Gift aid payments from trading subsidiary to parent charity where there are losses following COVID-19 lockdown

Many charities have trading subsidiaries which gift aid all, or a substantial proportion of, their profits to the parent charity. This is a very tax efficient way of raising funds for the charity as a company, which is wholly owned by a charity, is not liable to corporation tax on the profits which it donates to its parent as corporate gift aid.

The impact of lockdown for COVID-19 means that many charity trading subsidiaries may now be making significantly reduced profits or even losses. Charity trustees and trading subsidiary directors need to consider the impact this may have on gift aid payments for both the current and prior year and so on the subsidiary's tax liabilities.

Companies Act requirements for making gift aid payments

Corporate gift aid is legally defined as a distribution, like a dividend so can only be made from the company's distributable profits, that is accumulated realised profits less accumulated realised losses. For many trading subsidiaries, which donate their profit to the parent charity every year, the distributable profits will be limited to an amount very close to the profits for the last financial year.

Qualifying conditions for corporate gift aid payments

For a donation to qualify as a corporate gift aid payment it must be paid either during the year in which the profits are made or within nine months of the year end. The payment must be an actual transfer of cash from the subsidiary to the charity and not merely an inter-company transfer.

Company directors' duties

Before making a gift aid payment to the parent charity, the trading subsidiary directors must be satisfied that

- the company's distributable reserves are at least equal to the distribution, and
- the company will continue to be able to meet its liabilities as they fall due.

Any gift aid payment made in excess of distributable reserves in the company is a breach of the Companies Act and the excess is repayable to the company.

Trading subsidiaries may be facing losses as a result of the COVID-19 lockdown. The Companies Act says interim accounts should be drawn up on the same basis as the year end accounts, where there may be losses since the year end which have reduced distributable profits, to establish what are available.

Then also the company needs to review its ability to meet liabilities as they fall due. The charity may be happy to lend money to support this if forecasts show future profits will enable repayment and it is in the charity's interest to do so. This can help with cashflow but will not change the level of distributable profits.

Covenants

A trading subsidiary, which makes gift aid payments to the parent charity under a deed of covenant, may find itself in the situation where it has an obligation to make a gift aid payment in excess of the permitted amounts. Normally however a deed of covenant will say the payment will only be made if there are sufficient distributable reserves as it is illegal to exceed these.

Donations paid in year

If a trading subsidiary has made payments to the parent charity throughout the financial year, and prior to making those payments the directors were satisfied that such payments did not exceed distributable reserves, then those payments are legal distributions. This remains the case even if the subsidiary is subsequently incurring losses.

The payments made throughout the year may have been based on an estimate of the subsidiary's year-end profits. If the subsidiary is now making less profits, or making losses, then the tax advantage of some or all these payments will be lost.

Donations paid after the year end

Trading subsidiaries with year ends prior to the lockdown, may still be showing reasonable profits in their accounts. It therefore may be possible to consider making the anticipated gift aid payment to the charity now, rather than waiting until nearer the end of the nine months. Alternatively, the company could wait until nearer the end of the nine months to assess, with interim accounts, what distributable profits are available and pay those across to minimise the tax liability.

Tax liabilities and losses

If the permitted gift aid payment leaves the subsidiary with a taxable profit, it will have a tax liability to be paid nine months and one day after the year end. However, if the next financial year is loss making, the losses can be carried back and offset against this liability. However, the trading subsidiary will have to pay the tax when due and only reclaim it when the following year's tax computation is filed.