

Tax pitfalls for new churches

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stewardship[®]

PO Box 99, Loughton, Essex, IG10 3QJ

t: 08452 26 26 27

e: enquiries@stewardship.org.uk

w: www.stewardship.org.uk

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CONTACT DETAILS

Stewardship
PO Box 99, Loughton, Essex IG10 3QJ
t 08452 26 26 27 or 020 8502 5600
f 020 8502 5333
e enquiries@stewardship.org.uk
w www.stewardship.org.uk

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Tax pitfalls for new churches and charities – how to avoid the common problems

1 Introduction

It is important in church life, as the New Testament outlines, that we 'pay unto Caesar what is Caesar's and pay to God what is God's' – we believe it is right for the church to pay tax properly, fulfilling the laws of this country that good employers and charities should. However, it isn't right to pay tax that shouldn't be – especially if that has happened by making mistakes and ending up falling into pitfalls that were not spotted in advance.

There are four main areas of tax that generally affect churches and new charities:

- Taxation of payments for church workers
- Gift Aid tax recoveries
- Corporate tax or income tax on the charity itself
- VAT

It is impossible in a short briefing paper to explain any one of these areas in detail, let alone all of them. The aim is simply to set out some general principles and to highlight some of the main problem areas. There is much more space allocated to the first of these four areas, since we find in practice this is the area where the mistakes are most common and often, more expensive.

There are other resources that should be referred to if problem areas are identified. Many of these are free. The main ones are:

- HM Revenue and Customs. There is an enormous amount of extremely helpful and detailed information at www.hmrc.gov.uk, although readers not used to this material could potentially find it somewhat overwhelming. HMRC Charities Division has a 'helpline' manned by specialists and they can be contacted on 0845 3920203.
- Denominational centres. Many groups of churches have useful information available from their central bodies. These will be important if there is a specific agreement with HMRC on aspects of the work of the church.
- Stewardship (www.stewardship.org.uk). There is a wide range of free briefing papers on our site covering various aspects of church/charity compliance, including taxation issues that affect churches and charities. You can also subscribe to the Stewardship 'Consultancy Helpline' (see http://www.stewardship.org.uk/consultancy_helpline.htm). Within defined fields, we will also accept instructions for ad hoc consultancy assignments.
- Churches Legislation Advisory Service (www.clas.org.uk). Although written with the 'established' church in mind, the CLAS Taxation of Ministers of Religion: A Rough Guide (August 2009) is a good introduction to more detail.

- Accountants and tax advisers. Not every church or charity needs a tax adviser or professional accountant. However, if regular returns are required or there are complex matters involved, then a specialist adviser may be beneficial. We, at Stewardship, are happy to make recommendation of those that we know have relevant experience in different fields.

It should also be remembered that tax rates, rules and regulations change each year. This guide is written to set out the general principles as at October 2009. It is not intended to substitute for taking good professional advice from a tax adviser.

2 Taxation of payments for church workers

Taxation of individuals is generally a complex matter. This is made more complex in churches where the 'employment status' of workers is sometimes not clear – some may be paid employees, some may be self-employed vocational workers and some may be volunteers. Also, distinguishing between purchases that are for church purposes as opposed to being for personal purposes can be less clear in church life than in secular work life. This short guide is written to help new churches avoid the worst pitfalls that we see happen and to help them approach this area with good sense.

Throughout this paper we have used the terms 'pastor' and 'church worker'. In doing this, we have assumed that these are people employed by the church, or being appointed to an office¹ in the church. This is not always the case, although it is now by far the most common circumstance. It is possible that someone may be receiving income for what they do for a church and yet not be employed by the church. However, self employed status should not be adopted simply because it is 'the easy option'; it should only be done when the church is absolutely clear that this reflects the correct legal arrangements between the church and the person concerned and that consequently, this is the correct tax position in law. If a church is seeking to engage workers like this on a self employed basis, it is highly advisable that professional advice is sought in advance as the law on this is quite complex.

It would not be practical to set out all the possibilities in a short guide, but where something is normally taxable for an employee, it is likely that it will be subject to tax in some form for self-employed vocational workers. For workers who are genuinely volunteers, the tax rules will not be identical, but if volunteers are provided with benefits or payments which would normally be taxable, it means it is unlikely they would be really defined as a genuine volunteer. This can in turn mean that the National Minimum Wage is due for all the volunteer hours worked. More detail is given in Section 8 below.

2.1 Salaries, wages and gifts

Payments to the pastor or any other church worker by the church intended to reward them will normally be subject to tax and national insurance ('NIC') except in exceptional circumstances.

'Love gifts', collections, offerings or other gifts received because of being a church worker if they come from members of the church (*or from those whom the worker has served*) will very likely be taxable.

This will be the case whether the payments are regular or only infrequent.

There is the very important question of whether tax and NIC needs to be deducted by the church, as the employer, or if it is the responsibility of the worker to declare and pay tax on their income through their own tax return. This will depend on the legal status of the relationship; if the worker is employed by the church, or is paid for holding an 'office'¹ in the church, then it is very likely the church will need to deduct PAYE and NIC. If the worker is a self-employed worker,

¹ Here, we are referring to someone who is appointed to a position (or office) that has a degree of permanence and can be vacated and filled by a successor. Tax law can deem holders of an office to be taxed as if they were employees (taxed under pay-as-you earn and liable to employee/employer national insurance contributions, etc.)

it is their personal responsibility to declare and pay tax. It should be remembered that it is the **responsibility of the employer** to properly determine which is the right treatment. As a result, the church, as employer, could be found liable for tax and NIC on payments it has made to its workers, even if it did not think it should. HMRC can claim tax and NIC for past years as well as the current year in these circumstances.

If you are in any doubt about whether someone should have PAYE/NIC deducted by the church or whether something is taxable or not, it is recommended you contact HM Revenue and Customs on their 'Employer helpline' (0845 7143143) or speak with your accountant/adviser. If the matter is urgent you can call Stephen Mathews for guidance on 020 8502 8588.

2.2 Payment for expenses

Just because something is paid 'for expenses' does not mean it should not be taxed. This is an area where HM Revenue and Customs collects a lot of extra tax because employers have got it wrong.

Pastors and other church workers will spend money on behalf of the church which can and should be claimed back without fear of tax. However, this needs to be done with care to prevent a tax cost which could have been avoided.

If a payment is made which is 'round sum' (i.e. simply an estimate or a general amount not linked to detailed expenditure by the person receiving the payment) then it is likely to be treated as taxable, in the same way as if it were a payment for a service they provided.

e.g. if the Pastor receives £1,000 per month 'salary' and £600 per month 'expenses' the church should treat the £600 as subject to tax and NIC (under the PAYE scheme) in the same way as the 'salary' element (see section 1).

Where expenses are incurred, a 'claim' should be made to the church (in the same way as any ordinary employee would claim expenses from their employer) and this claim should:

- Detail the individual items of expense that have been incurred
- The amount, date and preferably an explanation of what it was for
- Wherever possible each item should be supported by a receipt
- Be totalled up to the figure to be paid by the church
- Be 'authorised' by another responsible person in the church (e.g. one of the Trustees or leadership team).

It is acceptable to claim less than the total; it is not a problem to be paid less. If more is claimed and paid than the person actually paid out, the excess will normally be taxable – and be treated as extra 'pay' for tax purposes.

2.3 Forms P11d and 'dispensations'

Every church with employees should be aware of both 'forms P11d' and the system of 'dispensations'. The 'form P11d' is a form that should be completed in respect of each employee to report to HMRC any benefits in kind that are provided to that member of staff. In addition, and very importantly, unless the church has a 'dispensation' (see below) for a particular type of expense, it should also record all expenses paid to a member of staff or paid

away by them (e.g. on a church credit card). This is required whether or not the expense was for church business.

Completing the form P11d can involve an enormous amount of work. But it is a legal requirement and must be submitted to HMRC by 6 July each year. If the required forms (one for each employee) are not submitted in time, there is an automatic penalty of £100 per month, plus further penalties if there is tax not paid as a result.

The good news is that the church can apply in certain circumstances for a dispensation. A dispensation is the written agreement by HMRC that certain types of expenses which have been incurred by the member of staff on church business don't need to be placed on the form P11d because it is accepted that no benefit or tax liability accrues. A dispensation can be applied for by completing the HMRC form 'P11DX' which is available for download, together with explanations, from the HMRC website (www.hmrc.gov.uk/payex/schemes/dispensation.htm). If there are new categories of expenses or a change in the way they are calculated this also needs to be agreed with HMRC.

It is strongly recommended that every church with any employees should have a 'dispensation' agreed with HMRC.

Some specific problem areas:

1. Cars

We do not recommend that a church worker has a car bought for them by the church or has the bills on their own car paid for by the church, without clearly working out what the tax implications will be. This could result in a very high tax bill for being provided with a 'company car'. This is the case whether the church owns or leases the car.

The tax liability is calculated by means of applying a % (normally ranging from 15% up to 35%, depending upon the CO2 emissions) to the 'list price' of the car when new, including any alterations, i.e. the tax is not based on the cost to the charity. This calculation becomes the annual taxable benefit for having the car made available.

[Example: Some models of new Ford Focus have 184 g/km of CO2 emissions. That means they would attract an annual % of 24% in 2009/10 tax year. If the car has a list price when new of £16,000, the tax charge on the worker would be calculated as if they had £3,840 of income because they were provided with use of the car (24% of £16,000). In addition, the charity would have to pay Employers NIC of 12.8% of £3,840].

There are some low emission cars where the annual % is lower than 15% but these are only on the most carbon efficient cars.

If the church buys a car and then gives it to the worker, they are taxed on the value of the car when it was given to the worker.

Also, it is unwise to simply pay something towards petrol of a car, whether it is owned by the charity or by the individual. This can lead to the worker having a 'benefit' without realising it. If the church owns the car and just 1 mile of fuel is paid for, which is for private purposes, this will mean the full fuel tax charge is applied – which could be £'000.

The simplest method of dealing with the use of the **worker's car** for church business is for the worker to claim back a mileage allowance from the church equal to the distance travelled on church business. This does involve some administration, but it is simple; all that is needed is a record of the trips that are made on church business and how long they are. The worker can then claim from the church for each mile travelled. HMRC publish rates of allowance which they regard as not attracting a tax charge. Currently this is 40 pence per mile (if the total miles for the church is under 10,000 in a tax year), and at 25 pence per mile for any miles over 10,000: these are known as "HMRC authorised mileage rates" and take account of all of the running costs of the car and not simply the fuel element. Therefore, no other amounts should be paid by the church for the car.

If the **church owns the car**, then the tax free rate to be used is much less than 40 pence, recognising that much of the cost of car ownership will be paid by the church anyway; the church should instead use the HMRC "advisory rates" which are on their website at www.hmrc.gov.uk.

If these guidelines are followed and are supported by the mileage record then no tax or NIC should be payable. It is open to the church to pay a lower amount. In that event, the employee can claim the difference between the authorised (or advisory) rate and the rate that they receive from the church against their employment income (usually via their own tax return).

A key issue that some churches face with their vehicles is the question of whether it is 'available for private use'. Many new churches do not own their own building and therefore the best place to park their church vehicle is at the pastor's house. There would normally be the automatic presumption among HMRC officers that a car parked at the house of the pastor and insured for him to drive would be 'available for private use'. Technically, if the car is available for private use, even if the pastor never actually drove it except when on church business, it will still be subject to tax; it is the fact that it is 'available' for private use and not the amount of such use that brings the tax bill.

If the church is in this situation, it is strongly recommended that there is a clear written agreement between the church and the pastor that use of the vehicle for private purposes is prohibited and that, as a matter of fact, it is not used at all other than on church business. A church should be prepared to provide evidence of this. It is not unusual for HMRC to look at the insurance policy to see whether it is a business policy or a private policy, so you should ensure that the insurance proposal also makes it clear that the vehicle is to be used solely on church business. Even with this letter, we would then recommend that the church obtains the written agreement of HMRC that there is no tax arising in this situation. It is far better to find out at the beginning if HMRC disagree than it is after a few years.

If the church owns or leases a minibus or van the situation is as follows:

- Minibus: if the church allows a church worker to use its minibus for personal rather than church purposes (e.g. driving the family to school, or doing the weekly shopping) then a potential tax liability arises. The definition of a 'minibus' is that it is capable of seating 12 persons and over – and meets the criteria to satisfy the legal safety requirements contained in the Road Vehicles Construction regulations. The tax liability is calculated by using a formula starting with 20% of

the cost of the minibus. Unless there is a specific agreement with HMRC, the tax is calculated **without** taking into account the % of use that is personal compared to that for the church. The resultant calculation can therefore cause a large tax bill for the worker.

[Example: a minibus with a cost of £15,000 is used by the pastor as his private vehicle as well as for church work. The church also pays £3,000 over a year in servicing, tax and insurance. The family uses it for only 5% of its overall mileage. The pastor would be taxed as if he had received income of £3,150 (£15,000 x 20%, NOT reduced for the fact it was only used 5% of the time, privately plus 5% of the running costs. The charity would also have to pay Employers NIC of 12.8% of the £3,150)].

- Vans: some vans (especially some of the newer 'double cab pick ups') come within the definition of a car and will be taxed in the same way. Some, the ones that are more like commercial vehicles, are taxed differently. But there is still a similar principle to that for the 'company car'. Namely if it is used for private purposes at all then it can be taxed in an expensive way. If the church is thinking of buying or leasing a van that may be used for private purposes, professional advice should be sought before doing this.

2. Mobile Phones

Mobile phones are now an essential item of equipment for all Pastors and any involved in pastoral ministry. However, if you are not careful, a lot of tax can arise when the church pays the bills.

Where the **church** has entered into the contract with the network supplier (Vodafone, T-Mobile, Orange etc.), the church worker can use the phone without worrying about whether it is a church call or a personal call. No tax would normally arise. This only extends as far as one phone per employee. If the pastor's spouse is also a church worker, then it may be possible to have a second phone for them, depending on the circumstances.

Where the worker pays with 'pay as you go' top ups, anything the church pays will be treated as taxable on the worker.

Where the **worker** has a contract and the church makes the payments due under the contract, the following will be taxable:

- ALL of the fixed air time element
- Any personal calls made not covered by the fixed air time charge (and unless there is a record of which calls are church and which are personal, HMRC can treat them all as personal).

If there is any other charge (e.g. for the phone itself) then this also will be taxed. These rules may seem strange and unfair, but currently in the UK these are the rules and they are enforced by HMRC.

3. Other phones

The rules on other phones, such as land lines, are similar to that for mobile phones, except that where the church has the contract for the line with the supplier, the part that can be paid without any tax is only:

- The line rental
- Any calls made for the church.

If any personal call costs are paid by the church, the cost of these would be taxable.

4. Computers

If the church owns a computer that is used by a worker for personal as well as church use, there is the potential for the worker to be taxed on it in the same way as the example of the minibus (see 1 above). HMRC have a practical guide in their staff manuals that if the employer makes it clear that the computer is provided only for work purposes, HMRC will not seek to tax it, even if it does have occasional private use. In practice, because the values are usually relatively small, we understand that it is rare to find that tax officers are concerned about this. However, if they thought that the church was buying expensive 'gaming computers' for its workers home use, this would be rather different!

5. Suits, clothing and 'grooming' costs

Virtually all clothes or grooming costs (e.g. haircuts, makeovers etc), if paid by the church, would be taxable. Only ecclesiastical robes and vestments are exempted.

6. House expenses

The rules on providing a house for a church pastor to live in can, at times, be very helpful, but it is very dangerous to assume that the church can pay towards a pastor's house without tax consequences.

If the church wants to buy a house for use by the pastor then this can, in certain circumstances, be done without personal tax being due by the pastor on the benefit in kind. However, this is NOT the case in all circumstances and great care is needed if the church wants to consider this.

If the church wants to rent (rather than buy) a house for the pastor to use, the rules are similar and come with the same warning as above. Please note, however, that the tax position is **very different** if the **pastor** rents a house and the **church** pays the rent – this is nearly always taxable.

If the pastor owns or rents the house, the church can pay some small amounts towards the costs the pastor incurs in using the house for church purposes but if the church wants to pay more than £3 per week towards those costs, this will involve careful thought and a full documental record of the costs that are incurred.

7. Conferences and ministry trips

The church can pay for church workers to attend conferences and go on ministry trips, where the purpose of the trip is for the work of the church.

However, difficulties can arise in the following situations:

- Where the trip has both a 'business' and 'holiday' element (e.g. where there is a church conference in Florida and the worker stays on for 5 days for a holiday);
OR
- Where the worker's family go on the trip with them (e.g. where the Pastor Paul goes on a church conference in Florida and his wife and children go with him).

The element of the costs that are 'church business' will need to be separated and the payment for the 'non business' element will be taxable on the worker.

Where the church pays for a holiday or similar as a 'thank you' for the worker, this will normally be taxable in full.

HMRC can ask for evidence of the ministry content of trips, including details of conferences attended, people met etc., especially if it is a long trip in a tourist area.

8. Payment of volunteers

It is common for people to work for the church or their charity without being paid as volunteers. However, to be a genuine volunteer, the extent to which the person can receive anything in return is limited. If the person receives anything more, then they are likely to be classified as an 'employed worker'. Not only does this raise the question of taxation on what they receive, but then it is likely that they would be entitled to receive the National Minimum Wage ('NMW') for *all the hours* they perform that service for the church/charity. Save in specific situations, the law does not permit a person to volunteer some hours and be paid NMW for the other hours that they work. HM Revenue and Customs (who are responsible for enforcing NMW compliance) have been known to impose the NMW in this way. The worker is also likely to receive normal employment rights in respect of redundancy pay, rights to fair dismissal etc.

Normally, the only payments that can be made, in this context, to someone who is *volunteering* their time is:

- The direct cost of travelling to the place they do their voluntary work
- The direct cost of expenses incurred by them doing the voluntary work (including reasonable meals taken while doing the work)
- Costs of childcare required for them to be able to do the voluntary work

Note: It is important to note that these expenses should be limited to the exact amount actually incurred by them. Some charities who have paid 'expenses' that were 'round sum' or intended to 'give the volunteer some reward' have found they have been considered to be employing the workers – with all the costs that this entails.

Some organisations try to avoid the above problems by referring to payments to volunteers as 'honoraria' or a 'gift'. If this is in any way habitual or expected, it is likely to be regarded as a disguised payment for services, be taxable and potentially affect the legal status of the volunteer. The authorities are extremely sensitive to the risk of employees being exploited and it is this that drives the way that they apply the NMW legislation very strictly.

In Appendix 1 there is a list of the more common 'benefits' that are seen in church and small charity settings.

3 Gift Aid tax recoveries

The Gift Aid scheme is an extremely generous and useful tax benefit to charities. Legislation allows charities to recover tax on gifts that are made to it by tax paying individuals. At the present time, this is worth 28.2% of the amount given –although it will reduce to 25% from 5 April 2011. It also allows tax relief to companies that give to charities.

Signing up for Gift Aid normally does not have any cost to the individual who is giving; in fact it is often highly beneficial to families that receive child or working tax credits (donations made under gift aid will increase the amount of tax credit that can be claimed), and people that normally pay tax at the higher (40%) rate of tax (gift aid donations will give rise to a personal refund of tax over and above that received by the charity). To make a gift aid donation, individuals must pay income tax or capital gains tax for the tax year of the gift at least equal to 25% of the amount gifted. The tax year is from 6th April to 5th April the following year. National Insurance and Inheritance tax are not relevant for these purposes.

Gift Aid can give rise to huge benefits, enabling charities to undertake projects or employ staff they would not have been able to do without it. If there are tax paying individuals or businesses who give to your charity, it will almost certainly be worthwhile to register with HMRC for these and then claim the benefit.

It is not complex for a charity to benefit from the scheme, although it does require good basic records to be kept. HMRC have some very good guidance on Gift Aid on their website (www.hmrc.gov.uk/charities/gift_aid/) which outlines the essentials and the records that are required. Alternatively, you can order their Gift Aid Toolkit (a SD Rom presentation) via www.hmrc.gov.uk/charities/gift_aid/toolkit.htm. These provide essential information for anyone operating the scheme for the charity.

Here are some of the most frequently occurring problems that we see in practice. This should not deter charities from using the scheme, but it is an advantage to be aware of them:

1. The record keeping is not as good as HMRC require. You should not need to engage professional advisors to run your gift aid scheme unless there are no staff or volunteers to do this diligently. But there are some basics that are needed. Our briefing paper, "Financial controls in churches and small charities" outlines the principle points that go wrong.
2. Expenditure by the charity does not meet the requirement that it is spent only for charitable purposes. This is a requirement of both the gift aid scheme and charity law. Non-charitable expenditure should not occur in churches and small charities that are operated properly, although it can sometimes happen inadvertently, even with the best

of intentions. HMRC have some guidance on this in their guides on Gift Aid and there are examples in our briefing paper, "Financial controls in churches and small charities".

3. Amounts that gift aid is claimed on are not the income of the charity. This is relatively rare, but can happen inadvertently. Our briefing paper, "When a charity's income is not its income" provides detailed guidance on this.
4. The amounts claimed are not gifts. Sometimes people pay into the charity amounts that are not gifts; they may be the payment for a service or an event. These are not gifts and should not be claimed.
5. The amounts given are not from taxpayers. A person needs to be paying UK income tax or capital gains tax for the tax year of the gifts they make in order to be claimed under Gift Aid. If not, HMRC have the right to claw back from the individual (not from the charity) amounts that have been incorrectly claimed by the charity. This is because when the donor makes the required 'gift aid declaration', they are declaring to the charity that they **will** have paid enough tax to cover the amount the charity will reclaim and they are authorising the charity to do so. This should not prevent a person who may occasionally not pay tax (e.g. those who are self-employed or occasionally earning) from giving under Gift Aid in years that they do pay tax, but it does mean that special care is needed.

Gift Aid is a very worthwhile means of Government support for the charity sector. A little amount of thought and organisation means churches and new charities can achieve the maximum benefit.

4 Corporate or income tax on the charity itself

Charities are not totally exempt from all corporate or income tax, but it is very rare for churches and small charities to suffer these taxes. Corporate tax or income tax normally would only arise when the charity is undertaking 'trading' and it would have to be trading that is not designed to directly achieve the charity's charitable objects. More on this below.

The following sources of income are exempt from corporate or income tax, provided that the funds are used only for charitable purposes:

- Gift income
- Interest or other investment income
- Rental income
- Capital gains.

Trading income is when the activity is directly achieving the charity's objects; known as 'primary purpose trading' (examples would be sale of Christian books and CDs, or charges for running a ministry conference). It needs to be remembered that the exemption only applies **if** the money is then spent on charitable expenditure. If it was used, for example, to provide excessive salary or benefits for the church leaders or members, or for some other non-charitable purpose, some or all of the income of the charity would become taxable. This is very rarely seen in practice.

This normally only leaves 'non-primary purpose trading' subject to tax. This most commonly happens in the following situations:

1. Where there are activities specifically to raise money for the work of the charity and it is not 'directly' achieving the objects of the charity. Fundraising for the charity is not primary purpose trading, **unless** the trade itself achieves one of the charitable purposes of the church / charity. So, for example, selling bibles is fine. Coffee mornings will not be primary purpose, unless they are held (for example) so that people can hear an evangelistic speaker (so that the main purpose is advancement of the Christian faith rather than purely social enjoyment). However, unless the trade is generating significant profit, tax should not be a real worry in practice. . A common example of where care would be needed is if the church ran a business in order to make a profit, rather than for evangelism or distribution of Christian literature.
2. Where a property is sold and the charity has undertaken some planning/development work in order to enhance the value of the property to make more money on its sale. This can happen when there are property developers involved or similar 'development potential'. HMRC see this as 'an adventure in the nature of trading' rather than a straightforward capital realisation. The rules in this area are complex and relevant professional advice should be sought whenever property is bought or sold by a charity.

HMRC have produced a very good leaflet which is available from their website entitled, 'Trading by charities'. If a charity is thinking of starting some form of fund raising activity, it is strongly recommended this leaflet is read and understood.

It is worth remembering that charities are exempt from tax on their investment income and, as a result, bank deposit interest should be received before any tax is deducted. If you are having tax deducted by the bank they (and not HMRC) should be contacted to correct this.

4.1 Tax returns

From time to time HMRC issue charities with 'tax returns'. These are either a 'Trust income tax return' (SA900 form) or a 'Company – Short tax return' (CT600 (short)). The former are for charities which are charitable trusts, the latter for those which are charitable companies. Trusts are always issued with returns for the period to 5 April (regardless of the accounting year that is used). Companies are issued returns for their 'tax reference period' which is normally the same as the accounting year.

If your church is issued with a return, you have a legal responsibility to complete and return it to HMRC within the deadline or **face a penalty starting at £100**. Until this year, it used to be the case that because the charity normally had no tax to pay, HMRC would cancel any penalty issued. This is no longer the case; even if it is one day late the penalty will now remain.

The deadlines are:

- For companies: 12 months after the end of the accounting year end.
- For trusts: 31 October after the 5 April in question – unless the return will be completed online in which case it is the 31 January following tax year end (5 April).

If you want to make your return online you will need to register. This can be done via the HMRC website (www.hmrc.gov.uk/trusts/tax-return/paper-online.htm) but do allow at least 7 days for this process.

Regrettably, the actual return HMRC send out in the post is not the only form that needs to be completed, as the form that needs to be completed in detail is 'supplementary' and is not sent, but has to be downloaded; for trusts this is the SA907 and for companies CT600E.

5 VAT

When VAT was introduced in the 1970's, it was referred to in some government documents as 'a simple tax'. Sadly this is very far from the truth! VAT has many extremely complex tax rules, but fortunately churches and most small charities don't need to be involved with it much.

Except in unusual circumstances, churches do not register for VAT. It is only if they are selling goods or services of over the VAT registration level (at October 2009, this is £68,000 per annum) that they would register. Charities which, as part of their objectives, are selling goods and services will need to consider VAT rules. Occasionally crossing the threshold can happen unwittingly, for example, if the charity receives commercial sponsorship which is considered, for VAT purposes, to be a 'taxable supply'.

Churches are neither 'totally exempt' from VAT nor can they recover the VAT that they are charged on what they buy unless they need to become VAT registered. There are some specific areas where there are VAT reliefs for typical church situations (see further below).

Churches and other charities should definitely consider the VAT implications if they are to be involved in buying, renting or undertaking significant improvements to property. Proper thought and planning is needed and it is often worth discussing this with suitably qualified and experienced professional advisors, such as lawyers being used to help with the transaction. Church and charity VAT is a very specialist area. So any advisor selected should have practical experience in this area. Stewardship have written a 'Guide to VAT for Churches' which is available from the online shop on our website (price £8.50).

The most common areas where churches and small charities should be aware of special VAT rules are in relation to:

Advertising

Most charity advertising should have VAT charged at 0% (the 'zero rate').

Rental charges (and purchases of buildings)

If the church/charity rents or buys a building to be used for a 'relevant charitable purpose', provided the right processes are gone through, the landlord or vendor is legally barred from charging VAT. In other words, the normal 'option to tax' rules that most commercial landlords or vendors will want to use, cannot apply.

"Relevant charitable purpose" means:

- Use by a charity otherwise in the course of furtherance of a business, or
- As a village hall or similarly in providing social or recreational facilities for a local community

Where a building is rented or bought, there is an **additional condition** that the building should not be used as an administrative office. More on this below.

For VAT not to be charged, it is necessary for the church/charity to give a certificate to the landlord or vendor, stating that they intend to use the premises for a relevant charitable purpose **before** the supply is made.

The 'office' condition does not apply where the building is being *newly constructed* for the church and it is intended to be used solely for a relevant charitable purpose.

The most common example of the application of these rules is where a church rents premises for Sunday worship, weekday activities etc., or as a church office. In the case of Sunday worship and weekday activities, it should be fairly straightforward for the church to be able to give the necessary certificate and therefore not be charged VAT. Local authorities are often not aware of the 'charity' rules and often try to charge VAT on renting school premises to churches. Be prepared to stand your ground!

'Office' accommodation can be a little more tricky. A landlord *can* charge VAT (opt to tax) the office element of any premises let to a charity. But, the option to tax will not apply to the part used for relevant charitable purposes, *provided that* the different functions are carried out in clearly defined areas. Where appropriate, the landlord should apportion the rent between the different functions and only charge VAT on the 'office' parts. At this point, it should be noted that where the law refers to 'an office', it means an office for general administration e.g. head office functions of the charity. So, a building that is used for worship, church activities, etc. but which just happens to have rooms with tables and chairs used for (e.g.) counselling, those rooms may still qualify for 'no VAT' treatment.

By extra statutory concession, a landlord/vendor can ignore less than 10% non-relevant use of a charity building and permit the entire occupation to benefit from exemption. However, from 1 July 2010, this concession is being withdrawn. From that date, a 95 per cent relevant charitable purpose (other than as an office) test applies. The apportionment between qualifying and non-qualifying use can use any method provided that it is fair and reasonable.

Light and heat

Most charity fuel bills should have a reduced 5% rate and not the standard rate.

Construction of an annexe

Properly planned construction of a charity annexe to a pre-existing building should be zero rated for VAT purposes. Advice is essential here.

Further help on VAT

HMRC has many detailed guides on VAT and they can be accessed on their website. The most relevant overall guide is VAT notice 701/1 'VAT and charities' although the last update was issued in July 2008. The text may therefore be out of date in places.

Stewardship Briefing Paper: Guide to VAT for Churches, which is available from the online shop on our website (price £8.50).

Stewardship Consultancy Helpline: For details, visit www.stewardship.org.uk/smartweb/support-services/consultancy:-employers

APPENDIX 1

List of common 'benefits' that are taxable on church workers

Cars, vans or motor bikes available for non-church use.

Petrol for non-church journeys.

Contributions to the cost of a private vehicle (e.g. paying the insurance or repairs).

Travel and accommodation costs for journeys only partly on church business.

Spouses or other family members being taken on church business trips.

Entertaining, unless it is essential church business.

Accommodation (e.g. where the church pays for the rental of a house or a church owned house is occupied by the worker) except where the strict conditions of the 'exemption for Ministers of religion' have been met.

Heating and lighting costs.

TV or media costs.

Equipment given to the church worker.

Mobile 'pay as you go' top ups.

Mobile phone charges other than:

- Business calls only
- Or where the charity has the contract for the phone.

Landline phone charges other than:

- Business calls only
- Or rental charges where the charity has the contract for the phone

Broadband or other similar charges.

Clothes, shoes or similar, except where it is:

- Protective clothing.
- Ecclesiastical robes.

Haircuts or personal grooming costs.

Gym or leisure centre membership.

Private parties (e.g. birthday or anniversary parties).

Private medical insurance.

Private medicals (unless provided for all staff).

Holidays or other personal benefits.

NB: Depending on the circumstances such benefits may be required to be treated as additional 'pay' or should be reported to HMRC on forms P11d and form P11d(b) by 6 July following the end of the tax year. Failure to submit the form P11d (b) by that date results in an automatic penalty of £100 per month (or any part of one) per 50 employees.