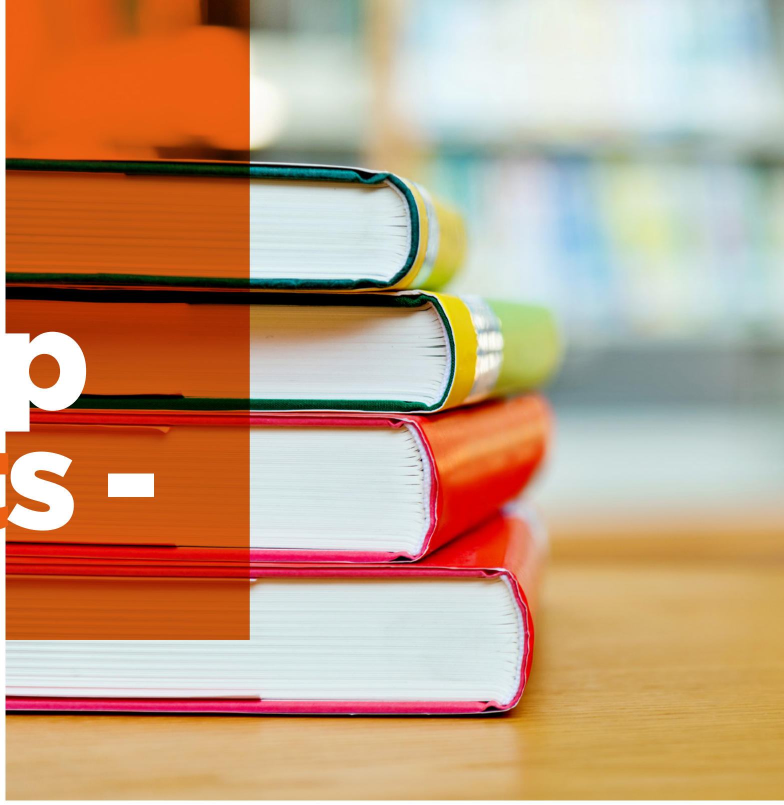
Charity sponsorship agreements - taxable income?



With growing uncertainty over public funding and increasing pressures on third sector services, it is logical for charities to seek income from corporates and other entities to further the charity's objectives. An increasing number of charities are entering into sponsorship arrangements with commercial businesses.

Whilst sponsorships are not a new arrangement, many charities are increasing the level of benefits being provided by the charity to the sponsor in return for the sponsorship payment. Where the charity is doing more than acknowledging and thanking the sponsor, HM Revenue & Customs (HMRC) may view this income as being derived from a non-primary purpose trade, causing the income to be subject to income or corporation tax.

Below is a reminder of the corporation tax rules for trading income received by charities, and we consider how this applies to sponsorship agreements.

Trading by charities

Many charities have trading activities to support their fundraising efforts. Trading is not defined in the tax legislation but takes the general meaning of one party paying another in return for goods and/ or services.

Income derived from trading activities by charitable companies can be exempted from corporation tax (or income tax for charitable trusts) via a specific exemption for primary purpose trades as well as for closely aligned ancillary trades. Examples of such activities are listed below:

Primary purpose trade	Ancillary trade
A school or college providing educational services in return for course fees	The sale of relevant goods/services, for the benefit of students by a school or college (e.g. text books) The provision of a crèche for the children of students by a school or college
An art gallery or museum holding an exhibition in return for admission fees	The sale of food and drink in a cafeteria to visitors of an art gallery or museum
Ticket sales for a theatrical production staged by a theatre	The sale of food and drink in a restaurant or bar to members of a theatre audience
Health-care services provided by a hospital in return for payment	The sale of confectionery, toiletries and flowers to hospital patients and their visitors.
Serviced residential accommodation provided by a residential care home in return for payment	
Sales of certain educational goods by an art gallery or museum	

In the above examples, the charity is carrying out a primary purpose trading activity which falls within the organisation's charitable objectives.

The ancillary trades also qualify as part of the primary purpose trading, because they are incidental to the carrying out of a primary purpose trade.

There is also a separate exemption where the trading is carried out mainly by the beneficiaries of the charity.

Non-primary purpose trading

Other types of trading activities, so called 'non-primary purpose trading' are not afforded the same exemption and so are fully chargeable to tax, even if the income from these activities is applied for charitable purposes.

There is a limited exemption for small levels of non-primary purpose trading, whereby, depending on the charity's gross annual income, the charity can receive turnover from non-primary purpose trading up to a specified level, shown in the below table, without having to pay tax.

If the level of turnover is above this, then the **whole** of the income is charged to tax.

Charity's gross annual income	Maximum permitted small trading turnover
Below £32,000	£8,000
£32,000 to £320,000	25% of the charity's total annual turnover
Above £320,000	£80,000

Sponsorship income

As mentioned above, it is common for charities to enter sponsorship arrangements with businesses to raise funds, either for the general work of the charity or for a particular charitable project.

Sponsorship often links the business with the charity or its project, creating, in the minds of the public, an affinity between the charity and the business. This can be a valuable marketing asset for businesses.

The tax treatment of payments received by charities under sponsorship arrangements will depend on the nature of the arrangement.

Where no goods or services are provided by the charity in return for the payment, the income is treated as a charitable donation, freely given by the sponsor, with no obligations on the charity other than that the money be used for charitable purposes.

The sponsor deriving good publicity or PR benefits from the payments does not automatically mean the income is trading income in the hands of the charity.

However, where a charity does provide either goods or services, such as advertising, in return for the sponsorship payments then this may be treated as trading income.

The most common form of publicity received in return for a sponsorship is the inclusion of the sponsor's name in publications, posters, and other such materials as well as at events organised by the charity.

Provided that such references amount to no more than acknowledgements of the sponsor's contributions they will not cause the payments to be regarded as trading income.

To determine whether sponsorship income is a payment in return for advertising services, and thus trading income, HMRC consider the specific services being provided. Examples of services which are deemed to be advertising, and therefore trading, are:

- large and prominent displays of the sponsor's logo
- large and prominent displays of the sponsor's corporate colours
- a description of the sponsor's products or services

For example, consider a project organised by a charity which is sponsored by a well-known company. Acknowledgement of the support in the form of the company's name and logo inserted in the corner of a project report would not be considered as advertising.

However, if the name and logo was substantially and widely displayed throughout the report, this might constitute advertising in return for the sponsorship payment.

In addition to the above examples, there are other services that a charity might provide in return for sponsorship payments that will be factors in determining whether the payments are trading income.

Examples of such services are:

- use of the charity's mailing list
- use of the charity's logo
- endorsement of the sponsor's products or services
- links to the sponsor's sales website from the charity's own website
- exclusive rights to sell goods or services on the charity's premises
- speaking at events

VAT

Sponsorship is invariably subject to VAT at the standard rate of 20%.

A person who receives sponsorship will normally be making taxable supplies if, in return, there is an obligation to provide the sponsor with a significant benefit or benefits. HMRC view the following as typical significant benefits:-

- naming an event after the sponsor;
- displaying the sponsor's company logo or trading name;
- participating in the sponsor's promotional or advertising activities;
- allowing the sponsor to use the name or logo of the person being sponsored;
- giving free or reduced-price tickets;
- allowing access to special events such as premieres or gala evenings;
- providing entertainment or hospitality facilities; and
- giving the sponsor exclusive or priority booking rights

This list is not exhaustive and there are many other situations where a sponsor may receive tangible benefits. What matters is that the agreement or understanding with the sponsor requires the person being sponsored to do something in return.

Any sponsorship income received from persons belonging outside the UK is outside the scope of VAT.

Where a sponsor's support is freely given and secures nothing in return, the recipient does not make a taxable supply and the sponsorship can be treated as a donation outside the scope of VAT.

A taxable supply is not created where the sponsor only receives an insignificant benefit such as a minor acknowledgement of the source of the support. This can include naming the donor in a list of supporters in a programme or on a notice.

How can PEM help?

PEM are able to review sponsorship arrangements, either those which are already in place, or any new arrangements not yet agreed upon, to ensure that the charity's compliance and payment obligations are being met.

Where previous income has been incorrectly treated as exempt from corporation tax, this may give rise to interest charges and penalties as a result of the error and late-payment of any liability.

Going forward, if it is determined that a specific sponsorship agreement falls to be treated as taxable income, there may be certain steps which can be taken to minimise the tax exposure, such as splitting the income into different categories where appropriate, or setting up a trading subsidiary to receive sponsorship income.

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