ACTIVE PRACTICE UPDATES

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ACCOUNTING FOR CHARITIES

An overview of accountancy issues in the third sector.

If you're in charge of running a charity, you'll know how it differs from operating a business and how its motives and goals vary.

Non-profit organisations are treated very differently under the law, and managing a charity's accounts can offer some unique challenges as a result.

The stakes are high, too. The work charities undertake can literally be a matter of life and death, for the beneficiaries of charity work, whether it's in the UK or abroad.

In recent years, charities have felt under pressure, a combination of reduced investment from central government combined with economic uncertainty – more people are looking for help from charities, while at the same time fewer people feel able to give.

In this context, careful and meticulous accounting isn't just nice to have – it's essential.

There's a reputational issue, too. More than other sectors, charities largerly depend on public trust, and are thus expected to be ultra-transparent.

It only takes one or two examples of fraud or financial mismanagement for faith in the entire concept of supporting charity to take a substantial knock.

This is one reason why the use of charity status in tax avoidance schemes has been such a hot topic of late.

To a degree, however, the main role of the accountant is to:

- ensure finances are managed carefully and systematically
- make sure no more tax is paid than necessary
- maximise income from investments and assets
- ensure compliance.

WHAT COUNTS AS A CHARITY?

Tax law contains an official definition of a charity: "a body of persons or trust… using all its income and assets for its stated charitable purpose".

One of the key tests to determine the status of a charity is whether or not it exists to benefit the public as all charities have to satisfy the public benefit requirement.

In addition, the people running the organisation must be judged "fit and proper", though there is no prescribed set of criteria for exactly what this means.

Because this rule is intended to counter "sham charities and fraudsters", it is kept deliberately vague to give the Charity Commission room for manoeuvre.

For example, though, it would typically prevent people who have already been thrown out of one charity from taking up a trustee position elsewhere.

HMRC essentially delegates the validation of charity status to the Charity Commission in England and Wales, the Office of the Scottish Charity Regulator in Scotland or Charity Commission for Northern Ireland.

Once the appropriate regulator has confirmed that a body meets the requirements to be considered a charity, that body can then register with HMRC, which will issue a charity tax reference number to the body.

Even if the regulator doesn't confer charitable status, a separate application can be made to the Revenue for tax-free status, which will be granted in certain cases.

ALL ABOUT THE SORP

Charities accounting has special treatment in law, with larger charities expected to adhere to the sector-wide statement of recommended practice or Charities Statement of Recommended Practice (SORP).

The mandatory SORP was first introduced in 1995, building on an earlier non-mandatory version, and has been updated several times since. It is owned and managed by the various charity regulators of Britain and Ireland working in partnership.

Under the terms of the SORP, charities matching certain size and income criteria must prepare an annual report and a set of accounts, and submit an annual return to the Charity Commission by 31 January.

Registered charities in England and Wales with a gross income of less than £10,000 in the financial year are asked to complete the annual return only.

GIFT AID

Anyone who has ever dropped off a bag of books at a charity shop or sponsored a colleague's 10km run online will be familiar with the question: "are you eligible for Gift Aid?"

In the simplest terms, Gift Aid enables charities to reclaim an additional 25p for every £1 donated by an individual (or on the amount your unwanted goods are sold for).

It was introduced back in 1990, initially to support and encourage one-off cash gifts of £600 or more. The donation threshold was reduced to £250 before finally being abolished altogether in 2000.

Because of the potential for abuse of the scheme, Gift Aid comes with a lot of responsibility and paperwork.

Most importantly, charities must get Gift Aid donors to make a declaration of eligibility, and keep an auditable record of Gift Aid donations valued above £30.

Although it's up to individuals to make sure they are eligible to make Gift Aid donations before signing any declaration, charities can pay the price if they fail to carry out due diligence. HMRC can insist that any repayments made to charities for incorrect Gift Aid donations are paid back by the charity.

Government guidance on Gift Aid is hefty and intricate, covering everything from church collections to charity auctions, so it's definitely worth consulting an expert, or at least reading the documentation very closely indeed.

TAX RELIEF ON GIFTS TO CHARITY

It is possible for individuals and companies to claim tax relief on certain types of investment, and land or buildings, given, or sold at less than market value, to a UK charity.

Qualifying investments include shares or securities listed on a recognised stock exchange, or dealt in on certain UK markets (AIM and PLUS are the only two for now); units in an authorised trust (AUT); and shares in an open-ended investment company (OEIC) based in the UK.

If you're gifting land or buildings, you need to make sure the charity is willing accept the gift – you can't just lumber them with the upkeep on a decrepit historic building and walk away – and get them to supply a certificate confirming the deal.

Over the years, more than a few people have thought they had found a loophole: what if I give my house away, claim tax relief on the gift, but keep living in the property?

It sounds like a win-win but no such loophole exists. To qualify for tax relief, you have to give away the whole of your 'beneficial interest' to qualify, and continuing to live in the house invalidates such a claim.

If you make a gift to charity that qualifies for relief, you should make the deduction when you calculate your income for the tax year in which the donation occurred.

If it's an outright gift, you can deduct the value of the net benefit to the charity; any incidental costs, such as broker's fees associated with the process; and can add back on the value of other benefits you receive as a result of the gift, such as a thank-you present from the charity.

Unfortunately, these reliefs have been exploited in complex tax avoidance schemes over the years and so the rules have become dense with corrective clauses.

Contact us for advice on charity accounting or donations.