

DISTINGUISHING INCOME AND CAPITAL (amended 3/10)

Main points:

- what is income? (25)
- what is capital? (26)
- distinguishing income and capital (27)
- calculating gross income (28)
- capital (endowment) in the Methodist Church (29)

Trustees and others are often confused by the terms **income** and **capital**. Part of the problem is that the terms have several meanings. It is therefore important to understand the context in which the terms are used.

25 Income

This has three meanings:

1. It may mean **profit** earned either from trading (trading profit) or investments (investment income).
2. It may mean the amount of **incoming resources** by an organisation for the year (as in Income and Expenditure).
3. It may refer to the way in which **resources must be used**: income assets must be used within a reasonable period (this contrasts with capital assets - see below).

Gross Income

This is a term used by the Charities Acts and is used for thresholds in the Act (such as Audit and Accruals accounts thresholds). Gross income is a specific part of **incoming resources** and so relates to the second definition of income given above.

(Section 28 sets out guidance in calculating gross income.)

26 Capital

This also has three meanings

1. It may mean the **amount that owners have invested** in a business (as in share capital)
2. It may refer to the way in which **resources must be retained**: capital assets held by a charity must be retained and only the income (= profit) generated from the assets may be spent. This type of asset is also called an endowment
3. It is otherwise used, in accountancy terms, to mean '**fixed assets**' of an organisation (as in capital purchases)

27 Distinguishing Income and Capital (Endowment)

Legally the assets held by a charity (Church) must be used only for the purposes for which they were provided.

Most assets are provided to be used up (i.e. expended) within a reasonable time of them being received. These are income assets and are held in **income funds**.

However if an asset was provided with the intention of it being **retained** by the charity, and only the profit earned by that asset (eg investment income) can be expended, then this is a capital asset provided and it is held in a **capital fund**.

Capital funds are also called **endowment funds**.

Capital may be a **permanent endowment**, where the trustees have no power to convert the principal into income, or **expendable**

endowment, where trustees may, under some defined circumstances, convert it to income.

Capital (endowment) funds may be investments (as when someone leaves the remains of a legacy to be invested for the benefit of a charity/Church) or they may be property (such as Church land and buildings or manses) which will be used for the charity/Church. Normally, Methodist property is not defined as endowment.

28 Calculating Gross Income (and Total Expenditure)

The Charities SORP (Statement of Recommended Practice) uses the term **gross income** to set thresholds for various duties of trustees (eg when audit is required). The SORP provides an interpretation of this term.

Gross income normally includes weekly giving and all tax efficient giving under gift aid, tax refunds, donations, bequests that are not capital (*see below*), rental and investment income, fund-raising (gross proceeds), and grants received.

Gross income does not include the following:

- loans received by the Church
- loan repayments to the Church

Gains or profits on sale of investments and fixed assets are incoming resources and therefore gross income. This includes capital receipts from the sale of property. (see guidance on the Standard Form of Accounts)

Gross income also excludes any money received which increases the charity's capital (endowment) funds.

Similarly **total expenditure** does not include:

- Loans repaid by the Church
- Loans made by the Church
- Payments made for investments and fixed assets
- Losses on the sale of investments.

However, depreciation (writing off of the original cost of fixed assets) which is found in accruals

accounts will count towards total expenditure. Depreciation is not found in receipts and payments accounts.

Total expenditure is no longer used to define the thresholds for accounting and scrutiny purposes.

29 Capital (Endowment) in the Methodist Church

The Methodist Church Act 1976 permits the Conference, by Standing Order, to prescribe what shall be capital and what shall be income (*see Model Trust 19*).

In the Methodist Church, capital funds include

- **proceeds of sale** of Methodist property (most proceeds of sale from chapels and manses go into the Circuit Model Trust Fund)
- **money raised for a building project** or to buy land where the land or building is already capital.

Monies raised for a building project must therefore be included in the calculation of gross income.

The Standing Orders of the Methodist Church give full information about:-

What is classed as capital and what is income (SO 915) and the purposes for which capital (SO 916) and income (SO 917) may be spent.

(See Guidance on use of Methodist funds for Methodist bodies and non-Methodist organisations on the website)