Membership organisations and corporation tax

The corporation tax position of membership organisations may be complex, as it will depend on the type of organisation and the nature of the activities being undertaken. Moore Stephens specialise in supporting membership organisations of all types and can help ensure your organisation only pays the right amount of tax.

A membership organisation is, in principle, subject to corporation tax on its profits in the same way as any company or unincorporated association, but any surplus arising from membership subscriptions and other income derived wholly and exclusively from its members would be outside the scope of corporation tax.

A proper review and analysis of an organisation’s income and expenditure streams should ensure that any corporation tax liability arises only on its non-membership activities.

What does a membership organisation pay corporation tax on?
As with any ‘normal’ company, a membership organisation will be subject to corporation tax on:
- profits from a commercial trade;
- investment income and chargeable gains.

As distinct from a ‘normal’ company, a membership organisation will mainly be carrying on activities for and on behalf of its members.
Not-for-profit
Membership organisations

Such activities will generally be outside the scope of corporation tax for one of two reasons:
1. Membership activities financed by subscriptions or donations are unlikely to meet the definition of a trade due to a lack of a commercial purpose or profit-making motive.
2. If, however, the activity is sufficient to constitute a trade, the resulting profits will not be taxable to the extent that they arise from mutual trading; i.e. broadly, from trading transactions carried on by the organisation with the members.

Whether trading
A membership organisation would not normally be expected to make a profit from its own members but to be funded sufficiently by its members to be able to provide the services required of it. Such a condition may also be written into the organisation’s constitution or governing articles.

On this basis, under general principles, the provision of services to its own members is unlikely to constitute a trade for corporation tax purposes due to the lack of a commercial purpose or profit-making motive.

Mutual trade
If a group of people join together for a common purpose their transactions with the umbrella body can be seen as mutual if:
• the body's legal framework passes the tests for mutuality;
• its transactions are with customers who are also members and accord with its legal framework.

Certain things need to be in place for a mutual trade to exist, and establishing the existence of a mutual trade can be complex. This will include ensuring that there is a reasonable correlation between the members who contribute to the funds of the organisation and those who are entitled to any surplus. Complications can arise if there are different classes of members.

Non-membership trading activities
A membership organisation will often carry on activities that generate trading income, but from third parties as opposed to members. Such income will be taxable trading income as it will arise outside the mutual trade carried on with the organisation’s members.

Thus a membership organisation will typically carry on a mixture of non-taxable membership activities and taxable non-membership activities. Some services may be provided to both members and non-members.

It is important to bear in mind that the organisation is only subject to corporation tax on the profit derived from such taxable trading activities. Thus it is crucial that a methodical approach be used to identify the organisation’s taxable profits to ensure it pays the right amount of tax. This would include a line-by-line review of an organisation’s sources of income, identifying the payer and the nature of the income, and then a similar line-by-line review of the organisation’s expenses so that any non-membership profits are correctly identified and taxed.

This review can be complex particularly when allocating expenses to different sources of income where there are shared costs.

We have carried out such exercises for many of our membership organisation clients ensuring that corporation tax is paid only on non-membership activities and only on the net profits from such activities.

Do you carry out non-membership activities? Have you reviewed the allocation of income and expenses recently?

Restructuring
The non-membership activities of an organisation may become sufficiently large and complex that, from a risk and commercial perspective, it may be appropriate to isolate them and carry them on in a dedicated subsidiary of the organisation.

The subsidiary would become fully subject to corporation tax in the same way as any other company but dividends could flow up to the membership organisation which would be tax-free in its hands. In addition, if the organisation decided to sell the subsidiary at a later stage, it might well not be subject to corporation tax on any chargeable gain provided it met the conditions of the Substantial Shareholdings Exemption. Professional advice should be sought prior to any restructuring.

Investment income and chargeable gains
Many membership organisations will hold significant investment portfolios in order to generate additional regular income on top of the membership subscriptions.
Any taxable investment income (for example, bank interest receivable) will be subject to corporation tax in the normal way. Similarly, sales of investments held by a membership organisation will be subject to the usual corporate chargeable gains rules.

This means the organisation, as well as carrying on a mutual trade of supplying services to members, would also be carrying on a business of making and managing investments. Costs in relation to the management of those investments would be tax-deductible separately as ‘management expenses’, and accordingly should be identified and claimed. These could include investment managers’ fees, stockbrokers’ fees and also salary costs of any employees in the organisation responsible for managing or monitoring the investments.

Trade protection associations
There is an alternative basis of taxation that applies to trade protection associations.

Ordinary trade protection associations, formed to protect the common interests of their members and funded by their annual subscriptions, are normally non-trading concerns; i.e. carrying on neither a mutual nor a non-mutual trade.

A member of a trade protection association is entitled to a tax deduction in its tax return for that part of its subscription which is applied by the association towards expenditure that would have been allowable had it been incurred by the member itself. This is called the Lochgelly principle, after an earlier case on the subject. This principle then requires each member to analyse the association’s accounts and make adjustments to the subscription claimed in its tax return to disallow its proportion of the association’s disallowable expenses. This can become very time-consuming and onerous, particularly for an association with many members.

To deal with this problem, a trade protection association, whose members’ subscriptions are not otherwise chargeable to corporation tax, may make an application to adopt a longstanding HMRC arrangement. This amounts to a contractual agreement under which:

- members’ entrance fees, subscriptions, levies and other payments, are allowed in full as deductions;
- payments that the association makes to members are treated in the hands of members as trade receipts;
- the association agrees to be assessed to corporation tax on any surplus of receipts over expenditure, computed under trading profits rules.

In other words, the association is subject to corporation tax as if it were a normal company and the members obtain full tax relief for their subscriptions to it.

Most existing UK trade protection associations operate on this basis. Complications can arise where the membership of the association includes a significant number of non-UK members because the association will be taxed on the surplus but there will be no corresponding UK tax relief for the subscriptions themselves.

Trade unions and provident benefits
Registered trade unions (TU) are also subject to corporation tax. The same principles as outlined above in relation to membership organisations should be applied in determining the membership and non-membership activities of the TU so that income and costs relating to services provided to members are excluded from corporation tax. Any costs incurred in connection with the political objectives of the TU are not tax deductible in any event.

Accordingly, the TU should only be subject to corporation tax on taxable profits derived from non-membership activities and investment income and capital gains.

However, as distinct from other membership organisations, a TU is exempt from tax on non-trading income and chargeable gains that are used to pay provident benefits, where the TU is prevented by law or by its own rules from providing benefits over £4,000 (for a lump sum) or £825 (for an annuity).

Provident benefits include any payment made to a member, or their representative, which is specifically authorised by the union’s rules, including a payment which is made:

- to a member for sickness or incapacity from personal injury or while out of work;
- to a member by way of superannuation by reason of age, sickness or incapacity from personal injury;
- to a member who has met with an accident;
- to a member who has lost tools by fire or theft;
- to cover funeral expenses of a member or their husband, wife or civil partner;
- to provide for the children of a deceased member.
The administration costs involved in providing these amounts are also allowable as provident benefits.

In addition, if the TU’s rules permit the following are also allowed as provident benefits:

• certain legal expenses;
• compensation for accident or injury;
• representing members at industrial tribunals in unfair dismissal cases.

Accordingly, a review of the provident benefits provided to TU members and the calculation of an appropriate element of administration costs should be undertaken each year to minimise any corporation tax liability arising.

Agreements with HMRC

With all membership organisations, their corporation tax position will be outside the norm and the preparation of a tax return will necessarily require certain judgments to be made in calculating the correct tax liability.

In addition, an organisation’s activities and income streams may change over time and will require regular monitoring to ensure the corporation tax position reflects those changes.

Although there is no statutory HMRC clearance procedure available in these cases and the normal Self-Assessment rules apply, it can be helpful to initiate a discussion with HMRC to obtain a general agreement on the corporation tax position particularly with regard to the allocation of income and expenses between membership and non-membership activities.

Let us help you

Our tax team acts for many membership organisations, trade protection associations and trade unions. We have a wealth of experience in all the above areas and can help with all tax aspects including:

• reviewing your organisation’s activities to ensure you are paying no more than the right amount of tax;
• negotiating and agreeing your organisation’s tax position with HMRC;
• advising on any restructuring of your organisation’s non-membership taxable activities.

We would be happy to meet with you to discuss your organisation’s tax position and learn about your needs, and to see where we can help.

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