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Charities, are your trading subsidiaries compliant?

Earlier this year, HMRC and the Charity Commission revised their guidance on charity trading so that payments made by a trading subsidiary to its parent charity must not be more than the profit available for distribution under the Companies Act 2006.

This means that the widely used custom of a trading subsidiary donating all taxable profits to its parent charity to claim charitable donations relief may, in some cases, now be unlawful.

This change follows the Institute of Chartered Accountants in England and Wales (ICAEW) issuing technical guidance in 2014 on the status, under company law, of charitable donations by a subsidiary trading company to its parent charity. This guidance stated that donations in excess of a trading subsidiary's profits available for distribution, as shown in its relevant accounts, constitute an unlawful distribution under company law.

The Charity Commission and HMRC have revised their guidance accordingly.

HMRC revised guidance

HMRC's detailed guidance for charities now states that:

- donation payments by a trading subsidiary to its parent charity are considered to be distributions. A trading subsidiary must not pay more to its parent charity than the level of profits available for distribution, even if the level of taxable profits is higher.

- this rule comes into effect for accounting periods starting on or after 1 April 2015.

- if unlawful distributions have been paid by a trading subsidiary to its parent charity in earlier accounting periods, then (subject to time limits):

    - the parent charity has a liability to repay the unlawful distributions;

    - the trading subsidiary has a right to receive the sums; and

    - the repayment of any such prior unlawful distributions by the parent charity to the trading subsidiary will not be taxable income in the hands of the trading subsidiary.

Charity Commission revised guidance

The Commission has revised its guidance *Trustees trading and tax: how charities may lawfully trade (CC35)* to state that:

- where a trading subsidiary has previously paid a higher figure of accounting profit to its parent charity, they may well need to take advice from a suitably qualified professional adviser on how to proceed.

- if, in order to rectify the situation and address the accounting issues, a parent charity is considering writing-off all or part of a loan made to a trading subsidiary, its trustees will need to be able to show that:

- the decision is in the parent charity's interests;
- the only purpose of the write-off is to rectify a technical problem resulting from the need to readjust its operations with this new guidance;
- the relationship with the trading subsidiary is itself legitimate, justifiable and clearly operating in the parent charity's interests;
- there is no previous history of the writing-off of loans due to the trading subsidiary's poor performance in repaying loans; and
- the trading subsidiary is otherwise financially viable and a going concern.

If all these conditions are not met, then the Charity Commission has warned that it will not issue any waiver or approval except in the most exceptional circumstances, where the trustees have taken professional advice and made a compelling case.

What to do next

It is extremely important that charities and their trading subsidiaries assess their relationship and the basis on which funds have been gifted from the trading subsidiary to the parent charity, taking professional advice where needed. Action should be taken in a prompt manner to avoid a parent charity having to repay funds to the trading subsidiary.

Charities should heed Charity Commission guidance and where loans may need to be written-off, seek Charity Commission consent before doing so.

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