of donation;
- for film or theatre performances, concerts, sporting fixtures, etc, the minimum charge is not less than the usual price of the particular seats at a normal commercial event of the same type; **and**
- for dances and similar functions, the minimum total sum upon which the organisers will be liable to account for VAT will not be less than their total costs incurred in arranging the event.

If the publicity material for a fund-raising event suggests that those paying a recommended extra amount are more likely to be admitted than those paying merely the basic ticket price, then the extra amount ceases to be a pure donation and as such it will be subject to VAT at the standard rate.

1(c) Fundraising and Direct Tax

For direct tax purposes the concession applies to all the profits of the event including those from admission charges and all ancillary sources of income such as sale of -

- refreshments
- raffle tickets
- programmes
- advertising space.

Each ancillary source of income must properly form part of the event and must not constitute a separate profit-making activity. The turnover of the ancillary source of income must be sufficiently modest so that it can properly be regarded as incidental to the main event.

If the event meets the criteria for VAT exemption then it will automatically qualify for the purposes of the Inland Revenue's extra statutory concession (ESC 04) for exemption from income and corporation tax.

If an association has a power to engage in the sort of trading for fund-raising which involves significant risk of loss to the charity then, should the trade prove to be unsuccessful, that is likely to be regarded as incompatible with the establishment of the association for charitable purposes. If an association which is a charity exercises that sort of trade *without* having any power to do so, then the trustees may be personally liable for any losses (i.e. they may not be able to look to the charity's assets for an indemnity). If there is such a danger, the charity should consider separating the trading from the charity, whether or not the concession/exemption is available.

2. Small Scale Events

The second exemption/concession for fundraising events is for small-scale events. Supplies at any number of small-scale events - where the gross takings are no more than £1000 per week - are now exempt from VAT and any profits are relieved from direct tax. The £1000 limit relates to the income of the event prior to any costs being deducted. If any of these events breaches the £1000 limit it will become one of the 15 large-scale events outlined above.

Community Associations can, therefore, organise as many small scale fundraising events as they wish, as long as they don't break the £1000 per week threshold, and hold 15 large scale events without incurring a VAT or direct tax liability, subject to their powers, objects, lease restrictions, etc.

3.4.2 Small Scale Trading

There is also now a general exemption on all the profits of small trading and other fund-raising activities carried out by an association that are not covered by other concessions or reliefs. The exemption applies to the profits of all other small scale trading, where -

- (a) the trading turnover in the relevant chargeable period for tax purposes is no greater than -
 - either £5,000; *or*
 - the lesser of either £50,000 or 25 per cent of the charity's total gross incoming resources;
- or -*
- (b) the charity had a reasonable expectation, at the start of that period, that the turnover would not exceed this threshold.

This exemption is in addition to all other exemptions for charity trading profits and applies to the profits of all trading activities, and most other incidental fund-raising activities, that are not otherwise exempt from tax, provided that -

- all the profits of the trade are used solely for the purposes of the association, *and*

- the association's total turnover from all the trading activities does not exceed the annual turnover limit, *or*
- if the trading turnover exceeds the limit at the end of the chargeable period, the association's trustees had, at the beginning of the period, a reasonable expectation that it would not do so.

Other things being equal, this exemption means that associations no longer have to set up a trading subsidiary to carry on trading activities where they fall below the threshold, or where there is the 'reasonable expectation' at the beginning of the financial year that they will not do so. However, should the turnover limits be breached and the reasonable expectation test not satisfied, then all the profits from the trade will be taxed - not just those that exceed the exemption.

3.4.3 *The Reasonable Expectation Test*

The reasonable expectation test has been devised to address the problem of fluctuating income/turnover near the new limits and give certainty to charities at the beginning of the year that all profits will be exempt from tax.

If an association can show that at the start of the year it was reasonable to expect the trading turnover not to exceed the limits, any profits will still be exempt from tax even if the turnover did subsequently do so. This might occur, for example, because the association's income was lower than expected in the year because it did not get a grant that it was expecting, or because trading income was greater than anticipated because of an unforeseen new market for its goods or services.

The type of evidence that an association would have to provide to pass the expectation test if challenged might include -

- Budget projections;
- Minutes of meetings;
- Business plans and cash-flow forecast;
- Previous years' accounts;
- Proof of fall in projected charity income over previous years;

- Reasons for trading turnover topping projections.

The small scale trading exemption applies to trading profits that are not otherwise relieved from tax by a concession or another exemption. Thus, if an association has several different trades, some of which qualify for a concession or other exemption and some of which do not, the turnover of the trades which do qualify for a concession or other exemption will not be aggregated with that of the non-qualifying trades for the purposes of the small scale trading exemption.

The exemption applies even if an association has a constitution (such as Community Matters' or the Charity Commission's model) which excludes 'any substantial trading activity' being undertaken.

4. Profits from Lettings

4.1 Letting out premises

Income from letting out a building is an important source of income for many community associations and other community organisations. The letting may be to other charities, to non-profit-making or profit-making organisations as well as to individuals. It may be for recreational and leisure time activities for the purposes of social welfare or for some other charitable or non-charitable purpose.

Income from lettings is treated as 'investment income' rather than 'trading income' by the Inland Revenue, for which charities have a general tax relief as long as the income is applied for charitable purposes.

Consequently, a community association will incur no Corporation Tax liability for income from lettings regardless of to whom the letting is made.

However, a distinction does need to be made between charitable and non-charitable lettings, for the purposes of complying with charity law. Non-charitable lettings should only be made where there is no competing

demand for the space from organisations wishing to engage in charitable activities. When making non-charitable lettings, community associations should seek to maximise their income from the arrangement as there is a duty on charity trustees to maximise the assets of the association.

Where a community association lets space to one of its own sections this is not income to the association or a charge to the association but a movement of funds within the association. There are therefore no trading or charity law implications.

Where a letting is to a wholly owned trading subsidiary of the association to provide a bar (or an independent social club committed to covenanting all its profits to the association), the income from the letting will be rental income and will not be subject to tax.

4.2 Services supplied as part of a letting

Whether any profit from the provision of services such as catering, printing, equipment hire, etc supplied as part of a letting is treated as taxable income is likely to turn on the nature and extent of the services provided by the association. For example, where an association is letting to an organisation engaged in providing leisure and recreational activities, the additional services might be justified as an ancillary trade and, therefore, free of any tax liability.

However, if the letting is to an organisation engaged in non-charitable pursuits the association may find that the additional services constitute a trading activity, the profits of which may be liable to tax depending on their magnitude. The difficulty in advising precisely on this matter is that the Inland Revenue will consider each activity on the facts in each case. Community Matters would therefore recommend that where community associations wish to provide such services they discuss the matter with their local Inland Revenue office.

In practice most community associations will not pay any tax on the profits from such

trading because of a range of concessions and exemptions, including a concession introduced in the April 2002 budget whereby small businesses, which in this case includes charities, pay no Corporation Tax on the first £10,000 of any profits made.

5. Lotteries

Community associations may run either society or 'small' lotteries (or both) in order to raise funds. Strictly speaking, a lottery is a trading activity; however, the profits from small or society lotteries lawfully promoted by associations or their subsidiary trading companies on behalf of the association are exempt from tax if the lottery profits are applied solely to the purposes of the association.

6. Sale of Donated Goods

The sale of donated goods is generally not regarded as a trade for tax purposes and is zero rated for VAT purposes. This is so even where the donated items are sorted, cleaned and given minor repairs. However, if the goods are subjected to significant refurbishment or to any process that brings them into a different condition from that in which they were donated, the sale proceeds may be regarded as trading income - for example, where donated cloth is made into garments for sale.

7. Donations

Asking the public for donations through street collections, flag days, etc, is not an event for the purpose of the relief for fund-raising events. However, the receipt of donations is not a trading or business activity and will not be subject to any form of taxation.

8. Business Sponsorship

Occasionally community associations may enter into sponsorship arrangements with businesses in order to raise funds. Business sponsors may fund the general work of the

association, though they are more likely to fund a particular project. Sponsorship arrangements often link the name of the association or its project with the business, creating in the minds of the public an affinity between the business and the charity. The tax treatment of payments received by community associations under sponsorship arrangements will depend on the nature of the arrangement. This is a complex area and it is advisable to refer to Inland Revenue publication IR 2001 for more detailed information if your association is considering such a course of action.

If the payments are not in return for goods or services provided by the association, they will normally have the character of charitable donations rather than trading income; but if the association agrees to provide some goods or services in return for the sponsorship payments they may be treated as trading income.

9. Requirement to Separate Trading Activities

Where an association wishes to engage in trading activities for fundraising purposes which fall outside the exemptions / concessionary reliefs it will, in any case, be necessary to set up a separate trading organisation. However, some forms of trading may qualify for the concessionary relief described above while exposing the property of the association to considerable risk. Charity law governs which activities charities may carry out directly and which must be conducted through a trading company.

The Charity Commission and Community Matters strongly advise trustees to take professional advice before doing anything to expand the charity's direct fund-raising activities in any way that exposes the assets of the association to considerable risk if the fund raising activities are unsuccessful. This is so even though the concessionary relief from tax on the profits is available. Large scale events such as celebrity concerts,

sporting events, etc, can be valuable ways of raising funds but it will normally be appropriate for such activities to be conducted by a trading subsidiary rather than the association itself, thereby protecting it from the risk of loss. In order for associations to take full advantage of the tax regime, a wholly owned trading subsidiary that pays over all its profits should be established.

For most community associations, the issue of setting up a trading subsidiary or independent trading organisation like a social club is most likely to arise when it is considering a bar for the centre for the provision of alcohol. Generally speaking, community associations will always have to set up a separated trading organisation to operate a permanent bar on their premises. For more information about this complex area see Community Matters Information Sheet No. 37, *Alcohol in Community Buildings*.

10. Glossary

(For further information on each of the following see Information Sheet No. 62, Community Buildings and Taxation).

Income Tax: the tax on the income of individuals and trusts, covered by the Income & Corporation Taxes Act 1988.

Corporation Tax: the tax on the profits and capital gains of companies, industrial and provident societies and unincorporated associations, covered by the Income & Corporation Taxes Act 1988.

VAT (Value Added Tax): a tax on the supply of goods and services. A supply can be 'business' or 'non-business'. A business supply may be exempt or taxable. A taxable supply is subject to VAT at 'zero rate', 'reduced rate' or 'standard rate'.

11. Further Information

11.1 Further Reading

Charity Commission publication:

CS2 - *Trading by Charities*

Inland Revenue publications:

IR 2001 - *Trading by Charities*

IR 46 - *Clubs, societies and voluntary organisations*

Customs and Excise publication:

VAT notice 701 - *Charities*

Community Matters Information Sheet:

No 37 - *Alcohol in Community Buildings*

12. Useful Addresses

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