

Having the right constitution can save you tax



The issue

Membership and trade associations are often excluded from having to pay tax on the profits that result from transactions with their members due to the available mutual trading exemption.

As part of our standard audit work for a new trade association client we reviewed their tax status to ensure they were set up to take advantage of the mutual trading exemption. This included a review of the relevant clauses within their memorandum and articles of association.

The company had previously been claiming tax exemption on mutual trading; however our review of their governing document disclosed that their constitution was not set up correctly to allow them to benefit from this exemption. Their articles of association stated that on dissolution of the company any remaining assets would be transferred to a similar organisation and not to members.

Had this been noticed by HMRC, this could have led to significant tax liabilities for the organisation going back over a number of years.

To be eligible for this exemption, associations need to have a common aim for its members. Clear guidelines setting out the relationship between the members and the association should be in place.



As a general rule:

- any profits should either be distributed to members or reinvested in the business;
- decisions about the future and general running of the association should be made by the members and;
- on any winding up any surplus funds must only be payable to members.

Eligible organisations are not liable to pay tax on trading profits that arise from their mutual trade –i.e. from trading with members. This does mean, however, that they can't utilise any trading losses which may occur from their mutual trade, or claim related capital allowances or expenses.

In some circumstances HMRC seek to restrict the tax relief for members on their subscriptions so trade associations agree with HMRC to be taxed on those membership fees in return for them being tax deductible for the members. Any such agreement should generally only apply to the subscriptions and not to other income from members.

The solution

We recommended our client should amend their articles to state that on dissolution any assets would be distributed to qualifying members of the association.

The company produced a draft amendment we reviewed. This was then incorporated into their governing document via a resolution passed by the members.

The amendment has retrospective effect from the time when mutual trading first occurred; therefore no back tax duties are payable.

This highlights the importance of regular check ups on the tax status of trade associations to ensure that the structures are set up in the most tax effective way to benefit from all possible tax exemptions and other tax saving opportunities.

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