

Generating Income – Tax and Accounting

Introduction

This guide supports charities and not-for-profit organisations to understand the tax, VAT, and accounting implications of generating income from goods or services. It is particularly relevant for Youth Investment Fund (YIF) recipients expanding activities, using buildings to generate income, or diversifying beyond grants and donations.

It explains how income from activities such as room hire, trading, contracts, and participant fees differs from grant funding, and outlines the key compliance issues organisations need to consider.

Commissioned by YIF Central Support, the guide was prepared in 2024 by Ross Palmer, Tax Director at Sayer Vincent, an accountancy firm that has worked exclusively with charities for over 40 years.

The guide provides a practical overview of VAT, corporation tax, and accounting issues, and should be used as a starting point. Specialist advice should be sought where circumstances are complex or unclear.

Many charities and not for profit entities, including YIF recipients, are exploring generating income from additional sources. For YIF recipients this could particularly relate to utilising new or redeveloped buildings to expand services or generate income.

It is important to consider the potential consequences of receiving income or funding where you may be supplying goods or services in order to ensure that the organisation is complying with its accounting, tax and legal responsibilities.

Examples of activities organisations might be considering include:

<ul style="list-style-type: none"> Leasing/room hire 	<ul style="list-style-type: none"> Trading – sale of merchandise or refreshments 	<ul style="list-style-type: none"> Fundraising events
<ul style="list-style-type: none"> Bidding for local authority/NHS contracts 	<ul style="list-style-type: none"> Charging participants/beneficiaries for activities 	

While these opportunities represent a great opportunity to generate much needed funds, it is important that organisations understand the potential impact of delivering services, as opposed to receiving grant or donation funding to support activities.

Below are summarised some of the key accounting and tax factors that a charity should be considering for both new and existing activities which involve the charity making a supply of goods or services.

VAT

Unlike grant and donation funding, which is outside the scope of VAT, income earned from supplying goods and services is generally within the scope of VAT. This is important to identify as:

- For a VAT registered organisation – identify if VAT needs to be charged, and whether associated VAT on expenditure is recoverable.
- For non-VAT registered organisations – any income earned that would be subject to VAT needs to be included in assessing whether the organisation needs to register for VAT against the registration limit (£90,000, as of January 2025).

VAT is a complex tax and while there are many exemptions and reliefs that can apply to charities, these are often subject to certain conditions. It is important to consider each new arrangement separately, as minor changes in the nature of a service can result in a different VAT treatment. Organisations which are VAT registered, or close to the registration threshold should ensure that the VAT treatment is considered for new activities in order to remain compliant.

Corporation Tax

While charities are exempt from corporation tax on the majority of their activities, this does not apply to all income a charity may generate. Key charity tax exemptions are:

- Primary purpose trading – The activity fulfils one or more of the charitable purposes of the charity, as set out in the charity’s governing document.
- The activity is mainly undertaken by the charity’s beneficiaries
- Income generated from a qualifying fundraising event.
- Income arises from a property business. This will generally cover letting of surplus rooms/space, but not where significant additional services are supplied.
- Small scale trading – income from non-exempt trading can be undertaken exempt from tax in a charity if kept within the following limits

Charity’s gross annual income	Maximum small trading limit
Under £32,000	£8,000
£32,001 to £320,000	25% of gross annual income
Over £320,000	£80,000

Charities should ensure that they review their activities to ensure that they are exempt in order to avoid any potential corporation tax charge and should seek out further guidance and advice where the position may be unclear.

Accounting

The accounting treatment of income earned from the delivery of goods/services is different than grant income. Key differences that may apply are set out below and charities should ensure they consider these when preparing annual accounts.

Grants & Donations	Delivery
Grants should be accounted for as restricted if given for a specific purpose.	Income earned from delivery of services will usually be unrestricted.
Usually recognised on receipt, with unspent restricted funds carried forward in accounts as a fund balance.	Income recognised based on delivery of the related service, deferred if not delivered under following year.
Unused funds should be offered back to funder, or alternative use agreed.	Unspent funds can usually be retained by the organisation as reserves or used to support other activities.

Summary – grants vs contracts

Grants and donations

A grant or donation is a freely given gift, with the timing, amount and frequency at the donor's discretion. There is no service provided in return to the donor.

Accounting	Grants should be accounted for as restricted if given for a specific purpose. Usually recognised on receipt, with unspent restricted funds carried forward in accounts as a fund balance. Unused funds should be offered back to funder, or alternative use agreed.
Tax	Freely given grants and donations are usually not subject to tax or VAT. Grants linked to a service or based on results can have tax consequences in some situations and may require further review. Freely given donations from individuals have the potential for Gift Aid, subject to Gift Aid scheme conditions.
Legal	Grants and donations are subject to trust law rather than contract law

Contracts

Income from delivery of services is usually delivered under a contract. For a contract to exist there must be an offer and acceptance, but it does not have to be in writing.

Accounting	<p>Income earned from delivery of services will usually be unrestricted.</p> <p>Income recognised based on delivery of the related service.</p> <p>Unspent funds can usually be retained by the organisation as reserves or used to support other activities.</p>
Tax	<p>Will usually qualify as trading income for both corporation tax and VAT purposes. Need to consider:</p> <ul style="list-style-type: none"> ● Whether income qualifies as exempt from corporation tax. ● If there are any relevant exemptions from VAT. If not, then the income is potentially subject to VAT and: <ul style="list-style-type: none"> ● VAT registered entities should charge VAT ● Non-VAT registered entities should include this income when assessing if there is a need to register for VAT.
Legal	<p>A contract is an agreement between two parties – but it does not have to be in writing. Contracts are legally binding and covered by contract law</p>