

Charities developing a trading arm to raise money

Traditionally grants and commissions have been the sole source of income for the majority of voluntary sector organisations, however in these challenging economic times, some voluntary sector organisations have started to develop trading arms. Developing a trading arm to generate income can seem like a complicated process., so here is a quick introduction to the basic information about the legal requirements on trading, VAT and fundraising, taken from [LawWorks' Trading Arm Factsheet](#).

There are two primary types of trading and tax under charity law (which may also be combined into 'mixed trading'):

- *Primary purpose trading: this refers to income that is generated to directly support the object of charity*
- *Taxable or ancillary trading: Trading activities that are not directly in pursuit of the objects of charity*

What is a trading arm and when should one be set up?

A trading arm is owned by the charity to generate income for its parent charity. A trading arm should be set up in the event that the trading undertaken by the charity itself is unable to fulfil the charities primary objective and where, if the charity were to carry out non-primary purpose trading itself, there may be risks to the charities assets. It should function independently from the charity itself as a self-sufficient limited company.

What are the legal obligations of trustees?

The parent charity's trustees must be able to justify financial support for a trading subsidiary as an appropriate investment of the charity's resources. In all cases the interests of the charity must be paramount. The same considerations apply to an investment by a parent charity in a trading subsidiary, as to any other investment of a charity's resources. Trustees must monitor the effectiveness of the trading subsidiary and its relationship with the charity.

Are profits taxed?

As it is a limited company any profits made by the trading arm are liable to corporation tax, however it can make gift aid payments to its parent charity.

Funding a trading subsidiary with share capital

When a trading subsidiary is formed, its parent charity can freely make a nominal subscription of share capital in the trading subsidiary. Charities should speak to an investment adviser regarding the implications of investing share capital in a trading subsidiary. There are benefits to such an investment such as the confidence it gives to suppliers, customers, creditors and prospective creditors. However there is a risk that share capital might not be repaid in full if the subsidiary were dissolved.

For more in-depth information on the pros and cons of the investment of share capital, and further general information view the full [LawWorks factsheet](#).