

December 2023.

Charities & Non-profit newsletter

pem.

Contents.

Some thoughts on VAT – savings and challenges	4-5
Charity trading subsidiaries – further considerations	6-8
...and other tax matters	9
Fundraising Regulator levy review now open	10
Letter from the Charity Commission and consultations	11
How to keep your parties and gifts un-taxable this Christmas	12-13
Failure to prevent fraud offence	13
FRC postpones periodic review	14

Some thoughts on VAT – savings and challenges.



Energy saving materials

The installation of energy saving materials in residential accommodation currently qualifies for zero-rating for VAT. This means that the installer can claim back the VAT on the cost of the goods installed and charge no VAT to the customer. In the 2023 Autumn Statement, it was confirmed that this relief is to be extended with effect from February 2024 to new technologies such as water-source heat pumps, and also to installations in buildings used solely for a 'relevant charitable purpose'. Full details will be published shortly.

The application of the zero rate to specified energy saving materials is a previously introduced temporary measure that is due to end on 31 March 2027. After that date, the applicable VAT rate will become 5% once again. Thus, the relief will still have some value with installers able to recover VAT on the cost of goods installed against a reduced VAT rate of 5% charged to customers.

It's good to see that the government will be expanding the list of qualifying materials to include additional technologies such as water-source heat pumps, although we don't yet know the types of products that the government has in mind.

It's also pleasing to see the reintroduction of the relief for the installation of energy saving materials in charitable premises. This was withdrawn in 2013 as being inconsistent with EU law, but now energy saving materials used 'solely' (taken as 95% or more) for a 'relevant charitable purpose' are coming back within the scope of a lower VAT rate.

Building work

More generally, certain other types of building work relating to 'relevant charitable purpose' buildings also qualifies for VAT relief, although the reliefs are not as widespread as one might think they ought to be.

Construction services relating to the construction of a new 'relevant charitable purpose' building qualifies for zero rate, as does building work to construct an annexe to an existing building where the whole or part of the annexe is to be used 'solely' for a 'relevant charitable purpose'. In addition, conversion work involving 'relevant charitable purpose' buildings can also qualify for the reduced rate of 5% in certain circumstances.

Use for a 'relevant charitable purpose' means use by a charity in either or both of the following ways:

- otherwise than in the course of furtherance of a business
- as a village hall or similarly in providing social or recreational facilities for a local community

So there is no universal relief for charitable buildings – the type and use of the building are relevant!

VAT on private school fees?

The provision of education in schools, academies, colleges and universities is not subject to VAT.

Education funded directly from local or central government is not a business activity and outside the scope of VAT. Education funded by making a charge is a business activity and is within the scope of VAT. However, the provision of education by way of business is covered by a VAT exemption.

Establishments which normally provide education in return for fees and are, therefore, in business include:

- independent fee-paying schools
- universities
- institutions teaching English as a foreign language

The trouble with exemption is that any VAT incurred on related costs is not recoverable whereas there is no such restriction for local and centrally funded schools.

The Labour party has let it be known that it would like to restrict the scope of the exemption and independent schools are in the crosshairs.

Should it win the next election, Labour intends to impose 20% VAT on independent school fees. The smart money is on Labour usurping the Conservative party and making the threatened change almost immediately on coming to power. The incumbent Conservative government intends to keep the exemption in place should they win.

A change in VAT liability from exempt to standard rated would mean that private schools would be able to recover VAT that is currently irrecoverable on related costs and that fact should not be overlooked. Because of this, the effective rate of the imposition of VAT on school costs and hence fees is likely to be nearer 15% than 20%.

Payments in advance ahead of any change of government would avoid VAT on future education to the extent covered by the prepayment. Schools are offering prepayment schemes and parents are looking to pay in advance. That is great, but schools need to consider the impact on VAT recovery entitlement.

A VAT registered school might currently recover 10% of any VAT incurred on costs attributable to both exempt education and taxable income from other sources under a turnover based method (with exempt income accounting for 90% and taxable income accounting for 10% of total income) and see that percentage significantly reduced if it receives a large slug of exempt income before the anticipated change. It would need to think about a change in its recovery method.

Schools need to crunch the numbers to see how the likely change will affect them, but this isn't easy with so many factors to take into account and possibilities to bear in mind. How far will the loss of exemption extend (to what extent will education related income, such as catering and accommodation, be affected)? What capital projects has a school carried out recently and have planned for the future? What method does the school currently use to calculate VAT recovery entitlement and does that need to change? If a school were to offer parents the ability to pay in advance, what discounts could be offered? What might a school realistically expect to receive in advance if it were to offer a pre-payment scheme?

If you would like to discuss any of the above VAT issues in more detail, please do not hesitate to get in touch with your PEM VAT contact or Rob Plumbly.

Rob Plumbly
Director, VAT

e. rplumbly@pem.co.uk



Charity trading subsidiaries – further considerations.

A recent PEM article discussed charity trading subsidiaries and the benefits these can offer for charities, namely minimising risk and managing complex investments, as well as having the potential to reduce Income Tax, Corporation Tax and VAT liabilities and to encourage commerciality.

Outside of the use of a subsidiary, please note that whilst it may be common for a charity to undertake a small amount of taxable trading, and benefit from the small trading profits exemption, charities need to ensure they're allowed to do this; some charities' governing documents say that the charity cannot undertake any taxable trading.

This article covers some of the key governance areas to be aware of when considering the use of, or running, a trading subsidiary.

Financing a subsidiary

Trading subsidiaries are often funded by their parent charities, although outside finance may also be obtained. Finance can be provided as share capital and/or loan capital. On some occasions financing is via invoicing i.e. the subsidiary invoices the charity for services and then uses these funds to pay its creditors, but this is not considered here and will not suit all situations.

Loan

Charities are bound by rules regarding where they can invest their money. The aim of an investment by a charity in a non-charitable organisation is to obtain the best level of financial return within the level of risk considered to be acceptable. This return can then be used by the charity to achieve its charitable purposes.

Any loan to a subsidiary therefore needs to be in line with this. The trustees of a charity must consider an investment in its trading subsidiary in the same way as they would consider any other investment.

The trading subsidiary cannot receive special treatment because of its links to the charity.

Before making a loan, the parent charity's trustees must consider:

- whether the charity has the required investment and lending powers (which may require an update to the charity's constitution)
- whether the trading subsidiary will be successful and able to repay the loan (including a review of the business plan and detailed profit and cash flow forecasts)
- the current commercial rates appropriate for a loan to such a company
- whether it is appropriate to register a charge over the trading subsidiary's assets (to ensure first option on any assets should the trading subsidiary become insolvent)
- a formal loan agreement

It is therefore generally preferable to ensure the terms of a loan to a subsidiary are on an arm's length basis, such that the charity's investment is commercial. There are however times when there may be sound commercial reasons for leaving loans outstanding, interest free.

The subsidiary must ensure it keeps up with interest payments, as well as any repayment of capital, in accordance with the agreement. To require a trading company to repay loan capital raises the question of how it could do so except out of retained profits, which would be taxable, so this must be considered when preparing the loan agreements. Some subsidiaries may decide to pay tax on their profits, in order to meet required loan repayments.

Trustees must also decide how the loan will be secured. Ideally loans should be secured against the assets of the subsidiary. This charge can be registered with Companies House to ensure the charity ranks higher in priority on a liquidation thus protecting their assets. This would be especially important where loans are for more than just funding day-to-day trading costs.

Share capital

As an alternative, or in addition, to loan capital, a parent charity can subscribe for share capital in the trading subsidiary. The investment can be as high or low as required, remembering that the subsidiary will likely require more than a nominal amount of capital to operate effectively.

Trustees must, whenever investing a charity's resources, be certain that the investment is within the charity's investment powers and strategy. As trading subsidiaries generally operate with the aim of generating profits to distribute to its parent, an equity investment in a subsidiary is likely to meet these aims. Any decision to invest in a trading subsidiary should be properly documented.

When deciding whether to invest in a trading subsidiary, the overall economic return to the charity should be thoroughly considered, balancing the benefit of Gift Aid distributions against the risk of losing share capital, either in full or in part, on a dissolution.

Charities need to ensure an awareness of the rules regarding a conflict of interest, remembering that the best interests of the charity need to remain the trustees' priority. Ensuring that the directors of the trading subsidiary are not all trustees of the charity is an important means of reducing the potential for a conflict of interest.

Decisions

Regardless of how a charity is funded, it must ensure that the necessary resolutions are passed when the decision is taken to set up a subsidiary.

When making decisions, whether in relation to deciding whether to invest into a trading subsidiary, or any other decision, trustees should ensure they continue to act within their duties. (See Charity Commission Checklist CC27 for guidance on trustee duties).

Should a charity consider any new activities, due care and attention should be taken to ensure that actions are within the charity's guidelines. A key area for consideration is the difference between trading to generate funds versus trading to carry out the charity's objects. (See Charity Commission Checklist CC35 for guidance on new trading activities).

Relationship with subsidiary

Once a decision has been taken to invest in a trading subsidiary, how the relationship between the subsidiary and the charity is arranged needs to be considered. For example, there's often a need for a recharge agreement between the entities. Where recharge agreements aren't prepared with sufficient care, this can lead to unnecessary Corporation Tax charges arising.

Some services and facilities etc. which are provided by a charity to its subsidiary can be charged on cost sharing basis. In many cases, members of a charity's staff may be partly or wholly engaged in the subsidiary's activities. Similarly, the use of joint facilities is common: communication services, computer systems etc. Such services cannot be provided free of charge simply because of the relationship between the two entities. Key examples include:

- a parent charity must not make donations to its sub, either in cash or in kind e.g. through purchasing stock on its behalf
- a parent charity must not settle the debts of a trading subsidiary
- a charity must, if allowing the use of its staff, buildings, or equipment by a trading subsidiary, make fair charges for those uses.

In terms of determining what is a fair and reasonable charge, consider the amount of time or space etc. which is being provided. For example, for a charity with a retail subsidiary, footage or turnover could be used to determine a reasonable charge. Generally, for resource sharing no profit margin would be charged by the charity, otherwise it could be viewed as making a taxable profit from the provision of services.

Where possible, a trading subsidiary should employ its own staff if they are engaged full time on subsidiary business and buy its own assets where they are for its sole use. ▶



Other areas where a formal agreement may be required is where one entity uses the IP of the other. As above, a licensing arrangement would be needed such that this is charged on an arm's length basis.

Examples where this would apply include for fundraising, as well as some IP deals such as where the charity licenses its name and logo.

A further, less well-known area, is where an agreement regarding the use of charity data, especially regarding ICO considerations, may be needed. For example, a charity may wish to licence data to its subsidiary. Where this is the case, the fair processing notice GDPR rules must be considered; in these circumstances, fair processing notices need to refer to both entities – the charity and the subsidiary.

Reviews

Once established, the arrangement between a charity and its subsidiary should then be reviewed annually to ensure the subsidiary remains appropriate, that it continues to be suitably funded and that costs are recharged correctly.

Charitable activity subsidiaries

Some subsidiaries may be carrying out directly charitable activities on behalf of the charity, such that it is a programme related investment or able to be grant funded, so the criteria for investment may differ in those circumstances.

Please get in touch with your PEM tax contact or Judith Pederzolli for more information.

Judith Pederzolli
Director, Business Tax

e. jpederzolli@pem.co.uk

...and other tax matters.

Gift Aid and cryptoassets

Charities should be careful when receiving donations in the form of cryptoassets. HMRC have stated that it does not consider cryptoassets to be currency or money, so any donations of cryptoassets will not be eligible for Gift Aid.

The charity may wish to consider asking the donor to convert the cryptoassets into money and then gift the converted money. Gift Aid can then be claimed by the charity, subject to normal qualifying conditions applying.

The donor will need to bear in mind any personal tax implications of this conversion.

Autumn Statement: Tax updates within the creative sector

To continue the support of the UK's creative industries the government has reformed current tax reliefs available enabling the promotion of new technologies. The current schemes provide tax relief by way of an additional deduction from profits or surrender of a loss for a tax credit. To aid growth and modernise the system, two new programmes of refundable expenditure credits have been introduced: the Audio-Visual Expenditure Credit (AVEC) (replacing Film Tax Relief, High-End TV Tax Relief, Animation Tax Relief (ATR) and Children's TV Tax Relief) as well as a Video Games Expenditure Credit (VGEC) to replace Video Games Tax Relief. These have similar terms of eligibility and similar definitions of qualifying expenditure, although 'animation' will be extended to include animated theatrical films as well as TV programmes. To find out if these reliefs apply, please contact a member of the PEM Business Tax team.

There will be a 34% credit rate for films, high-end TV and video games (with a 5% uplift for animation and children's TV to a credit rate of 39%) via AVEC, and a 34% credit rate for eligible video games projects via VGEC.

The new expenditure credits will be available to claim from 1 January 2024. To allow for the transitional period, new productions must claim under the new expenditure credits from 1 April 2025 and all productions must claim under the expenditure credits from 1 April 2027 when the current tax reliefs will end.

Creative sector online information form

Companies claiming creative tax reliefs will be required to complete and submit an online information form. This will include claims made for the new expenditure credits: the Audio-Visual Expenditure Credit (AVEC) and the Video Games Expenditure Credit (VGEC). For these two schemes, the forms are required from 1 January 2024 (date of claim submission, not relating to the accounting period in question). These online forms also apply for the cultural tax reliefs: Theatre Tax Relief (TTR), Orchestra Tax Relief (OTR) and Museums and Galleries Exhibition Tax Relief (MGETR), effective for submissions from 1 April 2024.

Receipt of feed-in-tariffs

Where a charity receives feed-in tariffs (FIT) for renewable electricity-generating technology e.g. solar panels, the receipt of these is not regarded as being part of a charity's primary purpose trading activity and, therefore, is not exempt from corporation tax. HMRC does not accept that a charity can receive FIT income as an exempt income source but rather that any tariff income will be taxed as miscellaneous income, for which there is no general exemption. There is however the usual small trading exemption where the turnover from all non-primary trading activities does not exceed the following thresholds:

Gross income	Max small trading turnover
Under £32,000	£8,000
£32,001 to £320,000	25% of charity's total annual income
Over £320,000	£80,000

When computing the level of miscellaneous income, no deduction can be taken for any interest costs, effectively meaning that the charity is taxed on the gross tariff income.

It is not always easy to route this activity through a subsidiary company, as the charity will own the buildings to which the solar panels are attached.

Rachel Blunt
Assistant Manager, Business Tax

e. rblunt@pem.co.uk



Fundraising Regulator levy review now open.

The Fundraising Regulator invites charities to share their views on the increases to the yearly levy it asks charities to pay. Responses are required by 9 February 2024.

The original levy was set in 2016 when the Fundraising Regulator was established. Apart from a small change in 2019 impacting smaller charities, this has not been amended. Their report sets out what they have achieved during that period and makes the case for the increase in levy.

The proposed fundraising model will have a scale charge so that while the levy will increase for everyone, the more you as a charity spend on fundraising, the higher that percentage increase will be. The proposals include two new bands and increases. The report states that following CPI would mean a 25% increase for all charities, so this model is more progressive in its structure.

Fundraising spend	Levy increase
£100,000 - £849,999	20%
£850,000 - £999,000	New band £2,500
£1,000,000-£7,499,999	30%
£7,500,000 - £9,999,999	New band £10,000
£10,000,000 +	50%

The administration fee for small charity registration will increase from £50 to £60 to reflect a rise in processing costs since 2016.

Following the consultation, the new rates will be confirmed in April 2024 and come into effect in September 2024.

Responses can be submitted online using the link here.

Nikki Loan
Partner, Charities & Non-profit

e. nloan@pem.co.uk



Letter from the Charity Commission and consultations.

In an open letter from November 2023, the Charity Commission has requested action from UK banks to support the provision of services to charities and provide improved bespoke services that support charity operations.

Specifically, the letter requests:

In our view there are solutions that you as banking providers should take forward:

- *The process for setting up a charity bank account could be made more straightforward and how to support charities could be better explained to banking staff, recognising that it is in all our interests to safeguard donated funds, and to support charities to prioritise meeting the needs of their beneficiaries.*
- *Training materials would ensure bank staff are aware of the different charity structures and how they are governed, so they request correct documentation and prevent avoidable delay driven by misunderstanding within banks.*

For charities who have experienced challenges with banks or with other regulators, there is currently a call for evidence on smarter regulation and the regulatory landscape which gives the opportunity for charities (and others) to make their views known on the regulatory environment and the actions of their regulators, be they HMRC, Charity Commission or other. The purpose of this call for evidence is to understand:

- What works well and what could be improved in how regulators operate to deliver for the sectors they serve
- Any further steps the government can take to reform the existing stock of regulation on the UK statute book.

This call for evidence is a core part of the government's smarter regulation programme of regulatory reform. More detail on the call for evidence is available here and you can respond online. The call for evidence will close on the 7 January 2024.

Nikki Loan
Partner, Charities & Non-profit

e. nloan@pem.co.uk



How to keep your parties and gifts un-taxable this Christmas.

As we approach the festive season, many employers will be thinking about Christmas parties and gifts for their employees.

However, if the party or gift becomes taxable on the employee, the seasonal feeling of goodwill will soon be lost.

Christmas parties

Christmas parties fall under the Annual Social Functions exemption and can be provided free of income tax and National Insurance Contributions (NICs), providing that the following conditions are met:

- The total VAT-inclusive cost of providing the event(s) does not exceed £150 per head (this is applied across all annual events during the year);
- The event is annual; and
- All employees are invited to the event.

The £150 limit was introduced in 2003, and, as it has not been adjusted for inflation since, it might be easier than expected to exceed the limit this year - especially if more than one Annual Social Function is held. Care must be taken when the £150 per head is calculated – it must include ALL costs for the event, including any transport or hotels the employer may provide.

If the £150 limit is exceeded across the year, the event that causes the limit to be exceeded becomes taxable in full, rather than just the excess over £150. Where more than one annual event has occurred in the tax year, employers can determine which event this is.

Where an event is taxable, the benefit is reportable on the respective employees' forms P11D, with income tax paid by the employee at their marginal rate and Class 1A NIC due from the employer.

The alternative is for the employer to agree a PAYE Settlement Agreement with HMRC to pay the income tax and NIC on behalf of employees on a grossed-up basis. While this route will ensure no goodwill is lost with employees, it does represent a further cost to the employer.

Christmas gifts

Where a gift is given to employees by an employer, it may fall under the Trivial Benefit Exemption and can be provided free of income tax and NIC – provided that it meets all the following criteria:

- The total VAT inclusive cost of the gift does not exceed £50 (per head if provided to a group)
- The benefit is not cash or a cash-voucher (a store gift voucher is acceptable)
- The employee is not entitled to the benefit as any part of a contractual obligation or pursuant to a relevant salary sacrifice arrangement
- The benefit is not provided in recognition of services performed by the employee as part of their employment duties.

The Trivial Benefit Exemption above is available all year round, but is perhaps most appropriate during the festive season, when gifts are provided for no reason other than the festive occasion. Although unlikely to be relevant for not-for-profit organisations, it is also worth noting that special rules apply to directors of close companies and their associates and the quantum of Trivial Benefits they can receive.

Volunteers

There is a risk that volunteers might be classed as an employee or worker by HMRC if they receive any payment, reward or benefit in kind in excess of out-of-pocket expenses. If a charity makes a small gift in kind, such as attendance at a Christmas party or a seasonal gift, to a volunteer (who is not an office holder or employee), there should be no income tax or NIC issues, as long as the cost is minor and reasonable.

Ensuring that any such entertaining or gifts fall with the annual social function or trivial benefits exemptions set out above, should assist with this, but due to the risk of HMRC challenge, care should be taken that the volunteers are not treated as employees over the Christmas period in respect of entertaining and gifts. It is important that any small gifts are genuine gifts and they should not be expected nor represent a reward for work or services performed by the volunteer.

Kate Millard
Director, Employment Tax

e. kmillard@pem.co.uk

Failure to prevent fraud offence.

One of the elements of the Economic Crime and Corporate Transparency Bill which received royal assent in October 2023, is the introduction of a new failure to prevent fraud offence.

However, the aim of the offence is to hold organisations to account if they profit from fraud committed by their employees; it does not need to be demonstrated that directors or management knew about the fraud. The only defence is to have reasonable fraud prevention procedures in place. Additional guidance will be issued by the government, prior to this being enforced, clarifying expectations on businesses.

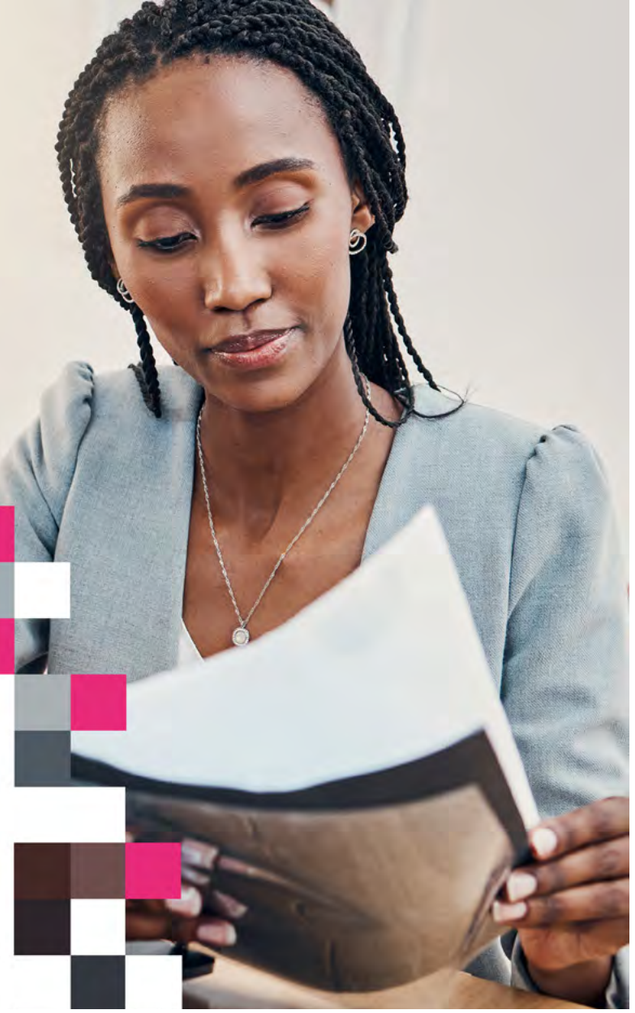
The offence will only apply to large bodies corporate, subsidiaries and partnerships. Large not-for-profit organisations, such as charities are also in scope as well as incorporated public bodies. Large organisations are defined using the standard Companies Act 2006 definition; if resources across a group cumulatively breach the size threshold that group will be in scope. The government factsheet states that is not intended to place a disproportionate burden on SMEs and would support economic growth. The offence is streamlined by limiting it to fraud and false accounting, money laundering responsibilities remain under the existing regulatory regime.

If convicted, organisations can receive an unlimited fine. The act does not introduce an additional liability for individuals for failing to prevent fraud as that was not considered proportionate. Individuals can already be prosecuted for committing, encouraging or assisting fraud.

Although the further guidance is not yet available, and not all charities are in scope, we would recommend that all directors and trustees review their fraud prevention processes.

Nikki Loan
Partner, Charities & Non-profit

e. nloan@pem.co.uk



FRC postpones periodic review.

The Financial Reporting Council (FRC) published a project update in September 2023 which confirmed that the implementation date of the periodic review amendments was to be delayed for a year. The FRC currently expect to issue the final amendments in the first half of 2024, with an effective date not before 1 January 2026.

Key points in the update were that the FRC are:

- Preparing final amendments for issue, taking into account the responses received. The final amendments are likely to differ in a number of respects from the FRED 82 proposals; the basis for conclusions will explain key judgements and decisions
- Continuing to work towards a 'five-step model' for all FRS 102 and FRS 105 preparers
- Working on fine-tuning the FRS 102 amendments in light of feedback received, and monitoring with interest the progress of the IASB's IFRS for SMEs project, which includes similar proposals and seeking further simplifications to ensure proportionality for micro-entities
- Continuing to work towards bringing leases on balance sheet for all FRS 102 preparers, including reconsidering how to ensure that the model is proportionate and understandable for FRS 102 preparers of all sizes. This may include, for example, clarifying the scope of the recognition exemption for leases of low value assets.

The update also refers to the UK government's smarter regulation non-financial report review which is considering whether the current company thresholds remain appropriate. The FRC state that "the publication and/or effective date of our final amendments will take into account the progress of this review." The call for evidence closed in August 2023.

The publication of the revised charity statement of recommended practice (SORP) will need to follow the publication of the amendments. The consultation response from the SORP committee is available on the charity SORP website and highlights alongside the increasing burden for small charities accounting under FRS 102 two particular concerns around leases and non-exchange transactions, where they have called for additional guidance to be included in the final SORP.

Nikki Loan
Partner, Charities & Non-profit

e. nloan@pem.co.uk



Kelly Bretherick
kbretherick@pem.co.uk



Nikki Loan
nloan@pem.co.uk



Michael Hewett
mhewett@pem.co.uk



Kathryn Hebden
khebden@pem.co.uk



Gemma Baratte
gbaratte@pem.co.uk



Judith Pederzolli
jpederzolli@pem.co.uk



Kate Millard
cmillard@pem.co.uk



Robert Plumbly
rplumbly@pem.co.uk

PEM
Salisbury House
Station Road
Cambridge CB1 2LA

t. 01223 728222
e. pem@pem.co.uk

pem.co.uk

KRESTON GLOBAL

For General Information Purposes only
Please note that this brochure is not intended to give specific technical advice and it should not be construed as doing so. It is designed merely to alert clients to some issues. It is not intended to give exhaustive coverage of the topics. Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein. The firm's full name and a full list of partners is available on our website.