

## **Property letting and disposal: Taxation tips**

Charities need to be aware of taxation issues that arise when they are using property assets to generate financial return.

### **General exemption for charities**

Section 505(1)(a) of the Income and Corporation Taxes Act 1988 is the main statutory provision providing exemption from tax for an incorporated charity's income where it is derived from land. Similar provisions relate to charitable trusts.

That section provides that the profits or gains in respect of rent or other receipts arising from an estate, right or interest in land belonging to a charity are exempt from tax provided that the profits are applied to charitable purposes only.

The exemption given by section 505(1)(a) generally covers rental income from lettings, hiring agreements or licences to occupy and any gains arising on the sale of property or the grant of a lease at a premium.

### **Additional services provided on or in property and taxable trading**

Services provided to occupiers may generate potentially taxable trading income if the nature of the service is not one normally provided by a landlord. Examples include income generated by the provision of administrative services to occupiers (other than beneficiaries of the charity), for example internet and photocopying services or the provision of a caretaker. If property is hired out for a conference, and additional facilities provided such as overhead projection equipment this could also result in a tax charge. The position will in many cases not be clear and, whilst there are de minimis allowances for a charity's trading income, care needs to be taken where the level of total trading income could exceed the permitted limits.

In some cases the liability for non-exempt trading by charities justifies use of a trading subsidiary, which carries out the non-exempt trading activity and then gift aids the profits back to the charity.

### **Tax charge on sale of property**

There may be a tax charge on a gain on the sale of land under section 776 of the Income and Corporation Taxes Act 1998.

### **Trading in land**

The section applies where land is acquired with the sole or main object of realising a gain from disposal of the land or where a charity holds land as “trading stock”. Whenever land is acquired for the primarily commercial purpose of realising a gain from the sale of the land at the time of acquisition this will result in a potential tax charge.

### **Actual development before sale**

Section 776 may also apply where land is developed with the sole or main aim of realising a gain from disposing of the land when developed. Charities considering undertaking building work to a property asset before sale, in order to maximise profits on sale, need to take care even where they did not purchase the land with any intention to redevelop.

Under section 36 of the Charities Act 1993 a qualified surveyor must advise charity trustees whether it is appropriate to alter land before selling it. One of the things that charity trustees should take into account is whether HMRC would regard proposed alteration as development.

### **Planning permission does not of itself amount to development**

The qualified surveyor’s advice required by trustees for the purpose of section 36 of the Charities Act 1993 must include advice on whether it is appropriate to obtain a planning permission before selling land.

HMRC guidance, in relation to section 776 indicates that while the sale of land with the benefit of planning permission secured in order to increase the value will not come within the section, but overage or ‘share of the action’ arrangements will do so.

### **Trading subsidiaries for development projects**

Where there is a potential tax charge, the charity should consider setting up and using a trading subsidiary. The profits and gain of the trading subsidiary will be taxable. However the profits and gains will attract tax relief when paid over to the charity by gift aid.

Charities making a disposal of property to a trading subsidiary must do so on the best terms that can reasonably be obtained.

They cannot therefore transfer property to trading subsidiaries at no cost.

### **How does the trading subsidiary fund the acquisition of the land?**

Charity trustees can invest in their trading subsidiaries, but must be able to make a proper case for the investment of charitable funds. Charities are obliged to apply their resources exclusively for charitable purposes. It is a potential tax issue. If the charity’s input is regarded as trading, it will be in breach of tax law as well as probably a breach of charity law.

HMRC states that investments will be regarded as made for charitable purposes and for the benefit of the charity if they are commercially sound. Charities should ensure that investments are secure and that they carry a fair rate of return that is actually paid. Charities should in due course actually recover any loans they make to the subsidiary.

The charity must charge a commercial rate of interest and usually take a legal charge over the land.

## **Connected person**

Most trading companies will be connected persons for the purpose of section 36(1) of the Charities Act 1993, so that the disposal will have to be authorised by order of the Charity Commission.

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