

Denbighshire Voluntary Services Council

Your local county voluntary council



7. Finding and getting money

7.8 Trading

Overview

Third sector organisations are increasingly being encouraged to diversify their income streams in a variety of ways to ensure long-term financial sustainability. This information sheet is intended to provide a brief overview on trading and the issues which third sector organisations should consider before embarking on a trading project.

What is trading?

Trading takes many forms including:

- Charging beneficiaries and user groups for services (e.g. training courses, room hire).
- Selling goods on the open market (e.g. publications, food and drink).
- Selling services on the open market (e.g. consultancy work, childcare places).

Trading is often referred to as 'social enterprise'. The term social enterprise can refer to a type of *activity* that third sector organisations undertake to generate profit, or to an *organisation* practising that particular type of activity.

Approaches to trading

There are a number of approaches to trading:

- **Mission-related trading** – Selling 'core' related goods or services which are directly related to an organisation's aims and objectives. As well as furthering an organisation's mission, this form of trading can also generate valuable surpluses.
- **Unrelated trading** – When it is not possible for an organisation to combine its services with generating income, unrelated trading may be considered; selling goods and services which may have little relation with core aims, but generates profit which can be used to subsidise core work.
- **Cost recovery** – An element of mission-related trading which involves charging user groups and beneficiaries to cover the basic cost of a service, not to make a profit but to provide a subsidised service.
- **Social firms** – This model is often a route into trading, arising from the nature of an organisation's activities. Social firms aim to create real jobs and training

opportunities for people marginalised from the labour market or seek to deliver high-quality, affordable services beyond those of the state.

- **Contracts** – This involves generating income through the provision of goods or services outlined via a contractual agreement with a purchaser.

Benefits of trading

Trading has many benefits:

- **Earned income is unrestricted** – it can be used to meet an organisation's needs rather than being spent as dictated by a grant funder.
- **Increased independence** – unrestricted income can help to further an organisation's mission.
- **Adoption of new approaches** – business-like approaches need to be adopted to build an entrepreneurial culture.
- **Refreshment of skills** – such as marketing, negotiation and financial management.
- **Involvement** – trading often allows service users to become involved in the planning of service delivery.
- **Efficiency** – by charging for things owned by an organisation that are unused or used infrequently (e.g. rooms or equipment), organisations can ensure that they are maximising the use of their assets.

Considerations

Before embarking on the development of a trading idea, the points below should be considered to assist in determining whether trading is an option:

- **Legalities** – Governing documents must allow for the undertaking of trading activities. As well as legal matters, registered charities must also consider taxation issues. Independent legal advice on these matters should be sought at all times.
- **Organisational culture** – Organisations must be ready to consider new approaches to funding and adopting entrepreneurial approaches. A reluctance to do this can often cause problems.
- **Planning** – Thorough planning must be conducted to explore all avenues available to an organisation and to determine any potential risks. Effective planning will contribute to success and continued development of trading activity.
- **Finance** – Start-up costs are usually unavoidable when undertaking a new activity. It is imperative that all start-up costs are calculated accurately at the outset to avoid any unexpected surprises.
- **Taxation** – Although charities benefit from some tax exemptions, trading could result in paying corporation tax or charging for VAT. It will be vital to seek specialist advice.
- **Training needs** – Conducting a skills audit and training needs analysis will determine what additional skills may be needed to ensure the success of a new venture.

- **Pricing v. cost** – also ensure that you realise the true cost of any project and that you recover all costs (full cost recovery).

Legal issues for charities

For charity law purposes, there are three categories of trading which are permitted:

- **Primary purpose trading** – trading that contributes directly to the objects of the charity. An example could be a charity working with disabled people selling goods manufactured by their service users. Profits are not subject to corporation tax.
- **Ancillary trading** – trading that indirectly contributes to the charity's primary purpose. For charity and tax law, ancillary trading is treated as the same as primary purpose trading, and profits are not subject to corporation tax. An example might be an art gallery or theatre that sells refreshments to its visitors.

Non-primary purpose trading – selling goods or services purely for profit thus generating income which can be used to subsidise core work. Charities can only engage in such trading where no significant financial risk is involved. This means that you have to be sure that the trading will make a profit. These profits are normally subject to corporation tax.

If the trading activity is unrelated to the charity's objects, and involves significant financial risk, then it should only be undertaken by a **trading subsidiary**. This is a separate company established for the purpose of trading. This can also create a useful separation between the trading activity and the charity's other work.

The following activities are not counted as trading for charities, and therefore income from them is not taxed:

- Investment income
- Rent from land
- Sale of donated goods

It should be noted that cleaning and making small repairs to donated goods is acceptable, but making significant alterations is not.

The first steps to trading

Developing an idea to generate income is not always as easy as it seems. To assist with this process, you may find it useful to use the questions below to facilitate a group discussion in order to collect your thoughts and ideas:

- **Why do you want to trade?** Consider whether you'll be trading to further your organisation's mission or to simply make money. This will influence your future activities.
- **What are you selling now?** This may be on a small scale but consider how income is currently generated. Can this be developed further?

- **What can you sell?** Saleable items are not always visible. Consider also the skills and knowledge within your organisation and services that can be provided for a charge.
 - **What do you want to sell?** It is not always possible to develop every idea that is generated. The capacity of your organisation to deliver must be considered in detail.
 - **Who can you work with?** Forming relationships with potential partners can help to develop larger-scale activities.
 - **Who will your customers be?** It always helps to understand your customers' needs before establishing a new service or product.
 - **Who will your competition be?** If your proposed product or service is already available in the local area, consider how you can ensure a better quality of provision.
- How much will you charge?** Any trading activity should be self-financing and ideally generate a surplus to support your organisation. You should ensure that your organisation does not have to subsidise a trading activity.
- **How are you going to sell?** Investing in marketing is vital to ensure the success of any trading activity. You must ensure that as many people as possible know about it.

Further information

The Charity Commission

The regulator and registrar for charities in England and Wales. Publication CC35 details the legalities surrounding charities and trading. Tel: 0845 3000 218

www.charitycommission.gov.uk

HM Revenue & Customs

A single reference point for information about tax and VAT for charities along with information about tax reliefs for charitable donations. Tel: 08453 02 02 03

www.hmrc.gov.uk/charities

Disclaimer

The information provided in this sheet is intended for guidance only. It is not a substitute for professional advice and we cannot accept any responsibility for loss occasioned as a result of any person acting or refraining from acting upon it.

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