Clemence Hoar Cummings

Chartered Accountants and Business Advisors

Charities – the essentials

Everything a trustee should know

Introduction

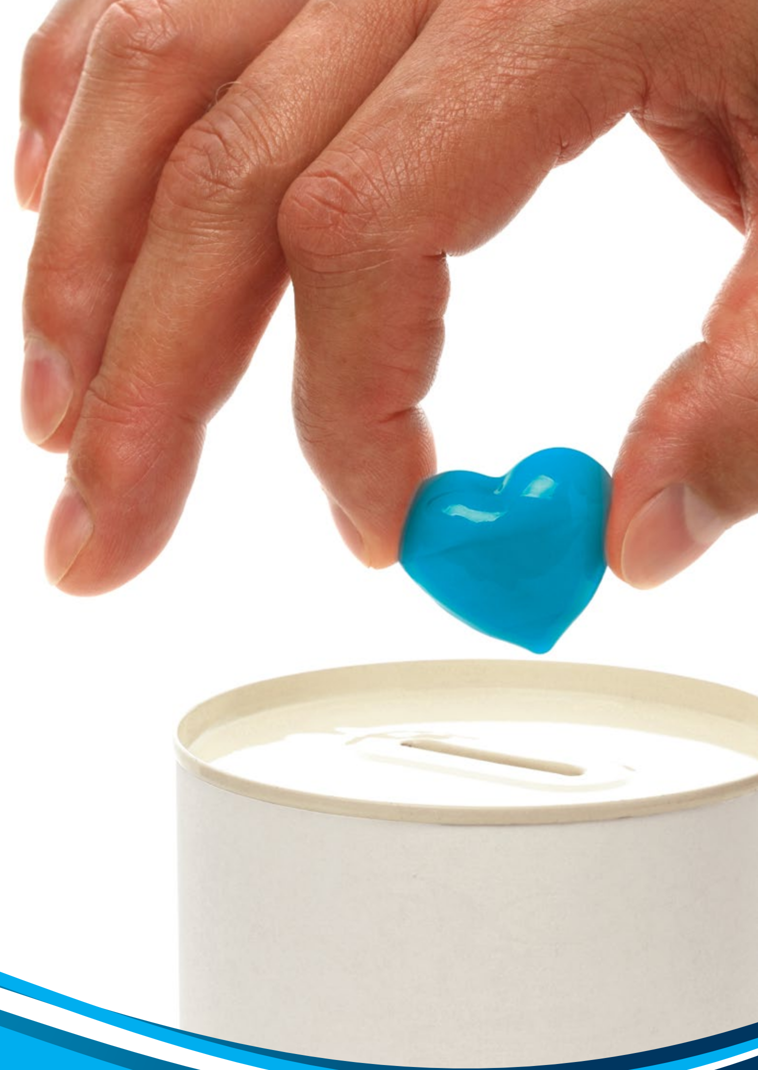
The 'not-for-profit' sector continues to develop a more business-like approach. As a result, expert and independent advice is crucial in this highly-regulated sector.

With our years of experience, we know it is important that our clients can rely on us to keep them updated on the ever-changing regulatory environment affecting registered charities.

In this sector, having a knowledgeable accountant is essential to ensure that you are not in breach of your duties as a trustee.

> The taxes and VAT regimes are under constant review while the new Charities SORP, the set of specialist accounting rules which governs charity accounting, represents a significant change to smaller charities.

In this guide we aim to give a summary of the key changes and the impact they have on the industry.



About Us

We recognise that our charity clients have a choice when it comes to selecting who they want to work with as a business partner, and we firmly believe that we can only be successful if we can improve your performance and genuinely deliver added value to your charity – added value that will provide you with competitive advantage that will translate through to, and be reflected in, everything you do.

High professional standards are maintained at all levels throughout the firm. This is evident from the excellent reviews we frequently receive from Investors in People and other business awards.

> If you choose to work with us, you can rest assured that we will always be on hand to help you with clear and considered advice at every step of the business life cycle, across our wide variety of services.

We recognise that each charity is different and that you may well require a specific tailored approach to suit your individual needs.

Our expert team consists of friendly, well-trained and highly motivated individuals that are dedicated to providing you with accessibility at all times.

You will have regular director contact while working with a consistent team of professionals who are thoroughly familiar with your charity and your requirements.

Among the areas we can advise on are the following:

- **Charity audits** – we have a proven track record of delivering cost-effective, focused and efficient audits to charities and 'not-for-profit' organisations against tight deadlines.
- **Charity accounts** – we will ensure that your accounts meet the requirements of the SORP and accounting standards, and we will advise on how you can present your accounts so that all your stakeholders, including beneficiaries, donors and regulators, are best able to understand the operations of the charity and its financial situation.
- **Regulatory advice** – we can also help trustees to draft trustees' reports to ensure that they meet the Charity Commission's requirements on reserves and risk statements. Many charities are reviewing their reserves policy, and we can use our experience to advise you of best practice.

Furthermore, we are able to provide guidance to trustees on the requirements on the public benefit for charities. The public benefit requirement is a legal requirement. Every organisation set up for one or more charitable aims must be able to demonstrate that its aims are for the public benefit, if it is to be recognised and registered as a charity in England and Wales.

Contact

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Charity Governance

Charities are generally governed by a trustee board that takes overall responsibility for its work. The National Council for Voluntary Organisations (NCVO) defines 'governance' as a term used to describe the trustees' role in:

- The long term direction of the charity, including its objectives or purposes.
- Implementing policies and activities to achieve objectives.
- Complying with legal requirements.
- Accountability to those with an interest or 'stake' in the charity.

Good governance should happen throughout a charity. The trustee board is responsible for good governance but they rely on many different people to be able to govern well: staff, volunteers, advisors, stakeholders, and of course, their accountants.

The Charity Commission advises that an effective charity is always seeking to improve its performance and efficiency, and to learn new and better ways of delivering its purposes. A charity's assessment of its performance, and of the impact and outcomes of its work, will feed into its planning processes and will influence its future direction. We can help you to do that.

> It adds that an effective charity should have the financial and other resources needed to deliver its purposes and mission. This is to ensure that it controls and uses them so as to achieve its potential. We will provide you with exactly that service.

At the same time a charity needs to be seen to be accountable to the public and others in a way that is transparent and understandable. Our experts can help you to do this.

There are a number of other codes and standards of good practice which are reflected in guidance created for many different organisations; e.g. National Housing Federation's publication "Excellence in Governance" and, "Good Governance: a Code for the Voluntary and Community Sector" which is jointly owned by NCVO, ACEVO, SCC, ICSA & WCVA and supported by the Charity Commission.

When governance goes wrong…

Each year the Charity Commission issues its report on investigations and compliance casework.

The 2015-16 Charity Commission report 'Tackling Abuse and Mismanagement' highlighted the most common types of mismanagement as:

- Fraud, financial crime and financial abuse.
- Safeguarding issues.
- Abuse of charities for terrorist-related purposes.

Charity Commission's own website states: "The commission has a statutory objective to ensure trustees comply with their legal obligations in managing charities and to promote public trust and confidence in charities more generally.

"The Commission also has a statutory function to identify and investigate abuse and mismanagement in charities."

One example of this is the Commission warning charities that any partnerships or agreements they draw up with commercial companies must not jeopardise their reputations.

> Some 1,700 organisations that claim to be charities are also operating as money-making businesses, the charity regulator has previously revealed. It is currently clamping down on charities that promote credit cards and savings accounts to their supporters, even if they are not the best deals.

The commission will issue a formal alert to those charities it believes are involved in a commercial arrangement and any organisations refusing to comply could see unfit trustees banned.

A survey of more than 2,300 UK adults by the discount website VoucherCodesPro.co.uk found that 62 per cent of respondents did not give to good causes in 2015.

> When asked why, 51 per cent said it was because they did not trust any charities, 33 per cent said they could not afford to donate money and 24 per cent said they did not know which charity would achieve the greatest impact.

Much of the distrust stems from scandals such as the collapse of Kids Company in 2015. MPs described the trustees of Kids Company as "negligent" as they outlined an "extraordinary catalogue of failures" leading to the charity's collapse.

We are here to make sure your charity is not tarred with the same brush.

As a result of various high-profile cases of poor governance, the Commission has:

- Changed its approach to monitoring charities that have been told to improve their compliance and governance.
- Improved its work to follow up on concerns raised during or shortly after registration.
- Taken steps to recover lost funds, including, where appropriate, taking restitution action.

The Charity Commission is hoping to promote the fact that it expects trustees to comply with specified good practice unless they are able to give sufficient reasons for not doing so, such as by complying via other means.

In instances that trustees are unable to justify why they haven't followed good practice, the Commission may view this as mismanagement or misconduct.

Essentially, good decision-making means:

- Acting in good faith and exclusively in the charity's interests.
- Acting within the trustees' powers.
- Managing conflicts of interest.
- Being properly informed.
- Where relevant, seeking appropriate advice.

Conflicts of Interest

The Charity Commission is the independent regulator of charities in England and Wales, and works to ensure that trustees comply with the following responsibilities:

- Acting in the interests of the charity.
- Operating in a manner consistent with the charity's purpose.
- Acting with due care and diligence.
- Ensuring that the charity complies with relevant legislation.

The Commission's guide on conflicts of interest states that this "affects charities of all types and sizes."

It claims that conflicts of interest can "lead to decisions that are not in the best interests of the charity and which are invalid or open to challenge. Conflicts of interest can also damage a charity's reputation or public trust and confidence in charities generally.

"These harmful effects can be prevented where individual trustees can identify conflicts of interest, and the trustee body can act to prevent them from affecting their decision-making.

"All trustees have a legal duty to act only in the best interests of their charity. We expect them to take appropriate steps in line with this guidance to ensure that they can do this.

"We expect trustees to identify and address effectively any conflicts of interest that affect them or their charity."

The following is a summary of the Commission's guide:

What is a conflict of interest?

The Charity Commission considers a conflict of interest to be any situation in which a trustee's personal interests or loyalties could, or could be seen to, prevent that trustee from making a decision only in the best interests of the charity. An example of this may be, if a trustee (or a family member or business partner):

- Receives payment from the charity for goods or services supplied, or as an employee.
- Makes a loan to the charity.
- Owns a business that enters into a contract with the charity.
- Uses the charity's services.
- Enters into some other financial transaction with the charity.

Conflicts of interest are common in charities. Having a conflict of interest doesn't mean that the trustee has done something wrong. However, action needs to be taken to prevent them from interfering with the trustee's decision-making ability only in the best interests of the charity.

Each charity should:

- Identify conflicts of interest.
- Prevent any conflict of interest from affecting a decision.
- Record any conflict of interest.

Identifying conflicts of interest

Each individual trustee is expected to do their upmost to avoid putting themselves in any position where their duty to act only in the best interests of the charity could conflict with one of their external personal interests.

> Individual trustees must identify and declare any conflict of interest and the trustee body must ensure that any conflict of interest does not prevent them from making a decision only in the best interests of the charity.

A conflict of interest can relate not only to a trustee's personal interests but also to the interests of those connected to them. The list of connected persons is wide and includes child, parent, grandchild, grandparent, brother or sister and spouse or civil partner.

It is good practice to have a written conflicts of interest policy and register of interests. Having such documentation can help individual trustees and the trustee body to identify conflicts of interest quickly and easily.

The Charity Commission has given guidance as to what should be included in such a policy. A register of interests should include relevant business and pecuniary interests and the Board of Trustees should ensure that their register of interests is kept up to date through regular review.

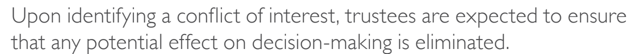
The trustee body should also consider conflicts of interest before appointing a trustee. If prospective trustees are likely to be subject to conflicts of interest, it may be inappropriate to appoint them in the first place.

Conflicts of interest usually arise where either:

- There is a potential financial benefit directly to a trustee or indirectly
- Through a connected person; or
- A trustee's duty to the charity may compete with a duty or loyalty they owe to another organisation or person.

Although declaring conflicts of interest is primarily the responsibility of the affected trustee, the trustee body should have strong systems in place to ensure trustees are aware of their duty to declare them, according to the Charity Commission.

The regulator also expects trustees to have a standard agenda item at the beginning of each trustee meeting, to declare any actual or potential conflict of interest.



Upon identifying a conflict of interest, trustees are expected to ensure that any potential effect on decision-making is eliminated.

This can usually be achieved by either taking appropriate steps to manage the conflict effectively, or by finding an alternative way forward which can by-pass the initial conflict of interest.

There are numerous legal and governing documents available in relation to specific circumstances which set out how differing conflicts of interest should be appropriately handled.

If there are no legal or governing document provisions available, a trustee should be absent from any discussions or votes on resolving the matter if the trustee could stand to benefit.

If they do not stand to benefit, the remaining trustees will need to decide on the best course of action to take, and the trustee concerned may be asked to either withdraw from or participate in the discussion. However, the trustees should always be able to show that they have made their decision in the best interest of the charity regardless.

Record the conflict of interest

Charities are expected to keep a written record of any conflict of interest and associated meeting, in order to keep track of how the matter was dealt with. This would normally include:

- The nature of the conflict.
- Which trustee(s) has/have been affected.
- If any conflicts were declared in advance.
- An outline of the discussion.
- Whether anyone withdrew from the discussion.
- How the trustees took the decision in the best interests of the charity.

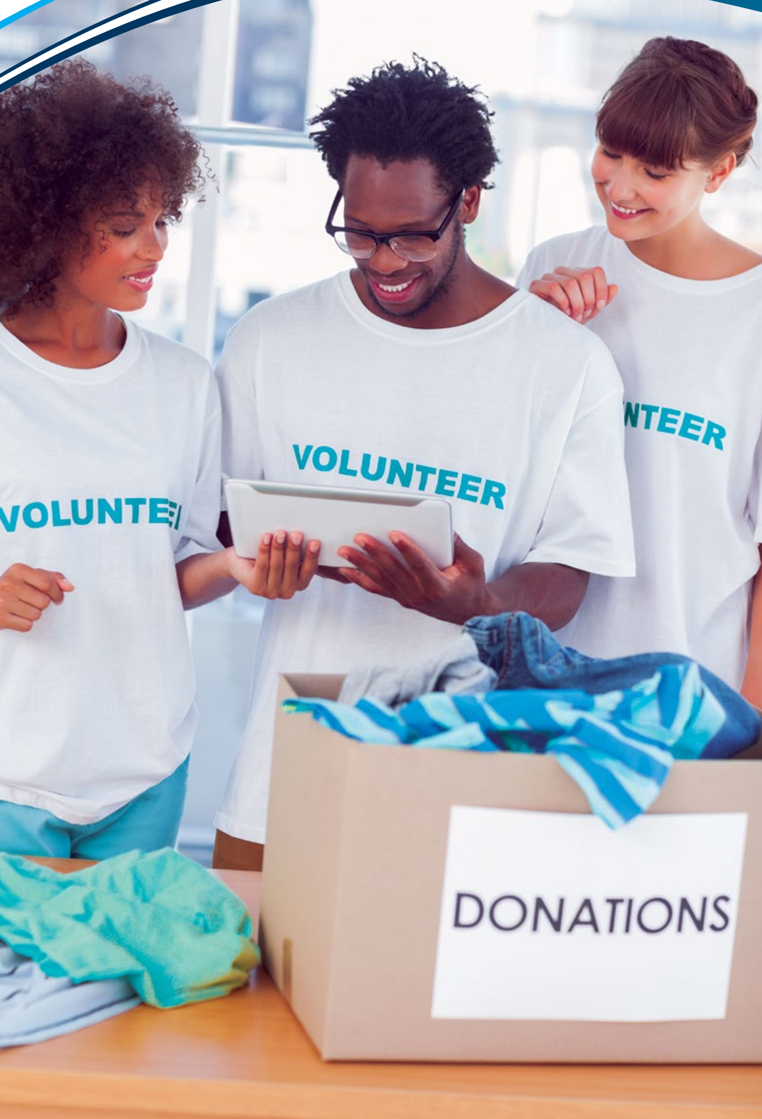
It is recommended, and in most cases it is a requirement, that details of payments and benefits to charity trustees and people connected to them are included within the charity's annual accounts.

If you get it wrong

Problems in charities are often caused by poorly managed conflicts of interest and it is estimated that about 90 per cent of Charity Commission investigations involve a conflict of interest. If you fail to identify and deal with conflicts of interest:

- The trustees' decision may be invalid and could be open to challenge.
- Trustees might have to refund any payment they received from the charity, even if the charity also benefitted from the arrangement.
- Trustees might have to make good any loss the charity suffers.
- The Charity Commission will take regulatory action where it's necessary to protect the charity from further harm or to deal with any misconduct or mismanagement by the trustees.

The Government advises that trustees should be aware of the profound negative impact a poorly-managed conflict of interest can have on the charity's reputation and on public trust and confidence in that charity.



Public Benefit

In order for an organisation to enjoy the benefits associated with charitable status, that organisation must exist for purposes that are for the public benefit or other good causes in the community.

Under the Charities Act 2006, these are:

- Promoting community interests.
- Relief of poverty.
- Advancement of education.
- Advancement of religion.
- Advancing amateur sport.
- Promoting the environment/or animal welfare.
- Assisting the young/aged or disabled.
- Promoting efficiency of police/ambulance/armed services.
- Advancing health/saving lives.
- Advancing the arts, heritage or science.
- Any other purpose which is reasonably deemed within the spirit of the headings above.

Revised guidance was issued by the Charity Commission at the end of 2013. The current Public Benefit Guidance issued by the Charity Commission is split into three as follows: The first part explains the legal requirements that a charity's purposes must be for the public benefit.

The second part explains the meaning of public benefit in the context of running a charity.

The third part explains the requirement for a charity trustee to report on how they have carried out the charity's purposes for the public benefit.

The three part Guidance does not lay down the law but rather explains how the law is interpreted and applied by the Commission. Individual decisions are based on the facts of a given case.

Charity trustees must be aware of the Commission's Public Benefit Guidance and have taken it into account, where it is relevant, and only depart from it where they have good reason.

The Charities Act states that Trustees should know exactly who can properly benefit from the charity, and give proper consideration to the full range of ways in which the charity's purposes can be carried out.

This includes having proper reasons for so doing, not excluding the poor and making sure that the decision is within the range that trustees could make, it says.

There are special considerations for membership charities and for charges for services where charges should generally be affordable to people of modest means and the level of provision for the poor "must be more than minimal or token".

There are also special considerations with regard to physical access to a charity's facilities and whether these can be restricted.

The Requirement to Report

Legal requirement: trustees of registered charities must report each year in their trustees' annual report on how they have carried out their charity's purposes for the public benefit.

This requirement is set out in the Charities (Accounts and Reports) Regulations 2008 (see Annex A Charities (Accounts and Reports) Regulations 2008).

For smaller charities, charity trustees must include a brief summary of the main activities undertaken by the charity to carry out its charitable purposes for the public benefit and a statement as to whether they have had regard to the Commission's Guidance when exercising any powers or duties to which it is relevant.

'Smaller charities' are registered charities with gross income not exceeding £500,000.

For larger charities there are more detailed requirements.

Legal requirement: trustees of larger registered charities must report on public benefit by:

- Providing a review in the trustees' annual report of the significant activities undertaken by the charity to carry out its charitable purposes for the public benefit.
- Providing details of purposes and objectives.
- Providing details of strategies adopted and activities undertaken to achieve those purposes and objectives.
- Providing details of the achievements by reference to the purposes and objectives set.
- Including a statement as to whether they have complied with their duty to have due regard to the commission's public benefit guidance when exercising any powers or duties to which the guidance is relevant.

Why is it important?

Public benefit reporting is an opportunity for the trustees to explain how they have done that each year. Public benefit reporting, when done well, can be an effective tool for trustees. Charity trustees, who say that public benefit reporting has helped their charity, tell the commission that it helps to:

- Stay focused on what their charity is there to achieve (its purposes) when planning activities.
- Demonstrate what their charity does and the value of its work, particularly when applying for grant funding or fundraising.
- Link with impact reporting and demonstrating the charity's transparency and accountability.
- Improve the overall quality of reporting on the charity's work.

Risk Management

Poor risk management can reflect badly on charities and trustees alike, effectively leaving the charity in a position of vulnerability (and potentially facing allegations of negligence) if something goes seriously wrong.

The importance of allocating responsibility

Each trustee's involvement in the risk-management process is essential, and it is important to allocate responsibilities to certain individuals in order to achieve the best results.

However, each unique charity is likely to face different risks to the next in terms of:

- Its finances.
- The complexity, size and nature of the activities undertaken.

As a result of this, trustees need to understand that their risk-management process will need to be tailored to suit their individual circumstances.

This can usually be achieved by allocating risk-management responsibilities to individuals in each department, so that the charity itself can benefit from each person's specialist knowledge of systems and processes they deal with and, in turn, identify and associated weaknesses and risks.

The importance of identifying risks

> Risk identification sometimes boils down to simple common sense. But – from major computer malfunctions to physical disasters such as fire – the fact of the matter is that serious events can and do occur, and therefore it is crucially important to identify what might need to be done to rectify such issues.

Any risks that are identified need to be assessed for their likelihood and impact. Decision must then be made on the processes to control and document them. This should be a collaborative process.

Establish a risk policy

It is important to be aware that all risks can arise out of both action and inaction. Equally, charities will have differing risk profiles according to their size, nature and the complexity of their activities, whilst unique organisations will have different capacities to tolerate and rectify risk. Charities need to understand their overall risk profile, their risk tolerance and the ultimate balance between higher and lower risk activities.

These considerations will form the basis of the trustees decision making in respect of the level of risk they are willing to accept, and from a starting point of which to undertake the initial risk assessment and determine the policy in respect of risk. The trustees will need to communicate the boundaries and limits set by their policy to ensure that there is a clear understanding through the organisation of acceptable and unacceptable risks.

Identify the major risks

The identification of risks is best achieved by involving the trustees and members of management and staff who have a detailed knowledge of the day to day operations of the charity. The wider the input the more comprehensive the assessment is likely to be. Achieving structured input can be difficult and may best be achieved by holding a series of workshops to gather information and ideas. If the charity has subsidiaries or branches, risk identification must extend to them.

> Examples of the general types of risks to which a charity may be exposed are mentioned above, and these can be used as a starting point/checklist. However, it is important that the process of risk identification is specific to the charity and not simply viewed as a generic exercise.

Assess the impact of identified risks

The requirement for trustees to report on risk management is focused on "major" risk. Accordingly it is important that once risks have been identified they are put into perspective in respect of their relative importance by considering the severity of impact and the likelihood of occurrence.

Regular Monitoring and Assessment

The identification and assessment of risk and associated controls must not be relegated to a one-off event. The management of risk is on-going and any process employed must ensure that new risks are identified and addressed as they arise and that established risks are reassessed on a regular basis.

Recording Risk Assessment

In order for risk management to be effective and allow trustees to formally evidence their assessment of risk, it is essential that the assessment is appropriately recorded. Many charities do so by adopting a form of risk register/matrix. There is no prescribed format which charities must adopt and the form and content will vary depending upon the size of a charity.

SORP

The Charity SORP is a single charity accounting framework for all charities regardless of their size. Changes following the introduction of an amended Financial Reporting Standard (FRS 102) in recent years have effectively annulled the previous concept of offering two separate accounting frameworks for charities, which were the (FRSSE) Financial Reporting Standard for Smaller Entities and UK GAAP.

New rules which came into force on 31 March 2015 also affected audit income thresholds for charities, with the limit raised to £1m from the previous limit of £500,000.

Key Differences between the FRSSE SORP and FRS 102 SORP

Following confirmation of the single charity accounting framework, it is useful to highlight that whilst many of the requirements of the FRSSE and FRS 102 SORPs are the same, there are some significant differences.

The more significant differences are considered below, with reference to the useful help sheet produced by the Charity Commission and its Scottish counterpart OSCR.

Trustees Report

The requirements of the FRSSE SORP and FRS 102 SORP are identical. Both SORPs require more information to be provided by larger charities. Larger charities are those with a gross income exceeding £500,000.

SoFA

There are a number of key differences:

- Gains and losses on investment assets count towards net income/ expenditure in the FRS 102 SORP, but are excluded from net income/ expenditure in the FRSSE SORP.
- An additional category of 'other gains and losses' is present in the FRS 102 SORP only.

The FRSSE required the separate disclosure of 'exceptional items' which are exceptional by virtue of size or incidence, whereas the FRS 102 requires the separate disclosure of 'material items'. FRS 102 has an additional category of 'extraordinary items', which fall outside of ordinary activities and are of an abnormal nature and unlikely to recur; these must be disclosed separately in the SoFA after striking the total for net income/expenditure.

Balance Sheet

The format of the balance sheet is common to both SORPs but there are some differences in terminology.

There are also differences of detailed accounting treatments, including:

- The FRSSE did not permit revaluation of intangible fixed assets.
- Under FRS 102 capitalised goodwill is assumed to have a life which does not exceed 10 years (except where the economic life can be reliably measured) whilst under the FRSSE the life of capitalised goodwill is not to be more than 20 years.
- The options of including tangible fixed assets and stock at a fixed amount (where certain criteria are met) were only available under the FRSSE.
- FRS 102 does not permit the exclusion from the category of investment property, properties which are let and occupied by another group undertaking.
- Under FRS 102 unlisted investments should be measured at fair value where practicable, whereas an alternate approach was permitted under the FRSSE.
- Under FRS 102 any contractual obligation to make additional payments to a defined benefit pension scheme must be recognised.

There are also differences in the approach taken to disclosure. FRS 102 SORP requiring greater disclosures in relation to:

- Fixed assets.
- Investments.
- Stock.
- Liabilities.

The disclosure requirements also differ in respect of contingent items. The FRSSE required disclosure of amounts to do with capital expenditure whilst FRS 102 requires an indication of uncertainties and any reimbursement.

Cash Flow Statement

The cash flow statement was optional under the FRSSE.

A cash flow statement is mandatory under the FRS 102 SORP and has three sections as follows:

- Cash flows from operating activities.
- Investing activities.
- Financing activities.

Accounting policies, concepts and principals

There are differences between terminology and definitions, some of the most significant being:

- Whilst both SORPs require trustees to assess going concern, the FRS 102 SORP specifies that their review covers at least 12 months from the date the accounts are approved.
- The FRSSE SORP referred to prudence and accruals which is not specifically mentioned in FRS 102.
- The FRSSE took a different approach to determining accounting policies than FRS 102 with users of the FRSSE 'having regard' to FRS 102 as 'current practice'.
- The FRS 102 requires more disclosures than the FRSSE.

Other differences

Donated goods, facilities and services

Both SORPs take the same approach to the criteria for income recognition with the definition of entitlement, measurement and probable (receipt is more likely than not) essentially the same, except for donated tangible fixed assets. The FRSSE required donated tangible fixed assets to be recognised at their current value whereas FRS 102 requires recognition at their fair value.

Holiday pay accrual

Under the rules of the FRS 102 SORP, a provision needs to be made for paid annual leave, including any paid sick leave and holiday pay. This is contrary to the old requirements of the FRSSE.

Disclosure of trustees and staff remuneration, related party and other transactions.

The FRS 102 SORP requires additional disclosures as follows:

- The aggregate value of unconditional donations made by trustees
- Disclosure of a charity's contributions to a pension fund for the benefit of employees
- The terms and conditions of transactions with, and the details of any guarantee given or received from, related parties
- Additional information on the nature, accounting policy and funding of termination payments
- Disclosure of the total amount of employee benefits received by key management personnel.

Financial Instruments

The FRSEE had a much less detailed approach to financial instruments with much less disclosure required.

Retirement benefits/retirement and post-employment benefits

Where a charity is participating in a multi-employer defined benefit pension scheme and is required to make additional contributions but its share of any actuarial pension liability cannot be identified, the FRSSE SORP permitted a charity to continue with its existing accounting policy whereas the FRS 102 SORP requires the present value of any additional repayments due to past service to be recognised as a liability. The FRS 102 SORP requires more disclosure for defined contribution and defined benefit pension schemes.

What we offer

Clemence Hoar Cummings has a longstanding involvement with charity clients, providing a wide range of added value services. We have, over many years, developed a reputation in the non-profit sector by making a commitment to being totally involved, and for also aiming to give something back.

Among the services we can advise on are the following:

- **Charity audits** – we have a proven track record of delivering cost-effective, focused and efficient audits to charities and 'not-for-profit' organisations against tight deadlines.
- **Charity accounts** – we will ensure that your accounts meet the requirements of the SORP and accounting standards, and we will advise on how you can present your accounts so that all your stakeholders, including beneficiaries, donors and regulators, are best able to understand the operations of the charity and its financial situation.
- **Regulatory advice** – we can also help trustees to draft trustees' reports to ensure that they meet the Charity Commission's requirements on reserves and risk statements. Many charities are reviewing their reserves policy, and we can use our experience to advise you of best practice.

Accounting records

All charities must comply with the following requirements in respect of the preparation and maintenance of accounting records:

- Prepare and maintain accounting records. These records which will include cash books, invoices, receipts, bank statements, wage details etc must be retained for at least six years (as set out in the Charities Act).
- Where Gift Aid payments are received, records must be maintained for six years including the details of substantial donors, in accordance with HMRC requirements.

Requirement to prepare and file accounts

All charities are required to prepare annual accounts in some form and are obliged to make them available to the public, upon request, together with, if required, a trustees' annual report. The availability to the public of the accounts and the trustees' annual report is needed to underpin the principle of public accountability and transparency of charities.

Also as a matter of public record, certain information has to be filed with the Charity Commission. The amount of information depends entirely on the level of income of the Charity, apart from Charitable Incorporated Organisations (CIOs) which are required to file an annual return, trustees' annual report and accounts regardless of the level of their income.

Charity Tax

Do charities have to pay tax?

There are numerous generous tax reliefs available for charities, but tax itself cannot be ignored.

Simply put, trustees must recognise that charities are effectively treated in exactly the same way as everyone else for tax purposes, unless the precise terms of a specific exemption or relief can be satisfied.

This effectively means that any charity which carries on a trade is subject to tax, unless that individual charity's trade fulfils one of several alternative conditions.

> Any charity which receives a taxable income must file a tax return to HMRC in exactly the same way as any other taxpayer. The charity also runs the risk of incurring the same penalties as a regular taxpayer would if it fails to meet its obligations.

Meanwhile, any charity that has employees will have the same PAYE obligations as any other regular employer, while a charity carrying on a business or receiving rental income may also be liable to have to account for VAT on its overall turnover.

Exemptions

Charities will not be required to pay any tax on the majority of their income and gains, assuming that these are used for charitable purposes. Any income and gains used in this way is referred to as 'charitable expenditure'.

This includes tax:

- On donations.
- On profits from trading.
- On rental or investment income, eg bank interest.
- On profits when you sell or 'dispose of' an asset, like property or shares.
- When you buy property.

However, it is worth noting that, in order to receive tax relief, the charity must be recognised by HM Revenue and Customs (HMRC).

Charities pay tax on

- Dividends from UK companies.
- Profits from developing land or property.
- Purchases – but there are special VAT rules for charities.
- Charities pay business rates on non-domestic buildings, but they get an 80% discount.

Charities will also need to pay tax on any money that is not used for charitable purposes – known as 'non-charitable expenditure'.

Community amateur sports clubs (CASCs) get different tax reliefs.

Community amateur sports clubs may be able to claim relief on money that they use to promote participation in and provide facilities for their CASC-eligible sporting activities.

What CASCs don't pay tax on

If the money received is used for qualifying purposes, tax will not need to be paid on:

- Bank interest.
- Gift Aid donations, including donations made by a trading company that's owned by your CASC.
- Capital gains (profits from selling or disposing of an asset).
- Trading profits if turnover is less than £50,000 a year.
- Income of up to £30,000 a year from renting out property.

If the money comes from members with full voting rights, the CASC also won't pay tax on:

- Income from membership fees.
- Profits from selling food and drink relating to the club's sporting activities, e.g. a members bar.
- Gift Aid cannot be claimed on membership fees.

What CASCs do pay tax on

CASCs must pay tax on money that isn't used for qualifying purposes.

They must also pay:

- VAT – although fundraising and sporting activities may be VAT-exempt.
- Tax on income of more than £30,000 a year from renting out property.
- Business rates, but relief of up to 80% can be applied for.
- Tax on trading profits if the turnover is more than £50,000 a year.
- CASCs will have to pay tax on the full amount, after deducting any allowable expenses, if their trading or rental income is more than the relief limits.

Paying tax

If a CASC is expected to pay tax, then it must complete a tax return. Furthermore, in any event that HMRC requests a tax return, one must be completed even if there is no tax to pay.

Reclaim tax

If a CASC receives income with tax deducted, e.g. donations that are liable for Gift Aid, this can later be claimed back.

If tax has already been taken from the CASCs interest, the organisation can claim it back for:

- The current tax year by asking their bank.
- Previous tax years by claiming it from HMRC.

Gift Aid

How does Gift Aid work?

The Gift Aid scheme is characterised by complex and confusing rules – but both companies and individuals are entitled to make payments through the ever-popular Gift Aid scheme.

Simply put, Gift Aid receipts from individuals (but unfortunately not those from companies) are treated as if they have previously had basic rate tax deducted from them. This amount is then effectively repayable to the charity.

> For example, with basic rate tax at 20 % a Gift Aid receipt from an individual of £100 will be treated as a gift of £125 – from which tax of £25 has been deducted, therefore generating a tax repayment of £25 for the charity.

Most charities will be familiar with the basic Gift Aid procedures for cash donations and we shall not cover those here. But there are some complexities worth noting.

Gifts of money

In most cases, Gift Aid relief can only be claimed only on gifts of money, which will include gifts paid by cash, cheque, credit/debit card and all other forms of money transfer.

The gift can be in either sterling or in foreign currency. However, it is worth noting that, in order to make a Gift Aid payment, the person paying must themselves be liable to pay UK Income Tax or Capital Gains Tax of at least the amount which is treated as deducted from the initial payment. In some instances, there are special rules regarding gifts given in shares, securities and land.

How to claim Gift Aid

> The donor must provide a Gift Aid Declaration, examples of which are available on the HMRC website. This is confirmation that they have paid, or will have paid, sufficient income or capital gains tax to cover the amount of Gift Aid the charity will reclaim from HMRC.

The declaration need not be written, and may be made by telephone or over the internet, providing the donor's name and address is obtained and detailed auditable records are maintained.

The charity then submits their Gift Aid claims online to HMRC by way of a summary spreadsheet attached to the claim form. The original declarations are not required to be submitted, but must be retained by the charity in case they need to be checked by HMRC.

Dividend tax changes hit those who use Gift Aid

A tax hike hit those who give to charity, following new rules for dividends which took effect on 6 April 2016.

Although it is individual donors, not the charity, who pay the penalty, it is incumbent on charities to make sure their donors are aware of the change, if nothing else to preserve donor goodwill.

Since 6 April 2016, individuals with predominantly dividend income who make Gift Aid donations could be unintentionally penalised through the scrapping of the dividend tax credit.

Gift Aid is an income tax relief designed to benefit charities and Community Amateur Sports Clubs (CASC). If you're a UK taxpayer, Gift Aid increases the value of your charity donations by 25 per cent because the charity can reclaim the basic rate of tax on your gift at no extra cost to you.

Gift Aid relief is available to those who pay enough tax to cover the basic rate on a grossed up donation (e.g. £20 UK tax for a cash donation of £80).

Prior to 6 April 2016, tax credits attached to dividends could be used to discharge an individual donor's requirement to account for basic rate tax deducted from Gift Aid payments. Dividends no longer carry a tax credit.

> The new dividend regime initially introduced a £5,000 Dividend Tax Allowance, meaning that a dividend income up to this limit was tax free. For the tax year 2016/17, individuals also had a personal allowance worth £11,000. However, for 2017/18 the Dividend Tax Allowance has been reduced to £2,000.

So a person can earn up to £16,500 in 2017/18 and pay no tax at all. Any Gift Aid donations made by such a person will therefore land them with a tax bill.

Close Companies

Charities have been partially exempted from rules that require them to pay a charge when trustees extract funds from "close companies".

Section 455 of the Corporation Tax Act 2010 creates a temporary tax charge designed to dissuade participators and their associates from extracting funds from close companies other than as remuneration or dividends.

Close companies are a type of organisation that is typically controlled by a small number of directors.

The Act says that an amount equal to 32.5 % of the loan or advance amount must be paid in tax when funds are extracted from close companies.

Changes made in the Finance Bill 2016 to section 455 exempts loans or advances made by close companies to charity trustees for charitable purposes.

The exemption applies where the loan or advance to the trustee is applied wholly to the purposes of the charitable trust.

Section 455 will continue to apply to charities where loans or advances are made in any other relevant circumstances. HMRC has said: "The reforms to section 455 apply to loans and advances made on or after 25 November 2015."

Digital filing system for charity accounts

Charities can now file their accounts digitally with the Charity Commission and Companies House after a successful consultation.

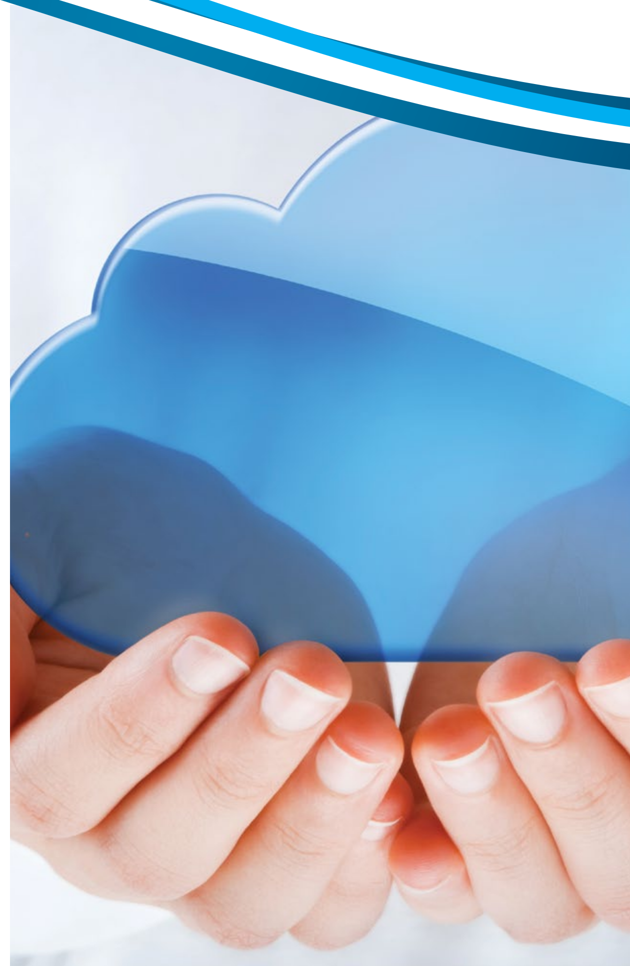
> A new system of classification allowing charities to file accounts digitally has been developed by the Charity Commission, which is the independent regulator of charities in the UK, and the Financial Reporting Council (FRC), the regulator in charge of corporate governance.

Although more than 70 per cent of companies now file digital accounts with Companies House, the lack of an appropriate taxonomy has prevented charities from following suit.

The latest news follows a consultation in October 2015 on proposed changes that will define the computer-readable tags that identify pieces of financial data in accounts.

The Charity Commission said that future benefits of digital submission include it being quicker and easier than doing so on paper, and it would also make accounts more accessible. In turn, this would help to improve accountability and transparency in the sector.

But some consultation respondents raised issues about the burden digital filing could represent for the charity sector. Among the concerns was that the new taxonomy "generally involves more time, and therefore resource, than the equivalent process for commercial companies".



Charity tax – VAT

The UK's VAT framework is complex and confusing – particularly in relation to charities. But staying on top of charity VAT law, planning for transactions and events are all key to avoiding costly mistakes and making the best of what is currently on offer. For example, in 2015, concessions were made for hospices and search and rescue charities – which were subsequently welcomed as a boost for the not-for-profit sector.

When weighing up their position in terms of VAT, all charities must consider the following:

- Whether their activities are by way of business or non-business.
- Whether those activities fall within any of the VAT exemptions or zero rates or are taxable at the standard or reduced rates.

Charities which make business supplies are subject to the same VAT registration requirements as other businesses and must register if their taxable business supplies exceed the VAT registration threshold. They can also choose to register voluntarily if they make taxable supplies under the registration threshold.

Despite this, most charities that make only non-business supplies are unable to register for VAT. However, in April 2015, special schemes were made available to certain Government funded bodies such as academies, museums, hospices and search and rescue charities. These schemes allow them to recover VAT paid on expenditure in relation to any non-business supplies.

Charities making a combination of business and non-business supplies are subject to the same registration requirements and must apportion their expenditure to claim only that part relating to business supplies.

To highlight the complexity of VAT we have included a recent case and the decision made:

The Trustees of the Institute for Orthodox Christian Studies, Cambridge v HMRC.

A recent First-tier Tribunal case has served up an expensive VAT reminder about charitable use buildings in normal circumstances, where the seller of a property has 'opted to tax' (ie he has elected to make the transaction a taxable supply rather than an exempt supply), VAT is chargeable on the value of the sale.

With the VAT rate at 20 per cent, the VAT chargeable on such a transaction can be very significant. Indeed, for charities that are not 'in business', the imposition of VAT on the purchase of a property can be and often is a significant financial burden.

UK VAT law recognises this and, for many years now, charities have been entitled to claim relief from VAT in cases where a building is intended for use solely for a "relevant charitable purpose" (RCP).

The appellant in this case was a religious charity seeking to purchase a new £800,000 base in central Cambridge. The seller was VAT registered and had opted to tax. The appellant was not VAT registered, but believed it could disapply the seller's option to tax because of its proposed RCP use of the property.

The two key difficulties for the charity in this case were that:

- To meet overheads pending conversion works at the property, existing tenants were allowed to remain in the building for a short period, paying rent to the charity (rather than have the building empty); and
- It charged fees for courses and other facilities (albeit these were subsidised by both Government grants and donations to the charity).

HMRC stated that the charity, through its lettings of excess space in the property and through the charging of fees to students was actively engaged in a business activity. According to HMRC, the option to tax should not have been disapplied and VAT should have been charged by the seller.

After reviewing the necessary evidence, the Tribunal subsequently sided with HMRC. It ruled that the letting of rooms and the fees it received in connection with religious studies could and should not be regarded as anything other than consideration for the teaching and other supplies it makes.

As a result of this, the Tribunal dismissed the appeal and confirmed that £133,000 VAT was due on the sale of the property.

> For a small charity, the application of VAT to the purchase price of the property will be a big blow. It is important for charities to fully understand whether their activities are business or non-business activities for VAT purposes.

Our experienced team of tax advisers would be pleased to meet with you to discuss how they could be of assistance to you.

Charitable Incorporated Organisations (CIOs)

What is a Charitable Incorporated Organisation (CIO)?

Charitable Incorporated Organisations (CIOs) are a new type of body corporate, brought into being by the Charities Act 2006. Detailed regulations are in the Charitable Incorporated Organisations (General) Regulations 2012 SI 3012.

What are CIOs used for?

CIOs are designed to be a more efficient way to run a charitable venture than standard charitable companies, owing to the fact that their regulation is not as complicated or onerous (for example, a CIO will only have to submit one annual return and one set of accounts per year; currently, charitable companies have to submit two of each owing to their dual responsibility to Companies House and the Charity Commission. CICs have a similar duty to provide 'duplicate' submissions to Companies House and the CIC Regulator.)

Advantages

The main advantages of the CIO are that it affords the benefit of limited liability as well as creating a vehicle with legal personality to hold property and enter into contracts in its own name.

Other advantages as against companies limited by guarantee are:

- That registration is with the Charity Commission which regulates CIOs. So accounts and annual returns only need to be submitted to the Charity Commission and not also to the Companies Registry.
- That CIOs are not subject to company law.
- It is possible to have a constitution in which the charity trustees are the members.
- The accounts may be prepared on a receipts and payments (rather than on an accruals) basis if the gross income of the CIO is less than £250,000
- It can be more straightforward for communications with members to be electronic.
- There are other special features which apply to CIOs only.

Disadvantages

From the outset, setting up a CIO can be time-consuming and complex and, at present, only unincorporated charities are able to convert to CIO status. It is also worth keeping in mind that a CIO will not be recognised as an existing company until it is officially registered with the Charity Commission.

Additionally, CIOs are not yet open to all types of charities and, being a relatively new type of structure, may be unfamiliar to donors and funders in some circles.

Furthermore, CIOs may not always be able to take on secured borrowing, while existing regulations in England and Wales do not make provisions for the Charity Commission to maintain a register of charges – such as mortgages over CIO property – in the same way that Companies House would. Keeping this in mind, CIO structure may be more suitable for small to medium charities and less suitable for their larger counterparts.

What is involved in registering as a Charitable Incorporated Organisation?

For new charities you will need to complete one of the model constitutions and apply on-line for registration with the Charity Commission. The model constitutions have been designed to make the process simple for charities although the trustees may need to seek legal advice if they wish to tailor their constitution.

For existing unincorporated charities, the Charities Act 2006 does not allow for conversion to a Charitable Incorporated Organisation. The charity will therefore need to set up a new CIO using the model constitution which will be registered with the Charity Commission. Once the Charitable Incorporated Organisation is in place, the old charity can then transfer the assets and undertakings to the CIO. The old charity will then be dissolved in accordance with its constitution and the trustees will then apply to the Charity Commission to remove the charity from the register.

For existing charitable companies, the provisions of the Charities Act 2006 allow them to convert directly to a Charitable Incorporated Organisation and this is a more straightforward process. The company will simply re-register as a CIO with a new constitution.

Companies limited by guarantee are tried and tested and charitable incorporated organisations are a new vehicle which have yet to stand the test of time.

Nevertheless as the registration figures demonstrate there is every indication that their popularity will increase.

Case Study – Providing a caring touch

Carers Trust EHHR is a local charity which provides support to unpaid carers in Havering, Redbridge, Epping and Harlow. Carers' needs are at the heart of everything Carers Trust does, ensuring that the enormous contribution carers make to those they care for and to society as a whole is fully recognised and valued.

The present-day charity, which follows the 2012 merger of Crossroads Care National and Princess Royal Trust for Carers, is based in Romford and has more than 100 personnel.

CEO Kathy Verges, explained how her business relationship with Clemence Hoar Cummings. She said: "We first started working with Clemence Hoar Cummings as a result of a word of mouth recommendation, back in 1994.

"They had a very good reputation locally, so I got in touch and they have been our auditors ever since.

"We are fortunate to have an excellent working relationship with Clemence Hoar Cummings' partner, David Belbin. He and his team have always been extremely professional and obliging, providing us with business advice whenever we have required it.

"Clemence Hoar Cummings were instrumental in developing and supporting our transition to SAGE, as well as supporting our complex finances transition post-merger. Throughout the process they were there to guide us and their depth of knowledge was superb."

Kathy added: "As well as the Clemence Hoar Cummings' business undertakings, David and his team have been tremendously supportive of our charity and the work we do, both for and with our carers.

"There have been many occasions when Clemence Hoar Cummings staff have given up their time by attending our fundraising events and have also endorsed our work to others in the community.

"The firm is not only professional but genuinely caring in its ethos too and I have already recommended Clemence Hoar Cummings to a number of colleagues in the charity sector."

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