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Pros and cons of using a trading subsidiary

There are a number of considerations charities and their trustees need to make in deciding whether or not to set up and use a trading subsidiary company to carry out certain trading activities that might otherwise be carried out by the charity. In most cases, it will depend on the type of charity, it's charitable objects, the proposed activity and expected level of income.

Some of the key advantages and disadvantages of the subsidiary structure for consideration are listed below:

Pros

• In situations where the charity would be subject to a corporation tax liability by virtue of its non-primary purpose trading activities, the liability can effectively be reduced to nil by carrying out the taxable trading activities through the trading subsidiary and **donating profits** to the charity. Non-primary purpose trading is essentially trading which does not fall within the charity's objects.

• A charity can still carry out small-scale trading (non-primary purposes) where the total income is not expected to exceed £50,000. However, using a subsidiary to carry out this activity **removes the need to continually monitor** whether **the £50,000** has been breached.

• A 100% charity-owned subsidiary has an **extended nine months** after its accounting period end to make a Gift Aid payment and still obtain a tax deduction for that period.

• Commercial activity is **ring-fenced** in a separate limited liability company to protect the parent charity from risk of losses or other liabilities relating to the activity carried out in the subsidiary.

• Can allow more flexible **sponsorship** and commercial participator arrangements which could otherwise be taxable in the charity and/or expose the charity to more risk from the commercial sponsor or participator.

• The subsidiary will be a separate entity, presented as a non-charity trading company, and may be able to **secure certain grants** that the charity would not be otherwise able to. Restricted funds and assets in a charity can sometimes deter funders.

Cons

• Cost and administration of **setting up** a new company with a separate company registration, constitution and bank account.

• **Ongoing additional costs** - the subsidiary will need to prepare and file statutory accounts and a corporation tax return every year (even if it never has to pay any corporation tax). **Consolidated accounts** would be required for the charity.

• The Gift Aid payment to the charity parent is a distribution under Company Law, and the subsidiary must therefore have **sufficient distributable reserves** at the time the Gift Aid payment is decided. If the subsidiary cannot donate all of its taxable profits, it may need to pay corporation tax on those profits.

• A **license agreement** should be established between the company and the charity for shared use of the charity's facilities and in some cases limited use of the charity's brand.

• The subsidiary company will not be entitled to the mandatory **business rates relief** awarded to charities of up to 80% on its business premises.

• Subsidiary accounts tend to show **little reserves** due to donations made to the charity. This may need to be explained in more detail if using the subsidiary to apply for grants, leases or any other contracts.

• **Documentation** will need to be in the subsidiary's name, including sales invoices, employment contracts and volunteer agreements, as well as Retail Gift Aid agreements. Donors might question?

• For Charity Shops, there is less reporting back to donors for items sold by a subsidiary under the **Retail Gift Aid Scheme**.

• The charity can inadvertently breach the **VAT threshold** if some commercial activities are not carried out separately in a subsidiary.

• The sale of donated goods by a subsidiary can also be **zero-rated for VAT** purposes.

• The subsidiary may be able to claim **tax credits** for research and development activities.

…and finally, having a trading subsidiary in place may encourage the charity to carry out more income **generating commercial activity** it would not otherwise carry out.

• The company and charity may still have to charge **VAT on intra-group** transactions such as recharged staff costs where the VAT threshold is reached, unless a VAT group is set up.

Get in touch

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