BSG Valentine
CHARTERED ACCOUNTANTS

ACCOUNTING FOR CHARITIES & NON-PROFITS

How the third sector is assessed for tax.

Anyone who's involved in operating a charity knows how it differs from running a business, both in terms of motives and objectives.

HMRC treats non-profit organisations and charities very differently to businesses, offering some unique tax breaks in the process.

If a charity is recognised by the tax authority, it will benefit from certain tax reliefs as long as the funds raised are used for charitable purposes.

Charities usually pay tax when they receive income that doesn't qualify for tax relief, or if any income has been spent on non-charitable purposes.

With unique tax breaks come unique challenges, many of which have been exacerbated by the pandemic, especially in the case of smaller charities.

The public's generosity has been directed largely towards the UK's major charities, including the NHS, leaving many others facing financial ruin.

There's a reputational issue, too. More than other sectors, charities depend on public trust, and are expected to be ultra-transparent.

It only takes one example of fraud or financial mismanagement for faith in the concept of supporting the charity to be dented.

Careful accounting for charities and non-profits isn't just nice to have – it's vital. With that in mind, we can help you to:

- ensure finances are managed carefully and systematically
- make sure no more tax is paid than necessary
- maximise income from investments and assets
- ensure compliance.

DEFINING A CHARITY

Tax law contains an official definition of a charity: "a body of persons or trust… using all its income and assets for its stated charitable purpose".

One of the key tests to determine the status of a charity is whether or not it exists to benefit the public as all charities have to satisfy what is known as the public benefit requirement.

In addition, the people running the organisation must be judged "fit and proper", though there is no prescribed set of criteria for exactly what this means.

Because this rule is intended to counter "sham charities and fraudsters", it is kept deliberately vague to give the Charity Commission room to apply judgement in each case.

For example, though, it would typically prevent people who have already been thrown out of one charity from taking up a trustee position elsewhere.

HMRC essentially delegates the validation of charity status to the Charity Commission in England and Wales, the Office of the Scottish Charity Regulator in Scotland or the Charity Commission for Northern Ireland.

Once the appropriate regulator has confirmed that a body meets the requirements to be considered a charity, that body can then register with HMRC, which will issue them with a charity tax reference number.

Even if the regulator doesn't confer charitable status, a separate application can be made to the Revenue for tax-free status, which will be granted in certain cases.

SORP

Larger charities are expected to adhere to the sector-wide statement of recommended practice or Charities SORP.

The mandatory SORP was initially introduced in 1995, building on an earlier non-mandatory version, and has been updated several times since.

Under the terms of the SORP, charities matching certain size and income criteria must prepare an annual report and an accompanying set of accounts, and submit an annual return to the Charity Commission.

Registered charities in England and Wales with a gross income of less than £10,000 in the financial year are asked to complete the annual return only.

GIFT AID

Whether you donated a bag of books to a local charity shop before moving home or sponsored a friend's charity bike ride, you might be familiar with Gift Aid.

Gift Aid enables charities to reclaim an additional 25p for every £1 cash donated by an individual that has suffered at least that amount of income or capital gains tax in the tax year (or on the amount your unwanted goods are sold for).

It was introduced in 1990, initially to support and encourage one-off cash gifts of £600 or more. This threshold was reduced to £250 before being abolished in 2000.

Because of the potential for abuse of the scheme, Gift Aid comes with a lot of responsibility and paperwork.

Most importantly, charities must get Gift Aid donors to make a declaration of eligibility, and keep an auditable record of Gift Aid donations valued above £30.

Although it's up to individuals to make sure they are eligible to make Gift Aid donations before signing any declaration, charities can pay the price if they fail to carry out due diligence. HMRC can insist any repayments made to charities for incorrect Gift Aid donations are repaid by the charity.

Government guidance on Gift Aid is dense and intricate, covering everything from church collections to charity auctions, so consulting an expert, or at least reading the documentation very closely, is a must.

TAX RELIEF ON GIFTS TO CHARITY

It is possible for individuals and companies to claim tax relief on certain types of investment, and land or buildings, that are given or sold at less than market value to a UK charity.

Qualifying investments include shares or securities listed on a recognised stock exchange, or dealt in on certain UK markets (AIM and PLUS are the only two for now); units in an authorised trust; and shares in an open-ended investment company based in the UK.

If you're gifting land or buildings, you need to make sure the charity is willing to accept the gift – you can't just burden them with the upkeep on a dilapidated building and walk away – and get them to supply a certificate confirming the deal.

Over the years, more than a few people have thought they'd found a loophole: what if I give my house away, claim tax relief on the gift, but keep living in the property?

It's easy to see how that might sound tempting but no such loophole exists. To qualify for tax relief, you have to give away the whole of your 'beneficial interest' to qualify, and continuing to live in the house invalidates such a claim.

If you make a gift to charity that qualifies for relief, you should make the deduction when you calculate your income for the tax year in which the donation occurred.

If it's an outright gift, you can deduct the value of the net benefit to the charity; any incidental costs, such as broker's fees associated with the process; and add back on the value of other benefits you receive as a result of the gift, such as a thank-you present from the charity.

Unfortunately, these reliefs have been exploited in complex tax avoidance schemes over the years and so the rules have become dense with corrective clauses.

Contact us for charity accounting advice.