

avoiding tax traps – for churches and charities

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1 Introduction

In our list of "The Top Ten Traps" for Trustees for 2004 (featured in our Legal and Financial Bulletin in January 2005), "Taxation" came out as Number One. In this Briefing Paper, we expand on this particular 'Trap'.

Many think that tax is not an important issue for charities "Charities don't pay tax do they?" An interesting example, which is typical of many charities, is the church of which I am a Trustee; payroll taxes amount to over 10% of total expenditure and Gift Aid tax recoveries to 18% of income.

In themselves, these may not be amazingly high, but one of the big problems with tax lies in the fact that it can "accumulate" over a number of years; underpaid/overpaid tax builds up unnoticed – because no one knows it is happening. For example; if a member of staff is taken on 'casually' and paid £15,000 per annum and no tax dealt with, after 3 years the charity has a potential to pay £30,000 to the HM Revenue & Customs in taxes and penalties. More than many small charities would have left!

The key to managing taxes in charities is the same as in business; plan for it, accept it and pay it – but don't pay more than you need to! Unfortunately, the words 'simple' and 'tax' in the same sentence are normally only used by politicians, but at the risk of putting you off – please read on!

What are the areas in which we have seen taxation issues cost charities serious amounts of hard won money?

2 Gift Aid tax not being recovered where it could

If a tax paying individual makes a Gift Aid payment to a charity of £100, the charity can recover £28.20 from the HM Revenue & Customs. This can be on payments made by cheque, cash or standing order and can be done for up to 6 years after the payment was received (but note different certificate rules apply to receipts prior to 6 April 2000) . We have seen charities in similar situations recover 28% of their total income and others recover nothing, due to administrative inefficiency.

The main areas that are often missed are; special collections or offerings (although not all of these can be subject to Gift Aid), and cash collections which can be included when you have means of identification of the source (such as an envelope scheme).

Whilst this point is a simple one it still makes up the largest single tax 'loss' that we see charities suffering.

3 Gift Aid tax recoveries being claimed for non-qualifying expenditure

This is a more technical area and a short article such as this cannot explain it in full. However, there are areas of expenditure that charities can (and do) make that could result in the HM Revenue & Customs clawing back amounts previously repaid to the charity under Gift Aid. Vulnerable areas are typically 'non-charitable' loans (e.g. loans to a church member to move house), gifts to staff or members of the church and large international gifts. Payments like this *can* be made and not prejudice the charity's Gift Aid position *but only if* in making the payment, the trustees are fulfilling one of their

'charitable purposes'. This question should be judged according to *charity law* rather than the layman's view!

Related to this, the Revenue issued new guidance in February 2003 and if you are involved in making substantial gifts or grants overseas then it is very important you know what this says. A copy can be found on the Revenue website http://www.hmrc.gov.uk/charities/guidance-notes/annex2/annex_ii.htm#ii4

4 PAYE/NIC not being paid where the employer has a liability.

This is a very common area and the Revenue have found rich pickings among all employers; businesses and not for profit organisations. So they do invest their staff time to identify where they have not collected all they think they should! The typical examples are; casual staff, cleaners and staff members who have been paid on a 'self employed' basis. As explained earlier, it does not take long for a very sizeable liability to arise if not dealt with properly.

There are examples of pastors and church workers who are genuinely self-employed. However, the Revenue do not accept this position simply because that is what is wanted but only when the facts support it. Many arrangements that we have seen in this last year suggest that it is doubtful the facts support the case! This is a fast moving area of tax practice but if you have 'self employed' individuals who are regularly being paid by your charity then it is strongly recommended that you obtain professional advice or match the facts of your case against the Revenue's own guidance (which can be found in the publications "IR56" and "IR148" (www.inlandrevenue.gov.uk/pdfs/ir148.htm). Remember though that these are written from an HM Revenue & Customs perspective.

We have heard it said that the Revenue have special rules in this area for church workers. Whilst there are a few special rules, these are very limited and you must be sure you do fit them exactly for them to apply. There is no general principle exempting churches or charities from applying normal rules to whether someone is an employee or not.

5 Employee benefits in kind

This is another area where the HM Revenue & Customs very commonly find tax underpayments. This may be through lack of awareness, knowledge or absence of simple thought by employers. In the commercial sector it is normally the company cars/vans and untaxed 'bonuses' or expense payments. In the charity/church field staff may be provided with a "thank you" in the form of a paid weekend, holidays, domestic appliances or simply payments where people don't think of tax.

The Revenue have a reporting mechanism by which employers provide them with details of benefits in kind provided to their staff. This is called form "P11d". However, this should report not just benefits in kind but also 'expenses and allowances' – those payments made to (or on behalf of) staff for expenses. A very useful 'dispensation' may be provided by the Revenue where employers specifically apply and all churches or charities should plan to obtain dispensations where ever they can. These are not normally granted retrospectively. In our experience it is only exceptional employers who don't need to prepare P11ds or obtain dispensations; in other words – if you haven't organised these you probably have some thinking to do!

Another area is that of 'round sum' monthly/annual payments to cover 'expenses'. The Revenue start by saying these allowances are subject to PAYE/National insurance which should be deducted by the employer. It isn't enough to say 'we're sure that he/she spends at least the amount that we pay' and go no further. It is possible, in some instances, to include allowances within a 'dispensation' from the Revenue, but then regularly there should be a check that the allowance does not exceed the amount of the legitimate tax deductible expense. If there is no dispensation and you are paying round sum expenses – there is a problem!

The next area that we think will cause problems to some is that of 'provided living accommodation'; such as 'manses'. There are specific exemptions in some instances that exempts the taxable benefit but these do not cover all occasions. Our recent experience suggests that the Revenue are taking a narrower view of when the exemption applies than they have in the past. In relation to the statutory tests for exemption, we are seeing the Revenue query the definition of 'a minister', why it is considered there will be 'better performance' by providing them with a house, to what extent do they 'perform duties other than administration' from the house, and whether it is 'customary' for the relevant church (or church group) to do this. Do not just assume that the standard exemption for clergymen applies in all circumstances !

We would also comment that the views expressed by individual Revenue officers in this area are not always consistent nor, in our view, always in line with the official Revenue statements.

6 VAT

The subject of VAT is a massive one. We can only give broad principles of some key areas in an article such as this. Fortunately it is not of major significance to most churches although for many charities it is very important; churches and charities are not simply exempt from VAT because of who they are.

Because VAT can be an important issue for some churches/charities a detailed Briefing Paper is being prepared and will appear on our website shortly. But whatever your organisation does you should at the very least read on!

The following points should be noted:

- a) Whenever you are undertaking any property purchase, redevelopment or lease you must plan for VAT. If not, you may waste a great deal of money.
- b) If you have significant 'training' income or expense you should also consider VAT. You may or may not need to charge VAT on your income and you may be missing exemptions from being charged VAT on some of your costs.
- c) If you obtain significant grants from commercial or other institutions you should carefully consider the nature of the transactions. They could contain standard rated VAT, zero-rated VAT or be outside the scope altogether!
- d) There are some specific areas where VAT should not be charged to charities. If you are spending in these areas and you are being charged VAT you are probably losing money unnecessarily; advertising, printed materials, church stewardship envelopes are the most common examples. However, most of the other VAT exemptions are specific to certain types of charities (e.g. those providing medical equipment or for disabled people).