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Join the Club - Members' Clubs and Taxation

It is said to be one of the characteristics of the British that they will take any opportunity to form a club. This article looks at the taxation of Members' Clubs.

Members' Clubs v Proprietary Clubs

Some clubs are commercial enterprises, run for a profit, and are subject to the normal rules for taxation of business profits – think of a nightclub, or a professional football club, for example. These are known as "proprietary clubs".

Other clubs are run for the benefit of their members and while they may make a profit, in many cases, that profit is not taxable.

Ownership and Membership

The simplest rule of thumb to distinguish between these two types of club is whether the ownership of the club is different from the membership. If this is the case, it is likely that the club will be a commercial enterprise, run to make a profit for the owners out of its dealings with the members.

Other clubs are owned by their members, in the sense that all the assets of the club belong to the membership, and so do the profits.

"Mutual Trading"

It is a basic principle of taxation that you cannot make a taxable profit by trading with yourself and this means that in the case of a club which is owned by its members and which exists to provide them with (for example) sports facilities, any profit made from the fees paid by the members is not liable to tax.

I belong to a small local clay pigeon shooting club. Every member pays an annual subscription and an additional fee each time they come to shoot at our ground. Members can bring their friends as guests, but the member bringing the guest is responsible for paying their guest's fees. We try to set our fees to produce a modest profit each year, which is spent on buying new equipment and any surplus above that is converted into alcohol and drunk at the two club dinners we hold each year – again, the dinners are for members and their personal guests only. Our rules state that if the club were to be dissolved, its assets are to be distributed between the members at that time – in fact this would be the case under general law, but we have it in our rules just to avoid any doubt. Club policy is decided by a vote of all the members at the (usually acrimonious!) Annual General Meeting.

This is a typical example of "mutual trading" and our club is not liable to tax on the income it makes from its activities.

How far does mutuality go?

It is possible for a club's activities to be partly mutual trading (exempt from tax) and partly normal trading (taxable). If, for example, my shooting club were to be open to anyone other than members and their personal guests, then we

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Mitchells Grievson

Our mission is to always add value whatever we do for you, we will always carry out our work with the aim of adding value to your business. We run a very cost-effective business by making the most use of modern technology and resources.

This newsletter is designed to ensure you are kept up to date with the latest tax advice. This ensures you are provided with the most up to date information to enable you to stay ahead of the game.

As tax advisers, our objective is to work closely with you to ensure you pay the minimum tax required by law. We will help you to understand the tax implications of your actions, in order that you can plan ahead and conduct your affairs in the most tax efficient way.

Please do not hesitate to contact us if you have any queries.

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would be liable to tax (corporation tax, in fact, because a club like ours is classed as an "unincorporated association") on any profit we made from our trading with those non-members. It would be necessary to apportion the running costs of the club between the members and the non-members, to arrive at a figure for the taxable profits.

There is a trap here that some clubs fall into. In an attempt to preserve their "mutual" status whilst making a few pounds out of the general public, they introduce such concepts as "temporary membership", where a member of the public pays a small fee for a membership lasting (say) 24 hours and is then allowed to use the club's facilities. HMRC take the view that this is not enough to bring the temporary member into the magic circle of "mutuality" and any profit made from dealings with those temporary members is taxable.

Keep it mutual

If you are involved in a club like mine and it need not be a sports club - it could be, for example, a local amateur history society, a writers' group, a group dedicated to restoring an old traction engine, or any other such spare time activity - then in order to benefit from the exemption from tax for mutual trading, you need to make sure of the following points:

- The club must be owned by its members, which means that the club's assets must belong to them all. This is normally the case under general law if the club is not formed into a company, but some clubs are set up as "companies limited by guarantee" – in this case the mutuality principle must be made explicit in the rules for membership.
- In the same way, any "profits" the club makes must be used for the benefit of all the members of the club – for example, to buy new equipment, or to pay for social occasions open only to the membership.
- The club must not allow non-members to use its facilities. It is, however, acceptable for members to bring genuine personal guests, providing the member pays any fees for the guest. Be careful not to abuse this rule – if a member is allowed to "sign in" someone off the street so that they can use the facilities, then you have strayed beyond the boundaries of mutuality.
- Do not use a conventional limited company with share capital as the vehicle for the club – such a company generally cannot comply with the mutuality rules. However, a company limited by guarantee (see first bullet point above) can.
- Note that the exemption from tax for members' clubs does not apply to any investment income received by the club – if you keep the club funds in an interest-paying account, for example, the club must pay tax on that interest.

Q&A

Q I have a son who has recently "given it all up" to play poker full time. This is quite a new phenomenon I believe but not uncommon with younger people today.

My question relates to his tax status and whether he should indeed pay tax on his "earnings" or not. There seems to be a conflict of opinion about this.

Can you clarify? Might help me and other concerned parents out there

A As a general principle, gambling winnings are not taxable (and gambling losses are not deductible!). This includes "professional gamblers" if all they do is place bets or play cards for money. The only way your son might come within the tax net is if he did something like give lessons in card playing, or write a book on the subject.

For example, there was a tax case involving the proprietor of a nightclub who regularly played 'three card brag' with his customers and won a lot of money, and he was found to be taxable on his winnings because they formed an integral part of the trade of running the club. As long as your son simply plays poker for money, he will not be taxable, even if he wins enough to make it his sole source of income. By the way, your son might like to consider making voluntary payments of Class 3 National Insurance Contributions, to preserve his entitlement to the basic state pension.

Q I am purchasing a house, which is under construction, for £308,000. I will be incurring additional costs to upgrade the kitchen and other internal specifications, for example, better doors. In addition the builder will be constructing a patio. The additional cost will be some £30,000. The question is, will I pay stamp duty on the £308,000 or the £338,000?

A If the sale does not take place until after the extra work has been done, then SDLT will be charged on the full cost of £338,000. If, on the other hand, you are buying the property in an incomplete state for £308,000, and AFTER the sale you are paying the builder to do £30,000 worth of work on it, then it may be possible to pay SDLT only on the £308,000. The rules about this can be quite complicated, but your solicitor should be able to advise you on which scenario applies.

Tax Tips

Do You Have a Part-Time Employee?

If you are paying them less than the "PAYE Threshold" (£100 per week for 2007/08), you may not need to operate PAYE on their wages – but it is essential to get them to complete a Form P46 to confirm they are not liable to income tax

Don't Touch That Ticket!

If an employee incurs a parking fine in his company car, and the employer pays it, the fine paid will be taxable on the employee, unless: The car is registered solely in the employer's name, AND The parking ticket is stuck on the car rather than being handed directly to the employee

Did You KNOW?

The looters who ransacked the containers on Branscombe beach in Devon recently will be pleased to learn that if they sell the goods they stole, they will not be taxable on the profits – but if they sell their ill-gotten goods to a fence and he sells them on, the fence will be liable to tax on his profits. Mad, but true – see the 1962 Tax Case of JP Harrison (Watford) Ltd v Griffiths (40TC281, at page 299).

Do you have a guilty conscience?

If you have not been declaring some of your income, or have underpaid tax for any other reason, contact HMRC and tell them about it before they catch you – the penalties you pay will be significantly lower if you do this, and in some cases they may be waived entirely.

Consider this!

What a lot of investors fail to realise is that if you transfer ownership of a property to another party (including husband/wife), then stamp duty land tax will be liable if the property is mortgaged and the mortgage amount being transferred is over £125,000. This is called the 'chargeable consideration'.

The New Construction Scheme

On 6 April 2007, the Construction Industry Scheme (CIS) undergoes major changes. The purpose of this article is to highlight the most important of these and how they will affect those involved in the scheme.

What is the CIS?

The CIS is a scheme which applies to those involved in "construction operations" and requires "contractors" to follow certain procedures when making payments to "subcontractors".

What is a "contractor"?

The CIS does not only apply to businesses in the mainstream construction industry. In addition to such businesses, the following are also "contractors":

- A property developer – note that this would include someone who buys a property, refurbishes it, and then sells it on for profit, as well as someone who builds a property from scratch with a view to selling it. It does not, however, include a business involving buy-to-let properties (because such a business involves investment properties and makes its profit from the rental income rather than from turning the properties over as trading stock).
- Any business (including a buy-to-let business) if its average expenditure on "construction operations" is greater than £1,000,000 per year. Under the new scheme, there is a slight relaxation of the rules here – expenditure by a trader on his own trading premises does not count towards the £1m test.

The main changes from April 2007

The current CIS scheme revolves around paperwork. When paying a "subcontractor", a "contractor" has to inspect the subbie's CIS certificate and depending on what type of certificate is produced, he must either deduct tax (at 18%) from the payment and give the subbie a voucher recording the deduction, or pay him without deducting tax in exchange for being given a "payment voucher" by the subbie.

The tax deducted and copies of all the vouchers are sent to HMRC within 14 days of the end of the "Tax Month" in which the payment is made. A "Tax Month" ends on the fifth day of the following month, so the January 2007 Tax Month ends on 5 February and the tax and vouchers must be sent in by 19 February.

The contractor then has to make an annual return summarising all the payments made.

Under the new CIS, all this will change.

No vouchers or certificates

These will be scrapped. Instead, when taking on a new subcontractor, the contractor must contact HMRC in order to be told which category the subcontractor falls into:

- Registered for Gross payment – no tax need be deducted
- Registered for Net payment – tax deducted at 20%
- Not registered – tax deducted at 30%

In order to get this information from HMRC (by phone or online) the contractor will need to tell HMRC the subcontractor's "Unique Tax Reference Number" ("UTR") and (in the case of a company) the company registration number, or (in the case of an individual) his National Insurance Number. This process will be known as the "verification procedure".

At the end of each month the contractor will need to supply each subcontractor with details of the amounts paid and the tax deducted, and his /her (the contractor's) "verification number".

Monthly, not annual, returns

There will be no annual return under the new CIS. Instead, every contractor will be required to make a monthly return of the payments he has made under the scheme. The deadline for these returns will be the same as for sending in the vouchers under the old scheme – the 19th of the month following the end of the tax month – so the first new CIS return will be due on 19 May 2007.

These monthly returns will include a declaration signed by the contractor that:

- He has operated the "verification procedures" correctly for each subcontractor
- He has considered the tax status of each subcontractor and satisfied himself that they are self-employed

There are potential problems with both of these.

Verification procedure

Because there will no longer be any registration certificates, "verifying" each subcontractor depends on being able to give HMRC the UTR and NI number of the subcontractor. As well as the possibilities for simple error (leading to a requirement to pay under deduction of 30%, because the subcontractor will not be "verified" when the contractor contacts HMRC) several commentators have raised the issue of identity fraud.

The original CIS scheme (introduced in 1972) was bedevilled by fraud. In particular, payment vouchers were routinely sold by their rightful owners to unregistered subcontractors. When I was a tax inspector, I knew of at least three pubs in my area where there was a thriving market in these documents. The "new" certificates introduced in 1999 were an attempt to deal with this problem.

Under the 2007 CIS, a registered subcontractor who finds himself a little short of cash could sell the details of his UTR and NI Number to an unregistered subcontractor. As this information is all that is needed to get through the verification procedure, it is difficult to see how this could be detected by the contractor. Worse still, HMRC have been sending contractors huge lists of registered subcontractors, showing their NI numbers and UTRs – if one of those got into the wrong hands it could be the basis of a lucrative (if illegal) cottage industry of selling CIS identities.

The accountancy profession has tried to raise this issue with HMRC, but they report that HMRC do not seem to be concerned about it.

Employment status

This is not a new issue, but the fact that the monthly return now includes a specific statement by the contractor that he has satisfied himself that the subcontractor is self-employed and not an employee must mean we can expect a renewed zeal from HMRC in checking the employment status of subcontractors.

The point is that the CIS only applies to self-employed workers. Before operating the CIS the contractor must first consider whether the subcontractor is his employee or not. This is not the place to go into the distinctions between employment and self-employment (see last month's Tax Insider for an article on this tricky subject), but contractors need to be doubly careful that they are not operating the CIS when in reality they should be operating PAYE because the individual they are paying is an employee of theirs.

Penalties

Making an incorrect monthly return can lead to a penalty of up to £3,000 for the contractor. These penalties will no doubt be enforced in the case of mistakes about employment status, but it remains to be seen what the attitude will be where the contractor has "verified" a subcontractor who is using a stolen identity, as described above.

Hanging on the telephone…

Finally, for me the most worrying aspect of the new CIS is the fact that it all revolves around the "verification" procedure and this involves contacting HMRC about every new subcontractor, by phone or on-line.

Call me a pessimist, but if you are a contractor I have two predictions for you:

- If you use the online procedure, the system will crash (HMRC's record on IT is less than illustrious – ask any accountant about the teething troubles with online filing of self-assessment tax returns).
- If you use the phone, I hope you like 'muzak' because you are going to be listening to a lot of it while you wait for an answer – at least the line is an 0845 number so you'll only be paying local call rates!

It's a Gift – Gift Aid tax relief for individuals

Gift Aid is a tax relief for gifts to charity. This article deals with relief for gifts by individuals – the rules for companies are slightly different.

The tax relief

If you make a gift to charity, providing certain conditions are met, the charity can claim some tax back and if you pay tax at the 40% rate, you can get some tax relief.

For example, if you make a Gift Aid donation to a charity of £100, this is treated as if you had deducted tax at the basic rate (22%), so the charity is treated as if it had received £128, and because charities are exempt from income tax, it can claim a tax repayment of the £28. In other words, your gift of £100 actually puts £128 into the charity's funds.

If you pay income tax at the basic rate, you are not entitled to any tax relief, but if you pay at the higher rate (40%), you get tax relief on your donation at 18% (the difference between the higher and basic rates) on the "grossed-up" amount of your donation. In the case of the £100 gift above, this "grosses-up" to £128 as we have seen, so you get tax relief of £23 (£128 times 18%). So your gift of £100 has only cost you £77.

Conditions

A Gift Aid donation must satisfy the following conditions:

- The gift must be to a UK charity, or to a registered "Community Amateur Sports Club"
- You must either be UK resident, or have income or capital gains taxable in the UK equal to at least the "grossed-up" amount of the donation
- You must pay enough UK tax (income tax or CGT) in the tax year to cover the amount of tax in the "grossing up"
- The gift must be in cash (not, for example, a gift of clothes to a charity shop)
- You must make a "Declaration" that the gift is a Gift Aid gift – the charity will usually be able to provide a form for you to do this, or if they have the appropriate facilities to record it, you can even make the Declaration to them over the phone.

Other tax reliefs for gifts to charity

You can also get tax relief for gifts of shares or land to charities. In the case of shares, these must be "listed" shares – that is, shares that are bought and sold on a recognised Stock Exchange.

The relief you get is equal to the market value of the shares or the land at the time you make the gift, plus any related costs – legal fees, etc. HMRC's Self Assessment Helpsheet IR342 gives further details.

In some cases, it may be better for you to sell the shares or land and donate the cash to the charity under Gift Aid. For example, if you own some shares that cost you £10,000, and they are now worth only £1,000, then (if you are a higher rate taxpayer and you have other capital gains in the tax year), the choice is:

Gift of shares to charity:

- You get tax relief for £1,000 at 40% = £400
- You cannot get relief for the loss of £9,000 on the shares, because a gift to charity is treated as "no gain, no loss"
- The charity gets shares worth £1,000

Sale then gift

You sell the shares, making a loss of £9,000 which you can offset against other capital gains. You give the £1,000 sale proceeds to the charity under Gift Aid.

- You get tax relief on the "grossed up" value of the gift = £230
- You get loss relief for CGT on £9,000 of your other capital gains, which could reduce your tax for the year by up to £3,600.
- The charity gets your £1,000 cash, plus a tax repayment of £282

If you have other gains in the tax year against which you can use the loss, it is likely that you will be better off selling the shares and donating the cash – but you need to do the sums before you make the gift to be certain. If you are a basic rate taxpayer, however, you may be better off giving the shares or the land directly to the charity – again, you need to do the sums.

The charity will always be better off if you donate cash rather than the shares or the land, because of the tax repayment it can claim.

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