DIXON WILSON
CHARTERED ACCOUNTANTS

DONATIONS TO PARENT CHARITY

Background

It has been common practice for wholly owned trading subsidiaries of charities to donate all taxable profits to the parent charity and to claim relief for the charitable donations in the year in which the profits arise, so that no corporation tax is payable by the subsidiary.

In some cases the amounts donated exceeded the distributable profits of the subsidiary company. This might occur where tax adjustments mean taxable profits are higher than accounting profits. Under previous Charity Commission guidance it was considered that these excess donations were not a distribution under Company law.

However the Charity Commission has recently changed its position stating that this previous guidance was incorrect and donations in these circumstances in excess of distributable reserves do represent a distribution.

The result of this is that some companies may have made historic 'unlawful distributions'. Where this is the case there will be accounting and tax implications.

Timescale

All excess donations made above distributable profits for the last six years need to be considered.

Accounting implications

The parent charity will be required to recognise a liability to repay the unlawful distributions received and the subsidiary company will need to recognise an associated asset. The asset would be subject to an assessment of recoverability.

It will need to be considered whether this adjustment should be made in the current year's figures or shown as a prior year adjustment.

Tax implications

HMRC have stated that tax relief will not be available for charitable donations which represent unlawful distributions. They will apply the new rules to any gift aid payments made in any accounting period commencing on or after 1 April 2015.

For previous periods it will be necessary to consider whether any adjustment will be required to disallow any excess tax deduction previously claimed.

Where the tax period is outside the enquiry window HMRC would need to raise a discovery assessment. This is considered to be unlikely if there was full disclosure in the tax return.

HMRC have confirmed there are no tax implications for the repayments of the liability that arises as a result of excess donations made.

Practical steps to repay any new liability

There are a number of potential options to settle the liability from parent charity to subsidiary arising from unlawful distributions including:

- Repayment of the liability.
- Offset against existing loan balances.
- Release of the liability - however distributable reserves are required and tax implications need to be considered.
- Declare a dividend - this would require distributable profits.
- Capital reduction - to create distributable profits. Care should be taken to avoid creating tax charges.

The most appropriate choice will depend on the specific circumstances of the subsidiary company and the parent charity. The accounting, tax and legal implications will need to be considered.

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Steps for future donations

Donation payments made should be restricted to the level of distributable profits available at the time of the payment.

Tax relief is available where a donation is made within 9 months of the year-end. If distributable profits have arisen after the year-end, suitable interim accounts will need to be drafted to consider what level of distributable profits are available to be paid as a donation.

Where taxable profits are likely to continue to exceed distributable profits in future years, a longer term solution may be required. This might include restructuring the subsidiary.

In some cases it will be the case that tax will need to be paid by the subsidiary company.

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