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## The Charity Law & Practice Review

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# WHAT'S NEW IN INLAND REVENUE BOOKLET CS2 ("TRADING BY CHARITIES")

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The Revenue's views on the scope of the charity trading exemptions, and on tax planning arrangements when the exemptions do not apply, are now published in booklet CS2, entitled "Trading by Charities." A good deal of the booklet is of course basic in nature and would be familiar to anyone who has read chapter 13 of *Tax Planning & Fundraising for Charities*.<sup>2</sup> The purpose of this article is to mention the most interesting points in the booklet which are new or at least, which were not generally known before the publication of the booklet.

By way of background, the reader will recall that there are four tax exemptions for charity trades. Charity trading income is not taxed for:

- (1) Trades which are a primary purpose of the charity ("Primary Purpose Trades").
- (2) Trades whose work is carried out by beneficiaries of the charity. ("The Beneficiary Worker exemption").
- (3) Lotteries.
- (4) Fundraising Events.

See s.505 ICTA 1988; Extra-Statutory Concession C4.

### Primary Purpose Trades

The first and most important statutory exemption for trading income applies where:

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<sup>2</sup> by Robert Venables QC and James Kessler, 2nd edition 1994 published, by Key Haven Publications.

"The trade is exercised in the course of the actual carrying out of a primary purpose of the charity."

This covers much charitable trading activity.

In most cases it is clear whether or not a trade is covered by this exemption but there are many doubtful areas and no reported cases. The booklet is very helpful here.

### **Ancillary Trades**

IR booklet CS2 4.4 includes an important section worth quoting in full:

"The exemption from tax extends to trades which are not primary purpose activities but which are ancillary to the carrying out of a primary purpose so that they can be said to be exercised *in the course of* the actual carrying out of a primary purpose. Examples of trades which qualify as primary purpose trades because they are ancillary to the carrying out of a primary purpose are:

The provision of accommodation to students by a school or college in return for rent.<sup>3</sup>

The sale of goods or services for the benefit of students by a school or college.

The provision of a crèche for the children of students by a school or college in return for payment.

The sale of food and drink in a cafeteria to visitors to exhibits by an art gallery or museum.

The sale of food and drink in a restaurant or bar to members of the audience by a theatre.

The sale of confectionery, toiletries and flowers to patients and their visitors by a hospital."

This has always been the author's view, but would it necessarily have been accepted by the Special Commissioners? It is helpful to see it confirmed as the Revenue view.

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<sup>3</sup> Depending on the circumstances, this may be Schedule A rental income, not a trade; but it makes no difference in practice.

### **Trades Partly "Primary Purpose"**

Some cases will be marginal. One can only say that it is a question of common sense, and one of fact and degree.

Take, for instance, a church which runs a shop selling religious books and artifacts. This trade will qualify for exemption. If the shop also sells a small proportion of non-religious objects, such as toys or souvenirs, that would not lose the exemption. All the trading income remains exempt. Suppose the non-religious sales became substantial. The exemption then ceases to apply.

The Revenue give three similar examples of such marginal cases:

- (1) A shop in an art gallery or museum which sells a range of goods some of which are and some of which are not, related to a primary purpose.
- (2) The letting of accommodation for students in term-time, and for tourists out of term, by a school or college.
- (3) The sale of food and drink in a theatre restaurant or bar, both to members of the audience and the general public.

The booklet continues with an important statement of Revenue practice. It is accepted that the exemption applies if:

- (1) The part of a trade which is not within a primary purpose is small in absolute terms, and
- (2) The turnover of that part of the trade is less than 10% of the turnover of the whole trade.

In cases of doubt the safe course is to seek clearance from the Revenue: if clearance is not forthcoming, it is best to assume that the trade does not qualify for relief, and to take appropriate tax planning steps.

### **Extra-Statutory Concession C4<sup>4</sup>**

"Bazaars, jumble sales, gymkhanas, carnivals, firework displays and similar activities arranged by voluntary organisations or charities for the purposes of raising funds for charity may fall within the definition of "trade" in TA 1988

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<sup>4</sup> The material in this section was first published in a Revenue booklet called *Fundraising for Charity* (February 1994).

s.832, with the result that any profits will be liable to corporation tax.<sup>5</sup> Tax is not, however, charged on such profits provided the following conditions are satisfied:

- (a) the organisation or charity is not regularly carrying on these trading activities;
- (b) the trading is not in competition with other traders;
- (c) the activities are supported substantially because the public are aware that any profits will be devoted to charity;
- (d) the profits are transferred to charities or otherwise applied for charitable purposes."

This is the text of Extra-Statutory Concession C4.

In the first edition of *Tax Planning & Fundraising for Charities* it was noted that the concession was misconceived. Charitable events organised on an irregular basis do not normally constitute a "trade",<sup>6</sup> and if there is no trade, there is no charge to income tax irrespective of the concession. The concession was re-

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<sup>5</sup> I would add: unless the Beneficiary Worker exemption applies: see above.

<sup>6</sup> See *British Legion, Peterhead Branch, Remembrance and Welcome Home Fund v IRC* 35 TC 509. The Lord President (Cooper) explained the position in these words:

"In my view, a person cannot be said to be engaged in carrying on a trade or a concern in the nature of trade within the meaning of the Income Tax Acts unless, in a reasonable sense, he is conducting business on commercial principles. If he is so conducting business, it matters not from what motive he acts nor to what purpose he devotes the profits, if any. If he is not so conducting the business, enterprise or adventure - if, for example, he is merely using some of the trappings of trade as a means of procuring subscriptions or donations not properly related to any service he renders or to any commodity which he supplies - he may be wearing an easily penetrated disguise which deceives nobody, but he is not trading. Instances of the latter type of operation which readily occur to the mind are the hawking of flags, the conducting of occasional bazaars and sales of work and whist drives, and the showing of private gardens for an admission fee, usually exorbitant."

In the *British Legion* case the charity was held to be trading by the Commissioners when it carried on one dance per week over a period of three years. Even this was a marginal case. The Court of Session held that the Commissioners' decision could not be challenged; but the Lord President expressed regret and said that he might have come to a different decision had he been a Commissioner himself.

worded in 1994 to take account of this objection. Where events do amount to trades, it does become necessary to consider the applicability of the concession.

### **What events qualify for the concession?**

The Revenue booklet states that "similar events such as fêtes, concerts dinner-dances and sports matches will often also fall within the concession": para 6.3. Likewise car boot sales: para 6.5.

The Revenue state in the booklet that events are only "similar" to "bazaars, jumble sales, gymkhanas, carnivals, or firework displays" if they are *small local* events. It is considered that this is wrong. The Notting Hill Carnival, for instance, is a "carnival". It is local; but it is not small. The Revenue's construction of their concession could be challenged, if necessary, in judicial review proceedings. If the concession is to be restricted to small events, this must come in the text of the concession and not in a commentary on it.

### **"Regularly carried on"**

The Revenue booklet states how this is understood, in a manner favourable to charities:

- 6.12 The concession does not apply to activities which are carried on on a regular or frequent basis. Normally, any event which takes place more than three times a year in the locality is regarded as "regularly carried on". For this purpose each type of event is considered separately, so that it is acceptable to arrange three gymkhanas and three firework displays in the same year. The size of the locality considered will vary from case to case according to the catchment areas of the particular events.
- 6.13 A two or three day series of concerts or other events for which there is a single admission charge will be regarded as a single event notwithstanding that the number of concerts within the series exceeded three. But where there is a separate admission charge payable for each day or for each concert the series as a whole cannot be regarded as a single event. The concession does not extend to a programme of events for which patrons can buy a season ticket but where each event can properly be regarded as standing on its own.

### **Tax Planning for non-exempt trades**

There are four main techniques of tax planning for charities in receipt of non-exempt trading income:

- (1) Artificially reducing profits of a trade
- (2) Covenants
- (3) Franchising
- (4) Use of trading companies.

The booklet mentions (and approves of) three of these. It is surely unique, among Inland Revenue publications, in taking a most positive and encouraging attitude to tax avoidance schemes.<sup>7</sup>

The reason for the omission - covenants by charities to other charities - is likely to be that are not widely known or used, rather than any underlying hostility.

#### **Artificially reducing profits of a trade**

The Revenue booklet CS2 wholly supports this:

"6.14 It may be possible to organise [a charitable fundraising] event so as to minimise the amount of tax payable. For instance, the charity might set a basic minimum charge (which will be taxable) and invite those attending the event to supplement this with a voluntary donation. The additional contributions will not be taxable if **all** the following conditions are met:

- (a) it is clearly stated on all publicity material, including tickets, that anyone paying only the minimum charge will be admitted without further payment
- (b) the additional payment does not secure any particular benefit (for example, admission to a better seat in the auditorium)
- (c) the extent of further contributions is ultimately left to ticketholders to decide (even if the organiser indicates a desired level of donation)
- (d) for film or theatre performances, concerts, sporting fixtures, and similar events the minimum charge is not less than the usual price for the particular seats at a normal commercial event of the same type

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<sup>7</sup> "The booklet describes ways in which non-exempt trading income can be passed to charity in such a way that no tax will be payable": para 1.2.

- (e) for dances, dinners and similar functions the sum of the basic minimum charges is not less than the total costs incurred in arranging the event".

This is only necessary for events which do not fall within ESC C4.

While condition (d) may be debatable, in practice a charity should stick to the Revenue's statement, or take the other officially approved routes to avoid a tax charge.

### **Use of trading companies**

It has long been known that the Revenue do not attack trading companies used by charities to avoid tax.<sup>8</sup>

The booklet has some interesting reading on tax planning by use of companies; especially chapter 11 ("tips on making profit-shedding work better"). But do not overlook use of covenants. They are often a cheaper and more convenient alternative to a trading subsidiary: See *Tax Planning & Fundraising for Charity* para 13.9.1.

### **When is sponsorship a trade?**

Lastly, the IR booklet has some interesting reading on the question of whether sponsorship amounts to a trade. This too should be noted by charities:

"8.5 Commonly a charity will play a part in publicising the business sponsor's affinity with the charity by including references to the sponsor in publications, posters, etc. and at events organised by the charity. Provided that such references amount to no more than acknowledgements of the sponsor's contributions they will not cause the payments to be regarded as trading income. However, references to a sponsor which amount to advertisements **will** cause the payments to be treated as trading income. The Inland Revenue will regard a reference to a sponsor as an advertisement if it incorporates any of the following:

- the sponsor's logo
- the sponsor's corporate colours, or

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<sup>8</sup> *Tax Planning & Fundraising for Charities*, para 13.10.2.

- a mention of the sponsor's products or services.
- 8.6 There are other services which a charity might provide in return for sponsorship payments which will be factors in determining whether the payments are trading income. Examples of such services are:
- use of the charity's mailing list
  - use of the charity's logo
  - endorsement of the sponsor's products or services
  - exclusive rights to sell goods or services on the charity's premises.
- .....
- 8.8 Where the arrangement amounts to a stand-alone trade the treatment of the profits for tax purposes will not be affected by the tax treatment of the other income of the charity. But where the sponsorship is intended to fund an activity of the charity which is itself a trade, the payments will be regarded as part of the income of that trade so that their tax treatment will follow the tax treatment of the profits of that trade. For example, where a business sponsors a stage production by a theatre the sponsorship payments will be regarded as part of the income of a trade of putting on the stage production, and the profits will be exempted from tax along with the other income of the trade (paragraphs 4.1 to 5.5).
- 8.9 Payments **solely** for the use of a charity's logo may be annual payments rather than trading income. This will depend on the precise terms of the agreement for the use of the logo. The payments must be made under a legal obligation, be annually recurring and be in the nature of pure income profit in the hands of the charity (rather than a receipt against which expenses have to be set in determining the charity's income). If the payments are annual payments the payer will have to deduct basic rate tax from them. The charity can reclaim the tax deducted provided the income is applied solely for charitable purposes".

### Conclusion

Booklet CS2 is detailed and helpful and available free of charge. What more can one ask? It should be read by charities who trade and everyone who advises them.