Charity Tax Map






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charity tax group

Nuffield Foundation

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Foreword

This is the second edition of the Charity Tax Map, a detailed and comprehensive review of taxes, exemptions and reliefs applicable to charities. It is my pleasure as Treasury Minister responsible for charities to write a foreword to this important and instructive publication.

Charities are at the heart of the Government's ambition to build the Big Society, enabling people to play an active role in their community. The Government is committed to encouraging charitable giving and ensuring philanthropy in the UK thrives and grows.

Through the tax system, the Government supports charities with a range of reliefs and exemptions including reliefs for charitable giving. This support is worth over £3 billion a year, with a large part of this delivered through Gift Aid.

Gift Aid was introduced by the then Chancellor, John Major in his budget of 1990. The scheme has since been expanded by successive Governments and is now worth over £1 billion a year to charities.

I am proud that following the Chancellor's announcement in 2011 we are enshrining the Gift Aid Small Donations Scheme in law. This will enable tens of thousands of charities and Community Amateur Sports Clubs to claim Gift Aid on small cash donations for the first time, where it is too difficult to obtain a Gift Aid declaration.

To ensure that tax reliefs are accessible to all those eligible regardless of their size and without placing undue administrative burdens on them, HMRC are introducing a new system of online filing for Gift Aid claims.

Through support for Gift Aid we are ensuring that everyone can give in a way that works for them and, if they are UK taxpayers, will give maximum benefit to the charity.

Finally I would like to take this opportunity to thank those at the Charity Tax Group, The Nuffield Foundation and all the other organisations, volunteers and professionals across the sector, for their invaluable contributions to charitable work both in the UK and abroad.

Sajid Javid MP

Economic Secretary to the Treasury

Charity Taxation: an introductory overview

A brief history of charity tax reliefs[1]

Governments have long recognised the importance of excluding charities from the general system of taxation. Under Elizabeth I grave concern for the plight of the poor – and a recognition that philanthropy could help – led to the Statute of Charitable Uses 1601. In the modern era charities have been exempted from taxation as the taxes themselves have been devised, beginning with exemption from income tax when it was introduced by the Income Tax Act 1799. In Victorian times, the subject of charities and tax was debated both in Parliament and in the Courts. In *Income Tax Special Purposes Commissioners v Pemsel* [1891] AC 531 their Lordships decided that charities of all persuasions should be entitled to exemption from taxation, a view that echoed Disraeli's exhortation, some years earlier, that charities' exemption from taxation "is not a privilege – it is a right".[2] However, as the system of taxation has become more complex, so too have the arrangements to secure appropriate reliefs and exemptions for charities. The level of complexity has now reached a point where it is hard to reconcile those arrangements with the principle enunciated by Disraeli in 1863.

Until it was withdrawn in 2000, tax relief on deeds of covenant had been the main tax-effective mechanism for charitable giving: a mechanism that can be traced back to the Income Tax Act 1842. However, charitable deeds of covenant were subjected to increasing restrictions; and in 1955 the Royal Commission on the Taxation of Profits and Income[3] considered the case for replacing them with a US-style donor relief system. In the event, the Commission rejected the proposal on grounds of practical and administrative complexity, concerned that a change would produce a short-term drop in charities' income and place extra administrative burdens on the Inland Revenue.

The system then underwent minor modifications; but a major change came in 1980 when, in response to a recommendation of the Goodman Committee on Charity Law in 1975, relief at higher rates was reintroduced with an initial annual ceiling of £3,000: £18,800 at 2009 prices when adjusted against the RPI. The new relief, one of several measures in the Finance Act 1980 intended to help charities, was expected to increase giving from higher-rate taxpayers and the ceiling was introduced to help manage the 'cost' of the relief (so far as HM Treasury was concerned) and because other countries with donor reliefs had similar ceilings. The ceiling was raised to £5,000 in 1983, to £10,000 in 1985 and abolished completely in 1986, though the minimum three-year duration for covenants was retained.

As well as abolishing the ceiling on higher rate relief for charitable covenants, the Finance Act 1986 introduced a new relief which allowed employees to have one-off or recurring gifts deducted directly from their pay up to an annual limit of £100 (£230 at 2010 prices): "payroll giving", launched in 1987 and based on the US United Way model. It was designed to encourage people to make small, regular donations, with payroll giving agencies approved by the Inland Revenue acting as intermediaries between employers and charities. The rationale behind the use of payroll giving agencies was to ensure that administrative burdens were not placed on employers and to reduce the need for the Inland Revenue to check that donations went only to genuine charities. Payroll giving did not replace the deed of covenant; but the cap was gradually increased until by 1996 it was £1,200 (about £1,812 at 2010 prices)

The 1986 Finance Bill also included an abortive proposal for a new definition of a "private indirect charity", intended to protect against abuse of the uncapped relief by "donor-controlled charities", a mechanism

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1 The material in this section draws in part on a paper prepared for the Gift Aid Forum by Jeremy Sherwood: *Tax reliefs for charitable donations – an overview.*

2 Picarda, *The Law and Practice Relating to Charities* Third Edition (Butterworths, 1999), 733

3 Cmd 9474.

for tax avoidance that had become of increasing concern to HM Treasury. It was feared that sham charities were being set up by donors with trustees who were either close family members or who could be relied upon to do as they were told and channel donations and the associated tax relief back to the donor by circuitous routes. However, because there was concern that the "private indirect charity" definition might impact adversely on genuine charities, the proposal was replaced by the current anti-avoidance rules in Schedule 20 Income and Corporation Taxes Act 1988, which impose a tax charge on charities where they carry out "non-qualifying expenditure" or make "non-qualifying loans or investments".

Gift Aid was introduced in the 1990 Budget, with the aim of increasing the incentives for charitable giving by supplementing existing incentives for regular donations through payroll giving and covenants with a new relief for sizeable lump sum gifts. It was intended as a tax relief for one-off donations that would:
- provide an incentive to donors to give more;
- be acceptable to the bulk of charities;
- be workable at a reasonable administrative cost;
- be acceptable to HM Treasury in terms of tax revenue foregone; and
- so far as possible, minimise the scope for fraud or abuse.

The minimum Gift Aid threshold of £600 was introduced mainly to control the reduction in tax revenue but partly because Gift Aid was not intended to replace payroll giving – which is why the Gift Aid minimum was aligned with the payroll giving maximum. In the event, however, the minimum gift was reduced to £400 in 1992, to £250 in 1993 and abolished altogether in 2000.

The mechanics of Gift Aid were modelled on the deed of covenant:
- the donor had to give a "certificate" to the charity in relation to each gift stating that the gift met the rules for the relief and that s/he had paid as much basic-rate income tax as the charity could reclaim on the gift;
- Gift Aid was restricted to gifts of money;
- the charity received credit for the basic-rate tax paid by the donor on an amount of income equivalent to the gross gift; and
- if a donor who was not a taxpayer gave a gift under Gift Aid and the charity claimed back the income tax, the donor would be assessed to tax on the gross amount of the gift.

The original rules disqualified any gift for which the donor received a benefit in return, because the relief was aimed at stimulating donations rather than payments for services or benefits.

In 1997 the then Chancellor of the Exchequer launched a review of charity taxation which was consolidated within a consultation document, *Review of Charity Taxation, March 1999,* published in the spring of 1999. Its stated purposes were to encourage donations to charities both from individuals and from businesses and to simplify the tax system for charities. At the time, charities were particularly concerned about the withdrawal of their Advance Corporation Tax (ACT) relief and the scale of irrecoverable VAT that they suffered; but the Government displayed no appetite to address either of those concerns. The review did not seek any radical alteration to the system. Nor did it substantially extend the scope of the reliefs and exemptions[4] from rates and taxes that charities already enjoyed. Furthermore, the review did not articulate a rationale for charitable tax reliefs other than to underline the value that the Government attached to charities generally.

The 1999 pre-Budget report announced a package of measures, *Getting Britain Giving,* aimed at modernising and simplifying the incentives for charitable giving, which had declined in the 1990s. The package, implemented in Budget 2000 and amplified in the Inland Revenue's note of November 2000, *Getting Britain Giving: Inland Revenue guidance note for charities,* included:
- the abolition of the £250 minimum limit for Gift Aid donations;
- a new Gift Aid declaration process enabling donors to make Gift Aid donations by telephone or over the internet;

[4] For brevity, reliefs and exemptions from rates and taxes will henceforth be referred to simply as 'reliefs'.

- new benefit rules, in effect combining the existing rules for covenants and for Gift Aid;
- abolition of the £1,200 maximum limit for payroll giving;
- a new relief for gifts to charity of quoted shares and securities; and
- removal of existing barriers facing those who wished to settle assets to charities through trusts.

The package also relaxed the requirement for the donor to have paid as much basic rate income tax as the charity would claim back on the gift: for the first time a claim could be covered by capital gains tax and income tax paid at any rates.

Further reliefs were brought in by the 2002 Budget:
- an extension of the gift of shares relief to include gifts of qualifying interests in land;
- an election for a Gift Aid donation to be treated as if it had been made in the previous year, so as to allow higher-rate donors immediate access to Gift Aid through the self-assessment return; and
- extending some of the charity tax reliefs, including Gift Aid on donations, to Community Amateur Sports Clubs.

Other less radical changes have followed in subsequent years.

A rationale for charity tax reliefs: views from Government

As noted above, the Labour Government did not make any substantive statement in 1999 as to the rationale for charity tax reliefs. However, a number of respondents to the consultation did attempt such a rationale: in particular, *The Government Review of Charity Taxation: Submission by the Charity Law Association 1999* summarised the historical and sociological reasons why it was desirable for a society to relieve charities from the burden of taxation that was otherwise to be applied fairly and universally to individuals and businesses.

A clearer view from government emerged during the final years of the previous Administration. The *Policy Overview Paper* published by HM Treasury in March 2010 made it apparent that the Government had two principal objectives in mind when considering charity tax reliefs and exemptions. The first was to encourage more people to give to charity – which was and remains uncontroversial. The second was to support and encourage charitable causes through the system of reliefs and exemptions and 'to improve sustainability of' the sector and 'finance' it through charitable tax reliefs.

The first, as noted above, was one of the main aims of the review of charity taxation in 1999. Though the second objective might appear benign at first glance, it reveals the central tenet of the previous Administration's attitude to charity tax reliefs: that they constitute *expenditure* by the Treasury and therefore represent an expression of the Government's (or at least of the taxpayer's) generosity. In short, the Government started from the position that charities – and gifts to charities – were in principle taxable unless a case could be made as to why it made sense in wider policy terms not to tax them.

The overriding budgetary objective of the Coalition Government has been to reduce the National Debt – as evidenced by the results of the Comprehensive Spending Review that it conducted in its first few months in office; and despite the Government's ambitions for the 'Big Society' – which might indicate that more resources should be available to support voluntary activity – the health and sustainability of the charitable sector has been seriously affected by public spending cuts and the resultant funding.

The Coalition Government appears to have maintained the 'official' view of its Labour predecessor that charity tax reliefs are a form of Treasury finance – and that stance inevitably raises all manner of policy and political considerations. On that basis, reliefs can only be justified politically if they conform to other policy objectives such as geographical redistribution of wealth, favouring or not favouring particular demographic groupings, or supporting the work of 'aligned' organisations and ignoring those whose purposes (though charitable) are not so aligned.

The counter-argument is that such concerns are simply irrelevant: an organisation established for purposes recognised as charitable (ie for the benefit of the public) warrants exemption from tax without further interrogation of the political value of those purposes. The 'official' view of successive Governments as to the proper basis for a system of charity taxation and reliefs is far from being generally accepted across the sector.

A rationale for charity tax reliefs: the unity of public purposes

In 1999 the Charity Law Association expressed a fundamentally different rationale. In its view, the overriding purpose of taxation is to raise funds from individuals and organisations within society in order to meet the expenditure required to service the needs of that society, including (in today's climate) reducing the National Debt: in short, expenditure for the public benefit. Because paying taxes is mandatory, their imposition carries with it a parallel obligation on the state to seek to achieve fairness, effectiveness and efficiency if taxation is to have general support – as the recent debate that led to the decision to limit Child Benefit for families in which one of the partners is earning £50,000 or more has illustrated.

Charities are by definition established to deliver benefits to the public. As well as setting out specific lists of charitable purposes,[5] the Charities and Trustee Investment (Scotland) Act 2005 and the Charities Act 2006 (which has now been consolidated into the Charities Act 2011) that resulted from the reviews of charity law in the two jurisdictions made explicit for the first time the long-standing precondition in both Scots and English common law that a purpose had to be for the public benefit if it was to be recognised as charitable.[6] The 2005 and 2006 Acts were undoubtedly intended to reinforce the mandate of charities and to reassure the public and the voluntary sector alike that the two Governments recognised the special value to society delivered by charities. Further, they removed any presumption that any particular purpose was inherently for that benefit.[7] While there is a current controversy about the application of the public benefit test in England and Wales,has been the subject of two separate challenges: whether or not the Charity Commission's guidance on and application of the law relating to public benefit and fee-paying schools was legally correct and whether or not "poor employees" and "poor relations" trusts conferred any public benefit at all. The first of these resulted in major changes to the Charity Commission's guidance which, at the time of writing, were still in draft.

In the broadest of terms, charities exist to serve society in a way that is comparable with (or at least complementary to) the way in which Government exists to serve society; the difference is that charities are funded by donations and Government by taxes. Moreover, a fundamental feature of charities which distinguishes their work from that of the State is the notion of voluntarism. Not only do people give their time, skills and money expecting little or nothing in return, they can choose whether or not to give to charities and, if they do so, which ones to support.

Furthermore, there are three respects in which charities may have an apparent advantage over public sector agencies. First, though many charities could do more to improve their own efficiency (and should be firmly encouraged to do so), public bodies are likely to have higher unit costs because they do not usually benefit from the unpaid work of volunteers. Secondly, civil society has a flexibility which the public sector sometimes lacks: when a gap becomes apparent in provision, assuming that resources are available the charity sector can often move quickly and effectively to fill it. Thirdly, charities can often innovate where Government cannot – or, at least, cannot do so easily. Public purposes funded directly by the State need to carry general public support, whereas charitable purposes will attract voluntary support so long as they appeal to individuals or organisations. One of the strengths of the legal meaning of 'charity' and the way in which the concept has been and still is allowed to evolve is that it is largely immune from the vagaries of political fashion or popular opinion and, by its ability to resist those forces, can accommodate needs and aspirations as they evolve within society.

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5 S 7(2) Charities and Trustee Investment (Scotland) Act 2005, s 2(2) Charities Act 2006.
6 S 7(1) (b) Charities and Trustee Investment (Scotland) Act 2005, s 2(1)(b) Charities Act 2006.
7 S 8(1) Charities and Trustee Investment (Scotland) Act 2005, s 3(2) Charities Act 2006.

For all these reasons it is critical that charities are able to operate within a regulatory and tax regime that is non-partisan and treats as equally worthy any purpose that falls within the legal concept of charity. For a Government to manipulate charitable tax reliefs to favour one charitable purpose over another would damage innovation by charities and undermine the freedom of choice which encourages charitable giving. Government is free, quite properly, to give grant-aid to particular types of charities where that is considered to be an efficient and effective means of delivering policy objectives. But the converse – to deny charitable reliefs except in favoured cases – has much more far-reaching and negative repercussions for the sector as a whole.

Competition

It is frequently suggested that tax reliefs give charities an unfair competitive advantage over commercial organisations. In reality, the situation is much more complex than that. Comparisons between for-profit enterprises and charities are misplaced: the former exist to deliver a private profit to their owners while the purpose of the latter is to deliver benefit to the public. Measures of 'success' in the two cases are quite different; and any disparity in their tax treatment reflects the fact that it makes no sense to divert assets already dedicated to the public in order to fund other public purposes. Moreover, charities that do not charge for their services incur a major tax liability that is not suffered by commercial organisations or local authorities: irrecoverable VAT.

Associated with this is the issue of state aid. It is sometimes argued that reliefs and exemptions from tax can amount to a state-sponsored advantage that threatens to distort trade (and, to the extent that such distortion could affect EU markets, might qualify as unlawful state aid). But European law recognises that reliefs and exemptions that form part of the integral and logical features of a tax system will not amount to state aid: see, for example, *Portugal v Commission (State aid) [2006] EUECJ C-88/03 (06 September 2006)*. The jurisprudence of the ECJ is at one with the view that it makes no sense – economically or sociologically – to impose taxes on charitable assets. If the argument about distortion of competition were to prevail, however, there could be a collision between charitable tax reliefs and EU rules on state aid, with catastrophic consequences for charities individually and for the sector in general.

EU tax harmonisation

Under section 30 and schedule 6 of the Finance Act 2010, charitable organisations established in other EU member states, Norway and Iceland are able to take advantage of UK charitable tax reliefs. The price is a redefinition of charity for tax purposes which involves compliance with any applicable requirement for registration (or the equivalent) and a subjective element: that the charity, whether based in the UK or in one of the other favoured states, must be managed by 'fit and proper persons', an expression which is not further defined.

This is a direct response to the judgment in *Hein Persche v Finanzamt Lüdenscheid* [2009] EUECJ C-318/07 (27 January 2009) in which the ECJ ruled that for a member State to limit its charitable tax reliefs and exemptions only to domestic organisations could amount to an unlawful restriction on the movement of capital throughout the EU. Member states were therefore required to take steps to lift such restrictions.

The effect of these measures, as perceived by Government, is likely to be to increase the 'cost' to the Treasury since a greater number of organisations will stand to benefit from reliefs and exemptions from UK tax. This will no doubt lead to concern that, overall, the Government will receive less 'value for money' from its 'contribution' to the sector. However, this concern is not entirely well-founded since, as other member states introduce equivalent measures, there will be a corresponding benefit to UK-based charities which will be able to take advantage of overseas tax reliefs.

It was helpful that the Government did not immediately choose to harmonise its treatment of charities in the UK and in the relevant states by means of a reduction in the level of relief.

Conclusions

More than a decade has passed since the 1999 review of charity taxation, during which there have been significant developments in charity law and the way in which charities are recognised and regulated, with the intention that charities should demonstrate that they deserve the advantages that they enjoy. The last few years have also seen a significant decline in the world economy and, in particular, a major increase in the UK National Debt, with the result that the perceived cost to the Treasury of reliefs and exemptions from tax is more keenly felt by Government than before. There has also been a growing tendency to view with greater favour those charities whose work directly relieves pressure on Government by delivering services in line with the Government's priorities. Finally, a number of developments within the European Union suggest that the historical treatment of charities and charity taxation within individual national tax systems is changing.

The 2010 general election brought all these elements into sharper focus and made it appropriate to look once again at the basis for the reliefs and exemptions from taxation afforded to UK charities. A hopeful sign in current Government policy is the emphasis that is being placed on the contributions that charities can make to the 'Big Society', as evidenced by the legislation that was going through Parliament at the time of writing in order to implement the Gift Aid Small Donations Scheme (GASDS) announced at Budget 2011 and somewhat refined at Budget 2012.

As noted below [16.4] The GASDS is not a tax relief but grant-in-aid and, strictly speaking therefore, outside the scope of the Charity Tax Map; however, its administration is closely connected with that for Gift Aid itself. In brief, under the proposed Scheme charities will be able to claim a "Gift Aid style" repayment on loose collections of cash only up to a value of £5,000 without the need to obtain Gift Aid declarations against those donations. It is unnecessary to go into further detail here: suffice it to say that the Scheme, once it beds down, will meet a long-felt need from charities that derive a significant part of their income from loose collection in circumstances where it is impractical to ask donors to complete Gift Aid declarations.

If it is the Government's intention to encourage voluntary effort and the participation of more members of the public in improving the quality of life for the whole community, there is every good and logical reason not only to ensure the proper regulation of charities but also to promote their work and to encourage donations of money as well as of time and effort. Both will be far more likely to be effective if supported by tax reliefs for charities and donors alike. The view that, as a matter of general principle, charities and charitable giving should be exempted from tax is the natural corollary of the Big Society – and it would be encouraging to see that view endorsed by the current Administration.

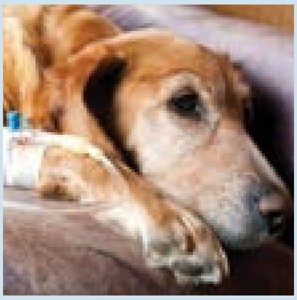
At a time when many are suffering unexpected financial hardship and undergoing unforeseen changes in their lives it is particularly important that there should be a thriving and confident charity sector which is free to concentrate its resources on providing the necessary help – and charity tax reliefs are critical in ensuring that the charity sector does indeed continue to thrive.

Thanks are due to Francesca Quint, Radcliffe Chambers, and Sam Macdonald, Farrer and Co, for their contribution to this chapter.

THE CHARITY TAX MAP: TAXES AND RELIEFS BY ACTIVITY

	Research	Welfare	Education	Arts/Cultural	Trading	Grant giving	Fundraising (7 & 9)	Membership (7 & 16)	Employment	Advertising/self promotion (7)	Advertising provided to third party (7)	Import/export	Non-charitable expenditure (9)	Investment – Income generation	Investment – Programme related	Property – Own occupation	Property -Direct Investment	Property – Heritage	Property development	Grant making	Fuel and Power (5)	Secondment (7)	Cost sharing (2)	Working overseas (15)	Equipment	Books	Medicine & handicapped aids	Energy saving materials	Foreign operations
Taxation (Actual or potential)																													
VAT																													
Business vs Non-business (1)	•	•				•	•	•						•		•						•							
CGS (3)																•	•	•							•				
Exempt (2)	•	•	•	•			•	•									•						•						
Partial Exemption (2&3)	•	•	•	•			•	•									•						•						
Reverse Charge (6)												•																	•
Cross Border Reporting (6)												•																	•
Import duties (8)												•																	•
Income and Corporate Taxes (9)																													
Non-charitable					•		•				•		•	•						•									
Miscellaneous Income							•							•			•		•			•							
Anti-avoidance																													
Overseas investment (10)														•															
Tainted charity donations (16)							•																						
Non-qualifying investment (9)														•															
PAYE and NIC (14 & 15)							•		•													•		•					
Overseas taxes (18)														•	•		•		•			•		•					•
Business rates (13)																	•												
CIL (19)																	•		•										
Taxation Relief (subject to conditions)																													
VAT																													
Reduced Rates (5)																•	•	•	•		•							•	
Zero Rates (4)	•				•		•			•		•				•		•							•	•	•		
Import Duties (8)	•	•	•				•																		•				•
Income and Corporation Taxes																													
Charitable purpose trade (9)					•		•							•	•														
Small Trade (9)					•																								
CGT (10)							•							•	•	•	•	•											
SDRT (12)														•	•														
SDLT (11)																•	•	•											
Business Rates (13)																•		•	•										
PAYE and NIC (14 & 15)																								•					
Gift Aid (16)							•																						
GASDS							•																						
IHT (16)							•																						
Payroll giving (16)							•																						
Gifts of assets (16)							•																						
Gifts of Art (16)							•																						
Climate Change Levy (17)																					•								
Lottery Duty (17)							•																						
Overseas Taxes (18)														•	•	•	•	•						•					•
CIL (19)																•		•											

The matrix is intended to be an aid to identify where taxes and reliefs might apply to particular activities. It is not a definitive analysis. Bracketed numbers are reference to chapters in the tax map.






Description of taxes and reliefs

1 VAT: general principles

1.1 Overview of the operation of the tax

The main reason why there are so many differences between VAT and direct tax is because VAT is a European tax and the UK has to comply with European Union law in respect of VAT. When VAT was enshrined in UK law certain derogations were allowed by Brussels, the most important of which for charities is the zero rate. Without this derogation the minimum VAT rate that would apply would be 5 per cent.

Generally, if a charity provides taxable goods or services in the UK for consideration in the course or furtherance of a business it will be entitled or required to register for VAT. A requirement to register will arise if the value of taxable turnover exceeds the VAT registration threshold (£77,000 with effect from 1 April 2012). Taxable supplies are subject to VAT at either the standard rate, the reduced rate (5 per cent) or the zero rate. Taxable turnover includes zero rated supplies but not exempt supplies. Exemption from registration is possible for a charity making largely zero rated supplies but the charity still needs to notify Her Majesty's Revenue and Customs (HMRC) of the liability to register.

Like other organisations, at the end of every month a charity, especially if it is close to the threshold, needs to look back over the previous twelve months to check if it has reached the registration threshold. If it has, it is required to inform HMRC by the end of the month after which it reaches the threshold. So if a charity exceeds the threshold in March 2012 it must notify HMRC by 30 April 2012 and registration will apply from 1 May 2012. Additionally, if there is an expectation that the threshold will be exceeded in the next 30 days alone, there is a liability to notify HMRC within 30 days of the expectation arising.

Interest and penalties can be payable in the event of late registration, as they can if VAT returns are submitted late. The time limit for correcting errors is four years – this applies both to the charity correcting errors and to VAT assessments from visiting VAT officers.

Once registered, the charity will need to establish the extent to which the VAT it incurs relates to its business activities and then the extent to which this VAT can be recovered as relating to taxable supplies.

A charity can choose to register voluntarily for VAT if it is 'in business' (see section 1.2) and below the registration threshold. Having done this, the charity would then have exactly the same responsibilities as a charity that is obliged to register. An example of when voluntarily registration might be beneficial is where a charity sells zero-rated items and buys standard-rated goods or services, because it would then potentially receive a VAT refund from HMRC. Any financial advantages of voluntarily registration would need to be weighed up against the administrative costs of submitting VAT returns and complying with the legislation.

There are certain goods and services on which VAT is never recoverable: for example VAT incurred for the purpose of business entertainment to UK customers.

1.2 Business/non-business

Generally, for a supply of goods and or services supplied in the course or furtherance of business (which is not exempt – see 2) it is subject to VAT.

"Business" is not specifically defined in either UK or EU law. It has a much wider application than the direct tax meaning of "trading." A charity can be carrying on a business for VAT purposes even if it is only undertaking its primary-purpose activities on a not-for-profit basis. Activities on which charities simply cover their costs or even make a loss can still be "business".

Deciding whether an activity is "business" for VAT purposes is crucial for a charity because that decision determines whether or not:

- there is a requirement or an opportunity to register for VAT;
- there is a liability to account for VAT;
- there is an entitlement to recover VAT on related expenditure (subject to partial exemption rules – see 3).

To be a supply for VAT purposes, the activity needs to be carried out in the course or furtherance of business. "Supply" is not defined in the legislation. It includes all forms of supply, but not anything done otherwise than for consideration. For VAT purposes consideration means everything paid to a supplier by a purchaser where there is a direct link between the goods and services received and the consideration paid. Note that consideration does not have to be paid in money, so a barter transaction could still be a supply.

Where taxable supplies are being made or are intended to be made, there is an entitlement to recover VAT incurred on related expenditure. However, VAT incurred on expenditure that directly or indirectly relates to non-business activities is not recoverable. VAT on expenditure relating to "exempt supplies" (see 2) is also irrecoverable subject to *de minimis* thresholds.

1.2.1 Key cases

There is extensive case law on the business test, both in the UK and European courts. The following indicators, as summarised by Ralph Gibson J in *Customs and Excise Commissioners v Lord Fisher* [1981] STC 238 at 245, are regarded by HMRC as a guide as to whether or not an activity is "business". The absence of one indicator does not necessarily mean that the activity fails to qualify as business:

- is the activity a "serious undertaking earnestly pursued" or a "serious occupation not necessarily confined to commercial or profit making undertakings"?
- is the activity an occupation or function actively pursued with reasonable or recognisable continuity?
- does the activity have a certain measure of substance as measured by the quarterly or annual value of taxable supplies made?
- is the activity conducted in a regular manner and on sound and recognised business principles?
- is the activity predominantly concerned with the making of taxable supplies to consumers for a consideration?
- are taxable supplies that are being made of a kind which, subject to differences of detail, are commonly made by those who seek to profit from them?

In *Customs and Excise Commissioners v Morrison's Academy Boarding Houses Association* [1978] STC 1 a charge for accommodation was being made by a charity on the basis of cost recovery (ie not with the intention of making either a surplus or a loss). The Inner House of the Court of Session ruled that this constituted a business activity for VAT purposes. The court commented that: "the natural meaning of the word 'business' does not require that what is done must be done commercially….or with the object of making profits".

In *Wellcome Trust Ltd v Customs and Excise Commissioners* [1996] ECJ C-155/94 (20 June 1996) it was held that buying and selling investments is not of itself a business activity. The court found that Wellcome was managing investments in the same way as a private investor as it was itself prohibited from engaging in trading in investments.

Yarburgh Children's Trust v Customs and Excise Commissioners [2002] STC 207 (29 November 2001) and *St Paul's Community Project Ltd v Customs and Excise Commissioners* [2004] EWHC

2490 (Ch) (5 November 2004) both concerned whether or not the charity in question was carrying out activities that were non-business for VAT purposes and therefore whether the construction services they were purchasing could qualify for zero rating. HMRC contended that the charities were in business because they were making a charge to users, albeit not at a commercial level but enough to top up their charitable income. The High Court decided in both cases that this did not amount to a business activity because the taxpayers were not predominantly concerned with the making of taxable supplies to consumers for consideration. Therefore, the expenditure was for non-business purposes ("relevant charitable purpose") and could qualify for zero rating.

Quarriers v Revenue and Customs [2008] UKVAT V20660 (25 April 2008) considered whether the charity could qualify for zero rating on the purchase of construction services in order to build a new epilepsy centre. The charity received approximately 93 per cent of its funding to carry out its primary purpose activity (ie assisting people with epilepsy) from local authority contracts and central government funding and used its own charitable donation income to meet the deficit. HMRC held the view that Quarriers was carrying out a business activity because the services were provided in return for the funding. The Tribunal concluded, however, that the services were provided on the basis of need and that there was no link between the costs of providing the service and payment of the funding. The construction costs for the centre therefore qualifies for the zero rates.

1.2.2 *Donations and grants*

Donation and grant income is not consideration for a supply and is a non-business activity which falls outside the scope of VAT. This is because this income is freely given with no strings attached and is treated by the charity as a gift. A grant or donation can have certain conditions attached to it as to what it can be used for; but these do not necessarily make it consideration for a supply because nothing specific is being provided to the funder in return for the payments.

If the charity merely acknowledges the gift then that does not make it business income. However, if the funder requires that specific deliverables be provided in return for the funding then that generally constitutes a consideration for supply and therefore makes the payments subject to VAT. Charities should always consider the substance of the arrangements and determine whether or not there is a supply being made in the course of business. This can be a difficult question of judgment, often involving a significant exposure to VAT; and it is likely that the use of professional advice will be required in many cases.

VAT incurred on expenditure that relates to funds raised for restricted charitable non-business purposes is not recoverable. However, where a charity which has non-business and business activities incurs VAT on fundraising costs and the funds raised support various activities of the charity, the VAT incurred will be recoverable to the extent that the funds raised support taxable business supplies. In practice, this means that VAT incurred on fundraising costs must be subject to a business/non-business apportionment to determine how much of the VAT incurred may be treated as input tax. The input tax will then be recoverable subject to the partial exemption rules set out in 3.

1.2.3 *Outsourcing by public bodies*

The distinction between grants and contracts can become an important issue when looking at public bodies outsourcing services to charities. There are two different funding methods available to the public body to finance the service: by grant-funding the charity or by procurement under a contract for service (i.e. by entering into an agreement with the charity, under which the public body pays the charity fees for providing a specified service). Grant-funding is not a business transaction for VAT purposes. Procurement is a business transaction for VAT purposes. It is also worth noting that if the services are procured as a contract for specific deliverables, as well as being business for VAT purposes the activity is likely to be trading for direct tax purposes – see section 9.5.

Where the service is subject to VAT (i.e. is not an exempt supply) the public body will pay VAT on the purchase price of the service. It may then be able to recover the VAT under its statutory right of recovery, but this depends on the particular VAT regime that applies to the public body in question. For example, local authorities can recover the VAT that they incur on goods and services purchased in respect of their statutory non-business activities. However, NHS bodies and a significant number of central government departments have a different VAT regime that allows them to recover VAT incurred on certain services that are used for their statutory non-business activities ("Contracted Out Services"). Not all public sector bodies fall within either of these special VAT regimes, in which case they may not be able to recover the VAT that is charged to them. In effect they would have the same VAT issues as charities and other not-for-profit organisations.

Where a charity charges VAT to public bodies, it will be able to recover the VAT for which it is liable on its costs attributable to the service. Where the service is an exempt supply, however, the public body will not be charged VAT on the purchase cost of the service, but neither will the charity be able to recover any of the VAT for which it is liable on its attributable costs.

This table summarises the position just described.

	Grant-funding	*Procurement*
Taxable service	There is no taxable supply because the grant is not a business transaction. The charity incurs irrecoverable VAT on its attributable costs.	The public body pays VAT which it will usually be able to recover under its statutory right. The charity can recover VAT on its attributable costs.
Exempt service	There is no taxable supply because the grant is not a business transaction. The charity incurs irrecoverable VAT on its attributable costs.	The public body pays no VAT. The charity incurs irrecoverable VAT on its attributable costs.

Note that if the funding method applying to the charity is grant funding it may be possible to come to an agreement with the funder for the irrecoverable VAT to be added to the contract price.

In *Hillingdon Legal Resource Centre* (LON/90/12Y) the charity operated a citizens' advice centre and received grant funding from a local authority. It argued that the payment was consideration for a supply on the basis that there was a condition requiring a detailed report and accounts be submitted to the local authority to show that the grant was being used as originally intended. The Tribunal ruled that the conditions were simply "good housekeeping" to ensure the correct use of the payment. Therefore no supply was made and the grant was outside the scope of VAT.

Similarly in *Wolverhampton Citizens Advice Bureau,* the CAB provided free legal, and other, advice and received grant funding from, among others, the local authority. The local authority, as a condition of grant funding, required a service level agreement to be entered into by the CAB, detailing opening times, levels of service etc. On this basis the CAB viewed the funding to be consideration for a taxable supply of services to the local authority. The VAT tribunal found that there was nothing in the service level agreement to support the CAB's view. Although strings were attached to the grant given by the local authority, that in itself did not create a supply. This was because the local authority *itself* did not derive any direct benefit from the advice *given* its only benefit was the indirect knowledge that it had helped fund a service that might be of benefit to its citizens. The only supplies made were to the local citizens and, as these were mainly free of charge, there was no supply for VAT purposes.

In *Bath Festivals Trust Ltd v Revenue & Customs* [2008] UKVAT V20840 (22 October 2008). The Trust ran an international music festival and had a service level agreement with Bath City Council and received funding from the Council. The festival would have been run by the Council if the Trust had not run it. It was found that the Trust was supplying services to the Council and that the payments made by the Council were consideration for those services and not the payment of a grant. For this reason the payments made were within the scope of VAT

1.2.4 *Publicly-funded research*

Grants provided by central government to fund research (as opposed to research commissioned by government) are generally paid by the granting body to fulfil its statutory and public duties to fund research rather than to secure a benefit for it or for any third parties. In those cases the grant does not constitute consideration for a supply made in the course of business for VAT purposes because the research is generally for the public good and the body funding it does not receive a specific supply of goods or services in return for the funding.

If research is funded in part by grants and in part by matched funding from commercial participators there may be supplies in the course of business where benefits are provided to the commercial funders in return for their payments. The status of the body providing the funding is not the issue; the test that will determine whether or not a supply is being made in the course of business for VAT purposes is this: "what, if anything, is required to be provided in return for the funding?" .

1.2.5 *Grant-giving*

A charity that makes a grant is not making a supply and grant-making is not a business activity. Therefore, VAT incurred on related expenditure would not be recoverable.

1.2.6 *Investment*

The acquisition or disposal of shares and other securities by a charity is not a business activity for VAT purposes. Therefore, any VAT incurred in relation to that activity cannot be recovered. In *National Society for the Prevention of Cruelty to Children* (NSPCC) [1992] (LON/92/602X) the Tribunal held that the charity's investment activities, though substantial, did not amount to a business activity because the charity was not predominantly concerned with those supplies. Also see *Wellcome Trust* [1.2.1].

Investment income is usually a non-business activity; but following the decision in *Church of England Children's Society v Customs and Excise Commissioners* [2005] EWHC 1692 (Ch) (29 July 2005) [see 3.7] HM Revenue & Customs announced that charities would be able to reclaim some VAT on investment management fees to the extent that the income was used to support their taxable business activities.

1.2.7 *Welfare at below cost*

The supply of welfare services by a charity is normally a business activity for VAT purposes and, depending on the nature of the activity, would be exempt or subject to VAT at the standard rate. However, by concession, charities that provide welfare services at significantly below cost to "distressed" persons for the relief of their distress may treat those services as being non-business (ie outside the scope of VAT).

The benefit of the welfare services being non-business rather that exempt from VAT is that the charity can then take advantage of zero rating and reduced rate reliefs that rely on activities being for a "relevant charitable purpose". For example, if a new building is procured by a charity that provides welfare services that fall within the above definition, the charity should be able to issue a qualifying use certificate in order to receive the supply at the zero rate. However, professional fees will *always* be standard rated and it is only the contractor's costs that can be zero rated: but see 4.5.1 with regard to design and build contracts.

To qualify:

- the services must be subsidised by at least 15 per cent;
- the subsidy must be available to all distressed persons, ie both to those who can and cannot afford to pay the full rate; and
- the services must be provided to the distressed individual and not, for example, to a local authority.

1.2.8 *Business / non-business apportionment*

Charities will be able to recover the VAT charged to them on expenditure relating to business activity that results in taxable supplies being made. They will not be able to recover the VAT relating to non-business activities.

If the VAT is used partly for business activities and partly for non-business activities an apportionment must be made and the proportion related to business activities recovered to the extent that it relates to taxable activities.

There is no set method for apportioning the VAT to business use; but the method used must be "fair and reasonable". The objective of the apportionment is to establish the extent to which the VAT on the costs incurred is used for the purpose of the business. While a method based on income (for example, establishing business income as a proportion of total income) might be a simple calculation, there is no necessary correlation between costs and income and, therefore, this may not provide a satisfactory result. Other methods might be based on, for example, expenditure, time, floor space or transaction counts.

There is no obligation to seek approval for business / non-business methods, but not to do so will leave a charity open to having its method contested. So a proposal will usually be put forward and HMRC will consider:

- whether the indicator of non-business activity on which the method is based gives a fair and reasonable reflection of the balance of the charity's non-business activities;
- whether the result is fair and reasonable;
- whether the method will reflect changes in the activities and whether the indicator upon which it is based is suitable for this; and
- whether the method is overcomplicated and prone to error and whether it can be easily administered by the charity and monitored by HMRC.

The charity should get a letter indicating the basis on which HMRC accepts the method. It will also be required to incorporate an annual adjustment calculation.

Unlike with partial exemption (explained in Chapter 3) there is no statutory *de minimis* level in terms of a monetary or percentage figure. HMRC may use its discretion to allow a waiver of apportionment – it will make a judgment as to whether the benefit in terms of revenue is outweighed by the cost to the organisation and to HMRC in carrying out and checking the apportionment. If a waiver is allowed the concession only applies for as long as the existing rate of non-business activity continues.

The default position is that the business / non-business apportionment calculation is carried out separately from the partial exemption calculation; but, since January 2011 it has been possible to operate a combined method as set out in Chapter 3.

1.2.9 Lennartz

Following *Hansgeorg Lennartz v Finanzamt München III* [1991] EUECJ C-97/90 (11 July 1991) ("*Lennartz*"), the UK tax authorities had accepted that VAT to be used for both business and non-business activities could be recovered in full in certain circumstances provided that the VAT was then accounted for on the subsequent non-business use of the asset in question.

However, further to the decision in *Vereniging Noordelijke Land- en Tuinbouw Organisatie v Staatssecretaris van Financiën* [2009] EUECJ C-515/07 ("VNLTO") this is no longer the case. *Lennartz* principles will only apply where the goods are used in part for making taxable supplies and in part for private purposes or, exceptionally, for other uses which are wholly outside the purposes of the taxpayer's enterprise or undertaking. These other uses do not include non-business activities which are part of the normal activities of the charity. What this means for charities is that if there is non-business as well as private and or taxable use then an apportionment has to be made at the time of the supply.

2 VAT: exemption

Certain supplies by charities are exempt from VAT. This means that although they are business supplies, no VAT is charged and VAT is not recoverable on the related costs (subject to the de minimis rules – see 3.2.3)

Some of the exemptions are public interest exemptions which were introduced because they deal with items that benefit society and, successive Governments have taken the view that the person receiving the services should not have to suffer VAT. This, however, means that the person delivering the service – including a charity – has to bear the VAT on the costs directly associated with the services subject to partial exemption rules – see 3.

2.1 Welfare

The supply by a charity of "welfare services" and any goods supplied in connection with those welfare services is exempt from VAT. Accommodation and/or catering which is ancillary to the main supply of welfare care services is also exempt from VAT.

"Welfare services" means services directly connected with:

- The provision of care, treatment or instruction designed to promote the physical or mental welfare of elderly, sick, distressed or disabled persons. This can include domestic help services such as cleaning, cooking and shopping where the recipient is in need of a high level of care and is unable to provide even basic self-care or has major difficulties in safely carrying out some key daily living tasks. HMRC regards care or treatment as including: "the protection, control or guidance of an individual, when this is provided to meet medical, physical, personal or domestic needs".

- The care or protection of children and young people. HMRC regards this as applying to services directly connected with the care and protection of specific children, rather than of children in general. For example, the exemption would include care provided in a children's home or the placement of a child with foster-carers by foster agencies.

- The provision of spiritual welfare by a religious institution as part of a course of instruction or a retreat, not being a course or a retreat designed primarily to provide recreation or a holiday. This would include providing spiritual counselling to an individual, discussion, meditation or prayer. It does not include conferences or retreats where the predominant purpose is not spiritual welfare, nor does it include educational courses in theology where the predominant purpose is to expand knowledge rather than provide spiritual welfare services.

As referred to in 1.2.6, "welfare" is a non-business activity rather than exempt where it consists of care for distressed people and subsidised by at least 15 per cent.

2.2 Education

"Education" is defined as a course, class or lesson of instruction or study in any subject, whether or not normally taught in a school or university: eg lectures, seminars, workshops, conferences, residential courses and distance learning. It does not include admission to plays, concerts, exhibitions, and sporting events.

The exemption applies to eligible bodies. HMRC states that where an organisation is a charity that cannot and does not distribute any profit it makes and any profit that might arise from its supplies of education, research or vocational training is used solely for the continuation or improvement of such supplies it is likely to be an eligible body.

2.3 Research

"Research" is defined as original investigation to gain, advance or expand knowledge or understanding. It does not include consultancy, market research/data collection without also involving analysis, nor confirming existing knowledge. Both the supplier and customer must be eligible bodies.

Note that in *Commission v Germany (Taxation)* [2002] EUECJ Case C-287/00 (12 June 2002) the Court of Justice of the European Communities [CJEU] ruled that "research" was not close enough to "education" for the exemption to apply. Nevertheless, the exemption still exists in UK VAT legislation.

2.4 Vocational training

"Vocational training" covers training, retraining and work experience for paid and voluntary employment. It includes lectures, workshops and seminars but not counselling, business advice and consultancy.

2.5 Closely-related supplies to supplies of education, research or vocational training

"Closely-related supplies" are goods and services which are for the direct use of the student and necessary for delivering the education to that person. They can include accommodation, catering, transport and school trips.

2.6 Cultural services

The "cultural services" exemption covers an eligible body's supply of a right of admission to a museum, gallery, art exhibition or zoo or to a theatrical, musical or choreographic performance. The exemption does not include entrance to botanical gardens or cinemas.

An eligible body is the same as in 2.2 except that, in addition, it must be managed and administered on a voluntary basis by persons who have no direct or indirect financial interest in its activities. In determining who manages and administers a body one must consider only those who take decisions of last resort concerning policy – particularly in financial and strategic areas – and who carry out the higher supervisory tasks. People who carry out purely executive tasks (those who implement, rather than take high-level decisions) can be ignored. The services must be provided by a non-profit-making organisation and any profits made from exempt admission fees must be applied to the continuance or improvement of the facilities made available.

Opportunities for extending recovery for charities providing cultural services (eg theatrical productions) were provided by the decisions in the cases of *HM Revenue & Customs v Mayflower Theatre Trust Ltd* [2006] EWCA Civ 116 (22 February 2007) and *Garsington Opera Ltd v Revenue and Customs* [2009] UK FTT 77 (TC) (28 April 2009). In *Mayflower*, the Court of Appeal found that there had been both taxable and exempt supplies in the right to see the productions: through sponsorship, catering and programme sales (which were taxable) and ticket sales (which were exempt). This resulted in partially-recoverable input tax. *Garsington Opera* has a month-long summer season funded by ticket sales, sponsorship and donations. The Tribunal concluded that there was a direct and immediate link between the opera production costs and, among other output items, the grants of sponsorship rights – again giving rise to the partial recovery of input tax.

2.7 Fundraising events

If a charity fundraising event qualifies for exemption the charity or its trading subsidiary does not have to charge VAT on things like entrance fees to the event. Equally, however, it cannot recover the VAT on the related expenses.

To qualify for the exemption the event must be organised by a charity or its trading subsidiary primarily to raise money for the charity. It must not be continuous trading and no more than 15 events of the same kind can be held at a single location in any year. Once the 15-event threshold is breached none of the events qualify for exemption. The 15-event limit does not apply to fundraising events where the gross takings from all similar events, such as coffee mornings, are no more than £1,000 per week.

The fundraising event must be organised by a charity or a trading subsidiary of a charity. HMRC will not allow trading to be undertaken through a series of events, and accommodation must not be provided for more than two nights. The event must be promoted as having a charitable purpose.

The exemption applies to ticket sales, sponsorship connected to the event and sale of merchandise at the event. Examples of types of events include dances, live performances, film, video or DVD showings, fêtes, fairs and festivals, horticultural shows, exhibitions, jumble and car boot sales, games of skill, firework displays, dinners and auctions.

This is one of the few examples of harmonisation between the VAT and direct tax rules. Note that the exemption is not optional; so if a charity does not want the exemption to apply – perhaps because it can charge VAT on the sponsorship and thereby recover some of its input tax on expenses – then in order not to trigger the exemption it would need intentionally to break one of the requirements referred to above.

2.8 Cost sharing groups

Increasingly, charities are working together to create efficiencies and add value; however the fact that VAT can get added to the cost as one charity charges another for services has acted as an impediment to collaborative working.

European law provides an exemption for certain services supplied within cost-sharing groups whose members carry out exempt and/or non-business activities.

Although this is a mandatory provision in the VAT Directive which most of the 27 Member States have adopted, it was implemented in UK VAT law with effect from 17 July 2012.

It applies when two or more organisations with exempt and/or non-business activities join together on a co-operative basis to form a separate, independent cost sharing group (CSG) to supply themselves with certain services at cost and exempt from VAT. It does not apply to the supply of goods. It is designed to help organisations such as charities, housing associations, universities and further education colleges to collaborate to share resources without being deterred by the cost of VAT on any recharges.

There are five conditions attached to the exemption:

1. There must be an 'independent group of persons' (a CSG) supplying services to persons who are its 'members'. A CSG is an independent group of persons that is separate from its members, but who work together. It can be a group of equals or, if all the members agree, one or more members can have effective control and/or majority ownership of the group. It must be a separate taxable person from its members in order to be able to make exempt supplies for VAT purposes to its members. The CSG must have at least two members. For example, if the CSG is set up as a limited liability partnership, it will be possible for one of the members to control more than 50 per cent of it. Provided that all the relevant conditions are met this could enable the CSG to be included in the same VAT group as one of the members.

2. All the members must carry on an activity that is exempt from VAT or one which is not seen as being a business activity for VAT purposes. HMRC consider that a member should have either:

- 5 per cent or more exempt and/or non-business supplies in the immediate 12-month prior to joining the CSG; or

- In its last completed partial exemption, business/non-business year prior to its membership of a CSG, 5 per cent or more exempt and/or non-business supplies have been made.

  If at the time of joining a CSG if it has not made 5 per cent or more exempt and/or non-business supplies, it must have a clear intention of receiving and does so receive qualifying services which are "directly necessary" from the CSG in the 12-month period starting from when the member joined the CSG and these supplies must be directly utilised within 12 months of receipt by the member to make 5 per cent or more exempt and/or non-business onward supplies.

3. The services supplied by the CSG to which the exemption applies must be "directly necessary" for the use by the members' in their own exempt and/or non-business activity. HMRC will accept that services are "directly necessary" if they are identified as follows:

- Only supplies of services received from a CSG that can be "directly attributable" to the member's exempt and/or non-business activities will be regarded as "directly necessary". Expenditure on services attributable to both taxable and exempt and/or non-business activities will not qualify.

- Where a member of a CSG has wholly exempt and/or non-business activities or negligible levels of taxable activity, all the supplies they receive from a CSG will be regarded as "directly necessary" for those exempt and/or non-business activities. "Negligible" means less than 15 per cent; therefore; where a member of a CSG has exempt and/or non-business activities that form 85 per cent or more of its total activities, all the supplies it receives from their CSG will be regarded as "directly necessary".

4. The CSG must only recover from its members the members' individual share of the expenses incurred by the CSG in making the exempt supplies to them. This includes any general overheads incurred by the CSG in providing services to its members as well as any discounts received or input tax recovered by the CSG. The CSG will be allowed to build up a surplus to cope with timing differences between receiving contributions from members and paying expenses.

5. The application of the exemption to the supplies made by the CSG to its members must not be likely to cause a distortion of competition. This means that it must not be an outsourcing arrangement and must not exist or compete in a market.

3 VAT: partial exemption

Having established the extent to which VAT has been incurred for the purpose of the business (ie the extent to which it is input tax) the charity must then consider the extent to which that input tax can be attributed to taxable supplies (as opposed to VAT exempt supplies as described above).

The first part of this is direct attribution. Input tax used exclusively to make taxable supplies is recoverable in full. Input tax used exclusively to make exempt supplies is not recoverable.

3.1 Apportionment

Unlike the apportionment for business activities, the apportionment between taxable and exempt supplies is set down in law. The regulations provide a "standard method" but also give HMRC the power to approve "special methods". Note that the value of capital items must be excluded from the partial exemption calculation.

3.2 Standard and special methods

3.2.1 The standard method

The standard method provides for an apportionment based on the value of taxable supplies as a proportion of total supplies. As with the income method commented on above for the business apportionment, while this method has the benefit of relative simplicity there is no necessary correlation between the value of supplies and the extent to which goods or services are used to make those supplies.

Since 2009 the default position has been that a charity uses the previous year's recovery percentage as the provisional recovery rate for residual input tax each period. It is possible, if preferred, to calculate separate recovery percentages for each quarterly VAT return.

3.2.2 Special methods

Special methods must be approved in writing by HMRC and an application for a special method must be accompanied by a declaration from the charity that the proposed method provides a fair and reasonable result.

Special methods typically use apportionments based on such factors as the ratio of inputs or input tax attributable to taxable supplies, the numbers of staff engaged in taxable activity as a proportion of the total, the number of taxable transactions as a proportion of the total or the floor-space used for taxable activity as a percentage of the total. In a more complex charity it may be desirable to use different methods of apportionment for different parts of the charity's activities.

3.2.3 De minimis

There are *de minimis* rules that allow VAT relating to exempt supplies to be recovered provided it amounts to less than £625 per month and is less than 50 per cent of the input tax incurred in the VAT accounting period. Since April 2010 there have been two simplified tests that can be applied:

- Test One: total input tax incurred is no more than £625 per month on average and the value of exempt supplies is no more than 50 per cent of the value of all supplies:
- Test Two: total input tax incurred less input tax directly attributable to taxable supplies is no more than £625 per month on average and the value of exempt supplies is no more than 50

per cent of the value of all supplies

A charity is *de minimis* if it passes Test One, Test Two or the original test, and if it passes any one test there is no need for it to consider the other two. The charity is still required to review its *de minimis status* at year-end as before and account for any under- or over-recovery of input tax as part of its adjustment.

The normal rules are that a *de minimis* test should be carried out in each period. However, a new annual test gives charities the option of applying the *de minimis* test once a year instead of four or five times a year. It allows a business that was *de minimis* in its previous partial exemption year to treat itself as *de minimis* in its current partial exemption year. This means that it can provisionally recover input tax relating to exempt supplies in each VAT period, saving the need for partial exemption calculations. Charities are still required to review their de minimis status at year-end; and if they fail the *de minimis* test for the year they must repay the input tax relating to exempt supplies that they provisionally recovered in-year. However, there is no need to carry out in-year partial exemption calculations.

The main risk of using the annual test is that if a charity provisionally recovers input tax relating to exempt supplies in-year but then fails the test at year-end it is required to repay this input tax to HMRC. If a charity thinks that it is likely to fail the test at year-end and repaying the input tax would cause it difficulties, then it would not be advisable for it to take up the option of the annual test.

3.2.4 Standard method override

A standard method override allows HMRC to impose a special method. It applies if the overhead recovery rate gives a substantially different result from that based on the use or intended use of the purchases received in making taxable supplies. "Substantial" means more than £50,000 (or more than 50 per cent of overhead input tax if over £25,000).

3.2.5 Annual adjustment

Input tax claimed in each VAT return is provisional and can be affected by seasonal variations. Therefore, an annual recalculation over the longer period is required and an adjustment for underpaid or overpaid tax. At this point the *de minimis* calculation also has to be rechecked where appropriate. The default is that the annual adjustment is calculated in the first VAT return after the year end. There is though, an option to bring forward the annual adjustment to the last VAT return of the year.

3.3 The capital goods scheme

The capital goods scheme is designed to recognise that certain items ("capital items") have a long life and that the extent to which those items are used to make taxable supplies may change during their life. Capital items are defined as:

- a computer or an item of computer equipment acquired for not less than £50,000;
- land or buildings with a value of £250,000;
- a building altered or extended to give an increased floor area of 10 per cent or more at a cost of not less than £250,000; or
- a building fitted out or refurbished at a cost of not less than £250,000.
- from 1 January 2011, an aircraft with a value of not less than £50,000; or
- from 1 January 2011, a ship, boat or vessel with a value of not less than £50,000.

These values are net of VAT.

If a charity acquires a capital item as above, the initial VAT recovery will be based on the rules described in 1.2 and 2. Assuming that VAT is recovered, the charity will then need to monitor the extent to which the item is used to make taxable supplies in subsequent periods (which would typically be done by reference to the partial exemption method adopted). If the extent to which the item is used to make taxable supplies decreases, the charity will be required to make a repayment to HMRC. Alternatively, if the extent to which the item is used to make taxable supplies increases, the charity will be able to reclaim an additional amount from HMRC.

There is an adjustment period consisting of five intervals for computers (or leasehold properties acquired with less than ten years to run) and ten intervals for land and buildings. The first interval will usually be less than twelve months and usually starts when the asset is acquired and ends on the day before the start of the next partial exemption tax year. The remaining intervals are normally in line with the partial exemption tax year.

Since January 2011 capital goods scheme adjustments are also required to reflect changes in levels of non-business use of the asset over the adjustment period.

3.4 Clawback / payback

If input tax is deducted in full because the relevant goods and services are intended to be used exclusively in making taxable supplies but, in the event, they are used either in whole or in part in making supplies with no right to deduct, the law requires that the original attribution of the input tax should be adjusted to take account of this fact ("clawback").

The reverse can also apply where goods and services initially intended for exempt use are actually used to make taxable supplies ("payback").

3.5 Combined business/non-business partial exemption method

The default position for determining how much VAT is deductible on costs is a two-step process. The first step is explained in section 1.2.7 and requires a charity to select its own "fair and reasonable" business/non-business (BNB) calculation. The second step is a partial exemption as calculated above.

From I January 2011, HMRC can approve one single agreement covering the business's BNB and partial exemption calculations, known as the "combined method".

The combined method operates as a special method so it is necessary for a charity to declare that the proposed combined method is fair and reasonable before HMRC can consider giving approval. Partial exemption *de minimis* rules do not apply if a combined method is used.

Note that from 1 January 2011 HMRC will no longer approve separate BNB and partial exemption methods; so if a charity is seeking assurance in respect of a new method it would need to be a combined method. If the charity does not have VAT on costs relating to exempt supplies it will still be able to seek approval for a BNB method.

Current agreements remain valid but HMRC advises organisations to seek approval for a combined method when next routinely updating existing business/non-business agreements.

3.6 Tax mitigation

Charities should consider whether their current VAT recovery methods (ie both for the business element and the partial exemption calculation) provide an appropriate level of VAT recovery. A combined method may be simpler to calculate but the overall recovery amount needs to be calculated and compared with existing methods before submitting a method for approval.

3.7 Input tax recovery: *Kretztechnik, Church of England Children's Society* and other cases

The decision of the CJEU in *Kretztechnik AG v Finanzamt Linz* [2005] EUECJ C-465/03 (26 May 2005) was followed by the High Court when deciding for the charity in *Church of England Children's Society v Customs and Excise Commissioners* [2005] EWHC 1692 (Ch) (29 July 2005) and provided an opportunity for charities to obtain partial VAT recovery on fundraising costs.

The result of *Church of England Children's Society* is that VAT incurred on costs of generating donation and investment income is not necessarily directly attributable to non-business activities; instead, the charity can attribute the cost to the activity that the donations and investment income will support. If these are generally supporting the overall work of the charity this means the VAT incurred can be partially recoverable. This will not apply where the donations or investment income are restricted for charitable non-business use.

HMRC had been accepting claims for partial recovery of input tax on investment management fees as well as general fundraising costs. HMRC's acceptance of the extension of the principle established for fund raising costs in respect of donations to fund management fees. That decision followed a considerable period of uncertainty on the point, with conflicting treatment by different control officers around the country; and the position was only resolved after a meeting between CTG and HMRC Charity Branch.

HMRC agreed to publish a *Business Brief* however CTG has now been told that HMRC is challenging the treatment of fund management fees as recoverable by charities as residual pot.

HMRC's reasoning is that raising funds by investing in stocks and shares is somehow different to doing so by seeking donations. CTG has previously pointed out that both are non-business activities of the charity which have a wider purpose: raising unrestricted funds which the charity can use to further its objectives. Additionally, both involve the purchase of taxable services from outside the charity (from fundraisers and fund managers). CTG has argued that if one is residual and open to the "look-through" principle to the wider activities of the charity then the other must be also. The Partial Exemption Branch does not agree and has told us that there is an appeal pending from a charity that will be tested in the First Tier Tribunal but which is not yet in the public domain. HMRC have said that there can be no *Business Brief* until the dispute is resolved one way or the other.

4 Charity reliefs: zero rates

There are no general charity zero rates. However, there are a number of targeted zero rates, some of which are available some available to all traders and others specifically for charities.

4.1 Books etc

"Books etc" are zero rated for VAT, although the actual scope of zero rating extends far beyond books and encompasses a range of printed material including brochures, pamphlets, handbills and programmes. In addition, a photo book will qualify for zero rating provided that it has as a minimum several pages, a cover stiffer than its pages and is bound. These reliefs are not specific to charities but they are clearly valuable to them.

4.2 Package test

By concession, zero rating can apply to a package of standard rated and zero rated printed matter:
- where there are more zero rated than standard rated items; or
- where there are equal numbers of zero rated and standard rated items and the value of the zero rated items is the greater.

4.3 Fundraising items

By a further concession, if printed matter used by charities in connection with collecting monetary donations is zero rated under the separate concession for such materials (see 4.8.6) those items are similarly treated as zero rated for the purpose of applying the package test. However, if any item in the package is not printed on paper or card the package test cannot be applied.

4.4 Talking books for blind people

Talking books for the blind and handicapped and wireless sets for the blind are zero rated. This relief is restricted to supplies to charities of equipment for the recording of speech, accessories and materials and repair of such equipment and the provision to a charity of radio sets and tape recorders for free loan to the blind.

4.5 Buildings and construction

The supply of certain buildings and the provision of certain construction services are zero rated.

4.5.1 New buildings

The construction of, or grant of a major interest (freehold sale or grant of a lease over 21 years) in, a building intended for use solely for a relevant charitable purpose or a relevant residential purpose is zero rated.

Buildings to be used for a relevant residential purpose include buildings such as children's homes, care homes and accommodation for schoolchildren.

HMRC clarified, in *Revenue & Customs Brief 47/11* (dated 30/12/11) the position relating to the VAT liability of the construction and first sale of dwellings that are linked to a separate provision of care (extra care accommodation). This accepts, regardless of the Use Class, that extra care accommodation is 'designed as a dwelling', and therefore its construction and first sale or long lease will be zero rated, if it meets all of the standard conditions, which are as follows:

- The dwelling consists of self-contained living accommodation
- There is no provision for direct internal access from the dwelling to any other dwelling or part of a dwelling
- The separate use of the dwelling is not prohibited by the terms of any covenant, statutory planning consent or similar provision
- The separate disposal of the dwelling is not prohibited by the terms of any covenant, statutory planning consent or similar provision
- Statutory planning consent has been granted in respect of that dwelling and its construction or conversion has been carried out in accordance with that consent

Buildings to be used for a relevant charitable purpose are restricted to those that are to be used by a charity solely for a non-business purpose or as a village hall or similar in providing social or recreational facilities for a local community. They do not include a charity headquarters used for both business and non-business purposes. HMRC interprets "solely" as at least 95 per cent use for charitable purposes.

These reliefs are particularly valuable for charities in the care or education sectors, such as hospices or charitable schools, research, and for charities using a building for a non-business purpose or providing local community facilities.

The zero rating does not extend to the supply of architectural, surveying, consultancy and supervisory services which is always standard-rated. However, it is possible to use a design and build company where the charity engages a contractor to carry out both the design and construction elements of the project. Where it is clear in the contract that any services of architects, surveyors or others acting as a consultant or in a supervisory capacity are no more than cost components of the contractors supply and are not specifically supplied on to the customer, then the whole supply can be treated as being eligible for the zero rate.

It should be noted that in *Jeanfield Swifts Football Club v Revenue & Customs* [2008] UKVAT V20689 (22 May 2008) a VAT Tribunal was prepared to regard the activities of a community amateur sports club as charitable for the purposes of zero rating the construction of its new pavilion even though the club was not registered under the Charities and Trustee Investment (Scotland) Act 2005: "It is a regulatory Act dealing with the supervision of charities in Scotland and has nothing to do with charitable status for the purposes of this question".

4.5.2 Charitable annexes

Works to an existing building are normally standard rated. However, where those works result in the creation of an annexe to the existing building and that annexe is to be used solely for a relevant charitable purpose zero rating is possible. The annex must be self-contained and have separate access: see, for example, *Treetops Hospice Trust v Revenue & Customs* [2011] UKFTT 503 (TC) (25 July 2011) and *East Norfolk Sixth Form College v HM Revenue & Customs* [2008] UKVAT V20816 (3 October 2008).

4.5.3 Relevant charitable purpose / relevant residential purpose – change of use

Where a change of use relating to relevant charitable purpose or relevant residential purpose occurs within ten years from completion of a zero rated building a change of use charge will apply.

Since March 2011, this charge applies:

- on each occasion that there is an increase in the use of the premises for a non-relevant purpose;

- when a person disposes of the entire interest in the premises (or part of); or
- where the premises (or part of them) are used for a non-relevant purpose.

The charity may, however, be able to deduct some or all of the charge as input VAT if the non-relevant use of the building is taxable. Once a building has qualified for zero rating, users must be careful when making even small changes to their use of the building that they do not trigger a change of use charge which could result in a VAT bill.

4.5.4 *Protected buildings*

A "protected building" includes dwellings and a building that is to be used solely for a relevant residential purpose or relevant charitable purpose and is either a listed building within the meaning of the Planning (Listed Buildings and Conservation Areas) Act 1990 or a scheduled monument as defined in the Ancient Monuments and Archaeological Areas Act 1979 (or within the terms of the equivalent legislation in Scotland and Northern Ireland).

Until 1 October 2012 zero rating applied to the sale of a protected building following a substantial reconstruction and to approved alterations (where listed building consent has been given) to a protected building. From 1 October 2012, approved alterations became subject to VAT at the standard rate and the circumstances in which the first sale or long lease by a developer of a substantially reconstructed protected building can be zero-rated have been narrowed, so that only buildings reconstructed from a shell continue to benefit from the zero rate. Transitional arrangements mean that zero rating will continue to apply until 30 September 2015 to projects for which listed building consent had already been applied for by 21 March 2012.

4.5.5 *Listed places of worship*

Under the Listed Places of Worship Grant Scheme, listed buildings used as places of worship have benefited from a matching grant to refund VAT spent on approved repairs and refurbishment for which listed building consent (or, in the case of the exempt denominations, the approval of the appropriate ecclesiastical authority) has been obtained in advance. The present Scheme was due to end on 31 March 2011; however, on 20 October 2010 it was announced that the Scheme would be continued until 31 March 2015 in a more limited form than hitherto. Grants would no longer be payable on the items added to the list of eligible works after the 2006 Budget (clocks, bells, organs, pews and – crucially – professional fees).

Following the announcement that the zero rate of VAT for approved alterations to listed buildings would be withdrawn from 1 October 2012, the Government announced that it would be extending the Listed Places of Worship Grant Scheme also to cover approved alterations. Additional funding of up to £30m a year (from 2012/13) has been allocated to the scheme for the duration of the current Parliament. The extended scheme will incorporate repairs, maintenance and approved alterations to listed places of worship and became operational on 1 October 2012.

From that date:

- The scheme returned to a system of monthly payments with the first payments made in November 2012
- Restrictions on claims for repairs on plumbing and electrical supplies where they form part of health and safety works as a result of deterioration due to age that are carried out at same time as eligible works, resulting in an upgrade of services or intended to improve energy efficiency, were removed.
- Most restrictions on claims on works to kitchens and lavatory fittings, floor coverings and handrails were removed.
- Claims on furniture, shelving, noticeboards and other detachable items remain ineligible.
- Floor coverings are eligible only where permanent and part of the fabric of the building.
- Decoration (including carvings, stonework, re-painting) is eligible provided it is to the fabric of the building.

- Works to pews are eligible.
- All asbestos removal is eligible.

The following items were added to the eligibility criteria for work undertaken from 1 October 2012:
- Claims on security and forensic systems to prevent crime.
- Repairs as a result of metal theft that were previously eligible for the scheme, where these expenses are not met by an insurance provider.

VAT levied on professional fees remains ineligible for refund under the Scheme.

4.5.6 Land and buildings and the option to tax

It is common practice for owners of commercial property to "opt to tax" the property and charge VAT on rents or sale of the property. Normally such activity would be exempt and mean that the owner is likely to be unable to recover VAT on the related costs. This option to tax would allow the owner to charge VAT and recover input tax on the relevant expenses. The option to tax is disapplied when the property is leased or sold to a charity that is to use the building for a relevant charitable purpose (as described above) but not as an office. In order to disapply an option to tax, the charity would need to issue a certificate.

A charity can also make use of the option to tax where, for example, it is a landlord and wants to recover associated input tax and increase its overall tax recovery levels. However, care needs to be exercised when deciding to opt to tax because it can only be disapplied in certain circumstances and selling or renting to another body that cannot recover VAT will result in an extra cost to the buyer or the tenant.

4.6 Lifeboats and marine fuel

4.6.1 Lifeboats

In the UK, if a charity provides rescue or assistance at sea the following goods and services are zero rated:
- any vessel for use as a lifeboat, and repair and maintenance;
- lifeboat launching and recovery equipment and repair and maintenance;
- the construction and modification of lifeboat slipways and repair and maintenance;
- spare parts and accessories for use with the above vessels, equipment and slipways; and
- equipment of a kind ordinarily installed, incorporated or used in a lifeboat.

A VAT Tribunal case, *Royal National Lifeboat Institution v HM Revenue & Customs* [2009] UKFTT 39 (TC) (07 April 2009) considered the scope of zero rating supplies to seagoing vessels. In particular it looked at whether or not alterations or repair and maintenance services for lifeboat stations and other equipment met the direct needs of lifeboats. The supplies concerned three types of costs: alterations and improvements, repairs and maintenance, and other services such as dredging of harbours and maintenance of cliff hoists. The law exempts the supply of services to meet the "direct needs" of a variety of vessels. A number of services under this area of the law, including the supply, repair and maintenance of vessels and equipment, are excluded. The Tribunal noted that the needs of a lifeboat were different from those of other vessels because they were intended to go to sea at short notice and in all weather. Notwithstanding this, the Tribunal found that the majority of services did not meet those direct needs. Exceptions were the maintenance, alterations and modifications of equipment in order to launch boats quickly (such as doors and launching gear) and included alterations to the lifeboat station to house a boat and associated architect's and surveyor's fees. Other services which also met the direct needs test included those that assist the boat to get to sea quickly, such as dredging of channels and maintaining slipways. It was also deemed that because the crews needed to be sufficiently trained, any training provided by third parties was also included.

4.6.2 Marine fuel

Marine diesel supplied to sea rescue charities for use in lifeboats is zero rated. This covers all fuels supplied to charities providing rescue or assistance at sea for use in lifeboats.

The application of the zero rate on supplies to such charities is important because they are not considered to be "in business" in carrying out their rescue activities and therefore have no entitlement to recover the VAT that they incur in providing them.

4.7 Drugs, medicines and aids for the handicapped

Specified goods and services supplied both to individuals and to charities are zero rated. Conditions for applying the relief are complex and a number of qualifications must be met. However, the relief can result in the zero rating of a wide range of goods including drugs, medical or surgical appliances, cars, lifts, chair lifts, hoists and alarm systems. Also potentially zero rated are the repair and maintenance of qualifying items, adapting goods to suit the needs of the disabled, providing ramps for access and widening doorways and providing or adapting bathrooms.

4.8 Other charity-specific zero rates

4.8.1 Donated goods

Some charities or their trading subsidiaries sell goods that have been donated to them. Subject to certain conditions, sales of donated goods can be zero rated. The benefit of the zero rating is that the charity or its trading subsidiary does not need to account for VAT on the sale but can recover the VAT incurred on costs directly attributable to making that sale. This is valuable both in terms of recovery of VAT on direct expenses and in improving the overall VAT recovery position of the charity.

The sale of donated goods by a charity or a trading subsidiary can be zero rated subject to the following conditions:

- the goods have been donated to the charity or its trading subsidiary with the intention that they will be sold or hired;
- the goods must be sold or hired in the condition that they are received – they may be cleaned or repaired but the structure of the goods cannot be altered.
- the sale or hire takes place as a result of the goods having been made available for purchase or hire (whether in a shop, at a charity auction or elsewhere) to the general public, to two or more disabled people or to people receiving means-tested benefits.
- the charity has not used the goods for any other purpose apart from being available for sale or hire by the charity – which means that if the charity uses the goods itself (for example, furniture in its offices) and then decides subsequently to sell them, the sale would not be covered by the zero rating of donated goods.
- the sale does not take place as a result of any arrangements relating to the goods entered into by the parties to the sale before the goods were made available to the general public.

There is an extra-statutory concession whereby donated goods, which would normally be sold to the public, are zero rated when sold to rag/scrap merchants, when the goods are unsuitable for sale to the general public due to the poor quality.

The law also allows for zero rating of goods donated by businesses to charities for sale, hire or export. Ordinarily, a business donor would have to account for VAT on such goods. Goods donated for the charity's own use do not qualify.

Where a trading subsidiary of the charity runs a shop it may zero rate sales or hire of donated goods if the entity is registered for VAT and declares in writing that the profits will be transferred to a charity or are otherwise payable to a charity. An entity under these arrangements is a "profits-to-charity person". However, the sale of trading goods bought by the charity is not covered by zero rating and the VAT liability of such items will therefore follow the normal VAT rules.

4.8.2 Issues and case law

4.8.2.1 Land:

HMRC takes the view that the sale of bequeathed land or buildings by a charity does not qualify for zero rating under this provision where the charity has not taken legal title. Its argument is that, in most cases where dwellings or land are bequeathed to a charity, the property would not have been a business asset of the deceased person or the charity. Any supply of the property is therefore normally outside the scope of VAT and the charity is not able to recover VAT on expenses connected with the sale.

4.8.2.2 Animals:

Gablesfarm is a charity that rescues lost, unwanted and homeless cats and dogs, many of which are subsequently sold to new owners. In *Gablesfarm Dogs and Cats Home v Revenue & Customs* [2008] UKVAT V20519 (04 January 2008) a VAT Tribunal looked at whether the fact that the original owner had not actually donated the animals to the charity (because many of them had simply been abandoned) affected its ability to treat income from the subsequent sale of the animals as zero rated income from the sale of donated goods. The Tribunal held that such sales were zero rated regardless of whether the animals had been provided to the charity by the public, the police or the local authority. *Gablesfarm* was followed in *Three Counties Dog Rescue v Revenue & Customs* [2011] UKFTT 817 (TC) (12 December 2011).

4.8.3 Auctions

Donated auction items can be zero rated subject to the rules as set out above (ie it does not cover donated services such as holidays).

4.8.4 Export of goods

Charities (particularly those engaged in international relief) may sometimes export goods from the UK, perhaps to a disaster area outside the EU. Although the supply of goods may be free of charge, a VAT relief is available to charities allowing the export to be zero rated rather than to be treated as a non-business activity. Commercial sales of goods to be exported would be zero rated under the normal export rules; but this additional relief for charities means that even if no consideration is received the zero rating can still apply.

These provisions enable a charity to recover VAT on goods which have been donated or purchased by the charity for export. Because such activities are zero rated, charities are entitled to reclaim VAT incurred on the goods themselves and on any handling, transport, storage or associated overheads, subject to the normal rules.

Charities must be able to satisfy HMRC that the goods have been exported. They are required to keep records of exports and should be able to provide a clear and ready link between those records and the proof of export required. For example, the normal evidence of sea freight exports is a copy of the bill of lading or sea waybill or equivalent.

A charity not ordinarily registered for VAT may register in order to benefit from this VAT relief. This means that if the charity exports aid free of charge it can choose to register for VAT and then reclaim any VAT charged on obtaining and exporting the goods.

Charities should ensure that their systems allow for any costs relating to the export of goods to be identified with the directly related VAT then treated as recoverable.

The effect of these supplies on the business / non business and partial exemption position should also be considered. Since no consideration is received in respect of these supplies, charities operating income-based methods are unlikely to be able to benefit . However, those using an inputs-based special method may be able to increase recovery of VAT on overheads (depending on the specifics of the method agreed with HMRC).

4.8.5 "Relevant goods" for medical care etc

This relief is designed to remove the VAT cost of certain medical goods or equipment purchased for use mainly in medical or veterinary research, training, diagnosis or treatment.

Zero rating can apply to the supply of "relevant goods" (defined in detail in the relevant HMRC Customs Notice 701/6) to any person or organisation when those goods are to be donated to a nominated "eligible body" (provided that the criteria detailed below are met).

In addition, the supply (including hire) of "relevant goods" directly to an "eligible body" may be zero rated if that body pays for them with funds provided by a charity or from voluntary contributions. Where the eligible body is not a charity, it must not have contributed, wholly or in part, to the purchase (or hiring) of the goods.

Zero rating also applies to the supply of "relevant goods" to an "eligible body" which is itself a charitable institution providing care or medical or surgical treatment for "handicapped" persons. "Handicapped" in this context means "chronically sick or disabled".

Where the "eligible body" is a charitable institution it is not regarded as providing care or medical or surgical treatment for handicapped persons unless the supply is made in a "relevant establishment" and the majority of the recipients are "handicapped". A "relevant establishment" is:

- a day centre other than a day centre which exists primarily as a place for activities that are social or recreational or both; or
- an institution which is approved, licensed or registered under the relevant social legislation or which is exempted from those obligations by that legislation.

A supply will qualify for zero rating where an "eligible body" provides medical care to handicapped persons in their own homes, and the "relevant goods" are used in or in connection with the provision of that care.

By concession, where "relevant goods" are supplied to a charity:

- whose sole purpose and function is to provide a range of care services to meet the needs of handicapped people (of which transport might form part); or
- which provides transport services predominantly to handicapped people,

the supply of those goods will be zero rated, as will the repair and maintenance of those goods and the supply of any further goods in connection with such repair or maintenance.

In order to demonstrate eligibility for this concession, a charity must be able to show that it meets either of the principal conditions through its charitable aims and objectives, its publicity and advertising material, its day-to-day operations, any documents which it has issued for the purpose of obtaining funding from a third party such as a local authority and any other evidence that may be relevant.

The repair and maintenance of "relevant goods" are zero rated provided they are owned or possessed by an "eligible body" and the services are paid for by a charity or from voluntary contributions. It does not matter how the goods themselves were bought in the first place. Spare parts etc supplied in connection with the repairs and maintenance are also relieved. If the owner or hirer of the goods repaired or maintained is not a charity it must not have contributed, wholly or in part, to the cost of the repairs or spares.

The goods and services can only be zero rated if the supplier is registered for VAT and is given a declaration in a prescribed form that the goods are either being purchased by an "eligible body" or are to be donated to an "eligible body".

"Relevant goods" include:
- medical equipment;
- scientific equipment;
- computer equipment;
- video equipment;
- sterilising equipment;
- laboratory or refrigeration equipment for use in medical or veterinary research, training, diagnosis or treatment;
- ambulances;
- parts or accessories for use in connection with the above;
- rescue equipment solely for the purpose of rescue or first aid services undertaken by a charity providing such services;
- unadapted motor vehicles with between seven and 50 seats used by an "eligible body" that provides care for blind, deaf, mentally handicapped or terminally ill people mainly for their transportation; and
- vehicles designed or adapted for transporting the sick or handicapped, including minibuses adapted for the carriage of handicapped persons in wheelchairs.

In the last case there are minimum statutory limits to the number of wheelchair spaces required in such as vehicle based on its seating capacity: for example a 27 seat vehicle requires a minimum of three spaces to attract the zero rating. The vehicle must be fitted with an electric or hydraulic lift or, for vehicles with fewer than 17 seats, an access ramp can be used instead.

An "eligible body" includes all health authorities and NHS trusts in England and Wales and their equivalents in Scotland and Northern Ireland. It also includes hospitals and research institutions whose activities are not carried on for a profit and charitable institutions providing care, medical or surgical treatment for handicapped persons, rescue or first-aid services.

HMRC may challenge the use of this relief in respect of items which are claimed to be parts or accessories. "Parts" are integral components without which the relevant equipment is incomplete while "accessories" are optional extras that are not necessary for the equipment to operate but are used to improve or better enable the equipment to operate in particular circumstances. Not included will be items which have an independent use (eg televisions), or are accessories to accessories, or are generic bulk substances (eg liquids, powders, sheets, pellets and granules).

4.8.6 Advertising and goods connected with collecting donations

Advertising

The placing of an advertisement by a charity in someone else's media can usually qualify for zero rating. Supplies made to a trading subsidiarity of a charity are excluded from this relief.

Advertising covering any subject, including staff recruitment, in a third-party medium can qualify for zero rating, including advertisements on television, cinema, billboards, buses, in newspapers, programmes, annuals, leaflets and other publications, and on internet sites.

Marketing and advertising of items to targeted individuals or groups are excluded from zero rate relief. HMRC states that this exclusion includes telesales and direct mail by post, fax or email and marketing aimed at people in selected businesses or buildings. However, certain items addressed to targeted individuals or groups may be zero rated because of the concessionary relief granted to pre-printed fundraising appeals and by the general relief available on certain items of printed matter.

The zero rating includes services such as design and preparation costs for artwork and typesetting that are closely linked to the production of a qualifying advertisement. It is not necessary for the design and preparation costs to be included in the same invoice as the advertising itself.

The relief does *not* include a supply used to create or contribute to a website that is the charity's own because in that case the advertisement is placed in the charity's own media rather than on someone else's. Where a charity supplies advertising services to another charity then these can be zero rated.

To obtain zero rating, the charity will need to give the supplier a declaration in a suitable format. This relief is available to charities whether or not they themselves are registered for VAT. Not all suppliers of advertising are aware of this relief so it may be necessary for a charity to bring this to the attention of the supplier. A VAT refund can still be obtained by a charity from a supplier in the event that the VAT relief had initially been overlooked. It is generally possible to correct the position subsequently, subject to any applicable capping provisions.

Goods connected with collecting donations
Under an extra-statutory concession, certain items used in connection with collections of monetary donations can be zero rated when provided to a charity.

The ESC covers the following:-
- collecting envelopes which ask for donations of money, and stewardship and similar envelopes used by religious and other organisations in their planned giving schemes;
- pre-printed appeal letters primarily aimed at seeking money for the charity; and
- envelopes used to send out appeal letters and envelopes for forwarding donations to the charity; provided each type is over-printed with an appeal request related to that contained in the letter, or are distinguishable from the charity's usual stationery.
- all types of boxes and receptacles used for collecting money provided they are capable of being sealed, for example by tamper evident sticker, tape or lock; are clearly charity collecting boxes for a named charity and either bear the name of the charity, for example by indelible printing or embossing or having raised letters, or allow for the charity name to be added later.

The following will also qualify for relief:
- specially designed tamper proof bucket lids with tamper evident stickers making them suitable for a charity donation;
- bucket shaped receptacles, which cannot be used for anything except collecting donations of money;
- bucket packs for assembly consisting of bucket, money collecting top and tamper evident seals and labels; and
- lapel stickers, emblems and badges which are to be given free as an acknowledgement to donors of money, have no intrinsic value and are low cost to the charity.

The third of theses reliefs is restricted to small items designed to be worn on clothing, of a kind that were traditionally attached to the lapel. Included are paper stickers, ribbons, artificial flowers (if these are used as a symbol of the charity) and metal pins and badges. Emblems or badges given in return for any non-specified donation or a suggested donation of up to £1 are also covered by the relief.

4.8.7 Medicinal products
Zero rating is available for the supply of certain medicinal products which are to be used by a charity for providing care, treatment or engaging in research. This zero rates the supply of a medicinal product to a charity providing care or medical or surgical treatment for human beings or animals or engaging in medical or veterinary research where the supply is solely for use by the charity in such care, treatment or research.

Medicinal products which qualify for relief are those capable of being consumed or otherwise absorbed into the body. For example, a pill to be taken orally would fall within this description, whereas a syringe would fall outside it.

HMRC states that "medicinal purpose" means:
- treating or preventing disease;
- diagnosing disease or ascertaining the existence or degree of a physiological condition;
- inducing anaesthesia; or
- preventing or interfering with the normal operation of a physiological function, whether permanently or temporarily, and whether by terminating, reducing, postponing, increasing or accelerating the operation of that function or in any other way.

HMRC also states that medical and veterinary research should be given its technical meaning: ie it is restricted to activities which are directed towards opening up new areas of knowledge or understanding or the initial development of new techniques, rather than towards mere quantitative additions to human knowledge.

"Medical or veterinary treatment" includes the administration of medicines, physiotherapy and surgery.

In order to qualify for the zero rating relief a charity must provide the supplier with the necessary declaration confirming that the medicinal product will be used for a qualifying purpose.

Imports by charities of medicinal products can be zero rated provided the charity gives the supplier a certified declaration that the goods are to be used for the specified purpose. The appropriate declaration must be presented with the Customs entry form.

This relief is restricted to charities that will be using the products themselves; a charity which donates these items to *another* charity cannot obtain relief. In addition, this relief is only available to registered charities; other not-for-profit bodies such as the NHS cannot generally obtain this relief.

4.8.8 Substances used in medical research

Zero rating is available for the supply of certain substances which are to be used by a charity for engaging in research. Zero rates apply to the supply to a charity of a substance directly used for synthesis or testing in the course of medical or veterinary research. "Substance" means any natural or artificial substance, whether in solid or liquid form or in the form of a gas or vapour. If the substance is purchased in the form of gas, the rating will also apply to the cylinder rental.

As with medicinal products above, HMRC's view is that research is restricted to activities which are directed towards opening up new areas of knowledge or understanding, or initial development of new techniques, rather than towards mere quantitative additions to human knowledge.

In order to qualify for the zero rating relief a charity must provide the supplier with the necessary declaration confirming that the substance will be used by the charity in the course of medical or veterinary research. Imports by charities of medicinal substances can be zero rated provided the charity gives the supplier a certified declaration that the substance will be used by the charity in the course of medical or veterinary research. The appropriate declaration must be presented with the Customs entry form.

Again, this relief is restricted to charities that will be using the substances themselves; a charity which donates these items to another charity cannot obtain relief. In addition, this relief is only available to registered charities: other not-for-profit bodies, such as the NHS, cannot generally obtain relief.

5 VAT: charity reliefs: reduced rates

In addition to the reliefs above that provide full relief to charities in respect of the specified supplies, charities can also receive certain supplies at the reduced VAT rate (currently 5 per cent).

5.1 Fuel and power

The supply of fuel, power, heat, refrigeration and ventilation are subject to VAT at 5 per cent when provided for a "qualifying use". A qualifying use includes use by a charity for non-business activities and use in a "relevant residential building" (for example, a care home, hospice or student accommodation). In addition, the provision of small quantities of fuel and power at a given site (for example, no more than 1,000 kilowatt hours of electricity per month or no more than 150 therms of piped gas per month) are treated as provided for domestic use and therefore also subject to the 5 per cent rate.

If 60 per cent or more of the fuel or power is supplied to the charity for use in non-business activities then a charity can pay the reduced rate of VAT on the whole supply.

If less than 60 per cent of the fuel or power is for non-business use VAT will be charged *pro rata* – that is, at the reduced rate on that portion which is for non-business use and at the standard rate on that portion which is for business use.

If a charity has a mix of business and non-business activities it will need to provide the supplier with a certificate that declares what percentage of the fuel and power supplied is put to non-business use.

5.2 Energy-saving materials

The supply and installation of "energy-saving materials" (including items such as draught strips, solar panels, central heating system controls, ground source heat pumps and wind turbines) to dwellings or a "relevant residential purpose" building (see fuel and power 5.1) or "relevant charitable purpose" building are subject to the 5 per cent VAT rate.

Note however that it was announced in the March 2012 Budget that the reduced rate for energy-saving materials for a relevant charitable purpose is to be removed, though it will continue to apply to the supply and installation of energy-saving materials for a relevant residential purpose, including accommodation operated by charities. Legislation will be introduced in the Finance Bill 2013.

5.3 Grant-funded installations

Heating equipment (for example, boilers and central heating systems) or security equipment (for example, smoke alarms, locks and bolts) can be supplied at the reduced rate to the extent that the provision is grant funded and provided to a person who is either over 60 or receiving certain state benefits.

5.4 Residential conversions, renovations and alterations

Works that result in a change in the number of dwellings within a building (or part of a building) can qualify for the 5 per cent rate. Hence, for example, converting an office into apartments or a house into flats (or flats into a house) all qualify for the 5 per cent rate. The 5 per cent rate also applies to works of renovation or alterations carried out on a single household dwelling that has not been lived in for two years or more and to a building which is to be used solely for a relevant residential purpose or a multiple occupancy dwelling, provided the premises has not been lived in for at least two years.

6 VAT and cross-border transactions

6.1 Overview

Specific VAT rules apply to any charity that provides or receives cross-border supplies of goods or services.

6.2 European trade: reporting requirements

6.2.1 EU sales lists

This is a requirement for VAT-registered charities that sell goods to customers registered for VAT in another EU member state. Submitting a simplified annual ESL may be agreed with HMRC if the value of such sales is less than £11,000 in a twelve-month period, total taxable turnover in a year is not more than the VAT registration threshold plus £25,500 and the sales do not include New Means of Transport. Since 1 January 2010 ESLs have applied to services with a place of supply in the customer's Member State, as well as to goods.

6.2.2 Intrastat

VAT registered charities must record the value of goods supplied to and acquired from other Member States. If the annual value of these "dispatches" or "acquisitions" exceeds the threshold (currently £250,000 and £600,000) the charity will need to start completing supplementary declarations ("Intrastat returns").

6.3 Place of supply

It is important to identify the "place of supply" for both goods and services in order to establish where and how VAT should be accounted for. The rules are complex and will have limited relevance to most charities – although their impact can be high when they are. The following comments address situations where charities are likely to find themselves making or receiving cross-border supplies.

6.4 Goods

6.4.1 Sales outside the EU

If goods are sold to customers from outside the EU the sale is regarded as made in the UK but can be zero rated as an export. Exports are divided into "direct exports" (where the seller arranges transport of the goods to the customer) and "indirect exports" (where the customer arranges the transport of the goods). There is also a "retail export scheme" under which retailers can zero rate sales to overseas visitors. In each case, retailers must comply with detailed rules.

6.4.2 Sales within the EU

Goods sold to business customers who belong to another Member State are supplied in the UK but are not subject to UK VAT. The customer is required to account for "acquisition tax" in the Member State of acquisition. This means that customers charge themselves VAT on the goods sold to them (known as "acquisition VAT") and can recover this as input tax subject to the local rules.

Conversely, a business customer (including a VAT-registered charity) who receives goods VAT-free from a supplier in another Member State is required to account for "acquisition tax" in the UK.

6.4.3 *Distance selling*

If goods are sold by a UK entity to a customer who belongs in another Member State but is not VAT-registered there (for example, private individuals, public bodies or charities) the place of supply is the UK and UK VAT is due until the "distance selling threshold" is exceeded in a particular Member State. Once the threshold is exceeded, the supplier will be required to register for VAT in that Member State.

Hence, for example, a charity selling goods by mail order would be required to register for VAT in Spain if the value of sales to Spanish customers exceeded €35,000.

6.4.4 *Purchases outside the EU*

VAT on imports of goods purchased from non-EU countries is normally charged at the same rate as if the goods had been supplied in the UK; however, certain donated goods can be imported free of VAT. The goods have to be either:

- basic necessities for the needy and vulnerable;
- goods to be used or sold at charity events for the benefit of the needy and vulnerable; or
- equipment and office materials to help run an organisation for the benefit of the needy and vulnerable.

6.4.5 *Purchases within the EU*

A VAT-registered charity buying goods from other EU countries will not normally have to pay VAT when bringing the goods into the UK. Instead, it will account for any acquisition VAT on the next VAT return, at the rate that would have applied if the charity had bought the goods in the UK.

6.5 Services

6.5.1 *Provision of services*

For determining the place of supply of services we need first to determine where the supplier and business customer have establishments and where they belong. From 1 January 2010 the basic place of supply is where the customer belongs if the customer is a business customer.

Where the place of supply is determined by where the customer belongs, the customer is required to account for VAT under the "reverse charge" procedure. This means that the supplier treats the supply as outside of the UK (i.e. as if it were zero rated) and the customers charge themselves VAT on the invoice value.

6.5.2 *Receipt of services*

Charities that are VAT-registered in the UK are required to account for VAT on certain services received from non-UK suppliers. From 1 January 2010 this requirement has covered all services (other than VAT-exempt services) where the place of supply is determined by where the customer belongs. Hence, for example, a UK charity that is VAT-registered would need to account for VAT under the reverse charge if it received consultancy services from a supplier in the USA.

The reverse charge can also result in an unregistered charity having an obligation to register for VAT because the value of supplies on which the reverse charge applies is taken into account when determining the liability to register. Hence, for example, a charity with taxable supplies of £60,000 in a twelve-month period which receives services to a value of £40,000 from an overseas supplier would be required to register for VAT because the combined total takes it over the current VAT registration threshold.

It should be noted that the changes effective from 1 January 2010 build on the decision in the case of *Kollektivavtalsstiftelsen TRR Trygghetsrådet v Skatteverket* [2009] EUECJ Case C-291/07 (6 November 2008) ("TRR"). Whereas the UK previously only required the reverse charge to apply when a service was received for a business purpose, VAT-registered charities are now required to apply the reverse charge irrespective of whether or not the service has been provided for a business or non-business purpose. This means that, in order to raise the necessary self-supply invoice and pay the output tax to HMRC, charities need to have a system in place for identifying those invoices from overseas suppliers that do not show VAT and where the supply falls under the rules above. Recovery of all or part the VAT as input tax will depend on the use of the services.

Since 1 January 2011, most business to business supplies of cultural, artistic, sporting, scientific, educational, entertainment and similar services are also taxed where the customer belongs. However, supplies of admission to cultural, artistic, sporting, scientific, educational and entertainment events, and services ancillary to admissions (such as cloakrooms) remain taxable where the event takes place.

The Government was planning to introduce secondary legislation in autumn 2012 to formalise the temporary arrangements under which supplies of freight transport and related services taking place wholly outside the EU are not liable to UK VAT when performed for UK businesses and charities.

7 Other VAT issues

7.1 Staff secondments

A supply of staff is in principle subject to VAT at the standard rate. By concession, where a member of staff is seconded by a charity to another charity and that member of staff has been engaged only in non-business activities of the seconding charity and will only be involved in the non-business activities of the receiving charity, the income received by the seconding charity is not subject to VAT provided it does not exceed "normal remuneration". Note that any other charges, for example for use of office facilities etc would still be subject to VAT.

There is a further concession which is not restricted to charities but can be used by them. If an employer seconds a member of staff and the recipient exercises exclusive control over the staff member and is responsible for paying the employee directly (and meeting all third party obligations such as National Insurance Contributions (NICs) etc) such payments are disregarded for VAT purposes. The concession will not apply if the employer derives any financial gain from:

- placing the employee with the recipient; or
- any other arrangements or understandings between the employer and the recipient.

7.2 Corporate sponsorship v donations

The key challenge for corporate sponsorship is to distinguish "sponsorship" (where the person or organisation making the payment receives a significant benefit such as having their logo displayed at an event, or being allowed free or preferential rate access to an event) from a "donation" (where the payment is freely given and the donor receives nothing in return but may receive a simple acknowledgement such as the donor's name being included in a list of supporters in a programme).

If a charity receives corporate sponsorship as above, VAT will be due unless the sponsorship is part of a fundraising event (see 2.7). Charities should therefore ensure that any agreement allows VAT to be charged in addition to the agreed payment. Where the sponsor is able to recover the VAT charged, that should not result in a cost to the sponsor and should be beneficial to the charity because it increases the value of its taxable activities. However, if a sponsor has a restricted ability to recover VAT – for example a bank or insurance company – a VAT cost will arise.

If the payment is a true "donation" it will be outside the scope of VAT.

If a donation is given in addition to the sponsorship payment this may be excluded from the taxable amount, provided that it is clear from any agreement that the donation is entirely separate from the payment for sponsor's rights.

7.3 Use of charity name and logo

This is the reverse of sponsorship – where companies typically give charities a percentage / amount for every product sold. In return they are allowed to use the name and logo of the charity to raise awareness of the relationship. HMRC regards this as a payment for services – being allowed to use the charity name in a way that will benefit the company.

As with sponsorship, VAT will be due and charities need to ensure that any agreement allows VAT to be charged in addition to the agreed payment.

Also, as before, if a donation is given in addition to the sponsorship payment this may be excluded from the taxable amount, provided that it is clear from any agreement that the donation is entirely separate from the sponsorship.

7.4 Barter transactions

Barter transactions are where no money changes hands but goods or services are swapped, which can result in the charity needing to raise a VAT-only invoice in some cases. For example, where a charity receives radio airtime and in return gives the radio station some charity Christmas cards for it to use, the supply of radio advertising to the charity is zero rated but the supply of Christmas cards by the charity is standard rated and the charity would need to issue a VAT-only invoice charging VAT on the value of the cards.

7.5 Tour Operators' Margin Scheme (TOMS) relating to challenge events

The Tour Operators' Margin Scheme (commonly referred to as TOMS) applies not only to conventional tour operators but also to any business that buys in supplies such as hotel accommodation or passenger transport and provides those supplies to a "traveller" without material alteration. The scheme could therefore apply to a charity that runs a challenge event where, for example, accommodation is bought in for participants. A challenge event typically involves participants in some kind of activity for which they raise sponsorship, for example, a trek overseas.

These types of events do not usually qualify for the charity fundraising event exemption because they often include one or more of the following:

- a package of both travel and accommodation;
- bought-in accommodation;
- more than two nights' accommodation from a charity's own resources.

If in running the event the charity acts as a principal or undisclosed agent it will need to operate the Scheme. VAT will be due on the margin between what it has cost the charity (excluding overheads) to provide a place on the event and what the charity insists on receiving as payment before allowing the participant to take part. For events / packages that take place within the EU, the margin will be taxable at the standard rate. For events / packages which take place outside the EU the margin will be taxable at the zero rate.

TOMS can also apply to charities making supplies of conferences and accommodation to business customers. It will depend on the particular circumstances such as whether the supplies come under the education exemption (see 2.2 above) and whether the activities are carried through the charity or its trading subsidiary.

Changes were made from 1 January 2010 withdrawing a concession which had allowed travel service providers who generally engage in normal sales but occasionally sell to other travel businesses for onward resale the option of accounting for tax at the standard rate of VAT. This widened the scope of TOMS

TOMS is a complex area and given the important of getting it absolutely right, we would suggest that those affected take specific advice and/or refer to the HMRC VAT Notice 701/1 Charities Update 2 issued in July 2008, VAT Notice 709/5 updated in November 2009 and Revenue and Customs Brief 27/09 setting out changes which applied from 1 January 2010.

7.6 Affinity credit cards

A charity may receive payments from a bank, building society or other financial institution in return for the charity endorsing that institution's credit card and recommending its use to the charity's members or supporters. Such cards are normally referred to as "affinity credit cards" and bear the name of the charity.

If a charity acts as an intermediary in bringing together a credit card provider with its members, any payment from the credit card provider to the charity is exempt from VAT.

In many cases, however, a charity does not act as an intermediary but receives a payment from the credit card provider for each new card taken out and then a small percentage of the ongoing turnover from the credit card. HMRC allows the charity to treat part of the payment as a donation and therefore outside the scope of VAT. The remainder is subject to VAT in the normal way.

To benefit from this treatment there must be two separate agreements:
- the first agreement, usually between the charity trading subsidiary and the card provider, should provide for the supply of the necessary marketing and publicity services and access to membership lists and other promotional activity for the card (marketing services) – these supplies are subject to VAT; and
- the second and separate agreement between the charity and the card provider should provide for contributions to be made by the card provider in respect of the use only of the charity's name and/or logo – contributions made under this agreement can be treated as outside the scope of VAT.

The concession states that at least 20 per cent of the initial payment should be treated as the consideration for the standard-rated business supplies by the charity. The remaining 80 per cent (or less) of the initial payment, and all the payments based on turnover, will be outside the scope of VAT. The arrangements work in the same way for the purposes of corporation tax.

This is a specific concession and does not apply to other joint promotions with financial institutions.

7.7 Subscriptions

Charges for subscriptions to an organisation are normally standard rated. However, if little or nothing is given in return for a subscription it can be classed as a donation.

Some supplies made to members by certain non-profit-making public interest bodies in return for a subscription can be exempt from VAT. These are bodies with aims that are in the public domain and are of a political, religious, patriotic, philosophical, philanthropic or civic nature. Supplies by such bodies are exempt except those which include:
- any supplies that are not referable to the aims of the organisation as set out in its articles of association;
- the right of admission to any premises, event or performance for which non-members have to pay; or
- any supplies that are not available without payment other than a membership subscription, that is, which are not provided automatically as part of the membership benefits and for which an additional sum is charged.

There is also a special concession for the VAT treatment of membership subscriptions by charities whether or not their supplies are exempt. Normally, there is one "principal benefit" within a package of benefits to which all the other benefits are supplementary or incidental. In such cases the package would be treated as a "single supply" for VAT purposes with the VAT treatment of the additional benefits following that of the principal benefit.

For example, if the principal benefit offered by a theatre club is theatre seats and the other benefits – such as the right to receive a theatre magazine (zero rated) – are incidental, the whole supply would be treated as a supply of admission, which would be standard-rated or exempt depending on whether or not the exemption for cultural activities applied. However, charities and non-profit-making organisations can choose to treat packages of membership benefits as "multiple supplies". This means that they can apportion the VAT treatment of each benefit individually. In the example above it means that they could benefit from being able to treat the supply of the theatre magazine as zero rated

7.8 Sponsored Events – London Marathon – Gold Bond

If a charity asks individuals to "pledge" or "commit" to raise a certain amount of sponsorship but does not insist on any payment before allowing the individual to take part in the event, the total amounts raised can be treated as donations and outside the scope of VAT. A charity can encourage individuals to pass on sponsorship money as they receive it but cannot insist on receiving a certain amount before allowing the individual to take part, as that would make the amount subject to VAT.

Charities can choose to charge a registration fee of a fixed amount and then invite additional sponsorship and include a suggested level for this. The fee is taxable at the standard rate whereas the sponsorship is a donation outside of the scope of VAT. Where this occurs the charity will be entitled to reclaim the VAT it incurs on related expenses (eg VAT on Gold Bond places for the London Marathon.)

7.9 The European perspective

VAT in the EU is set out in the Principal EU VAT Directive and the rules are brought into effect by domestic legislation in each Member State. Some parts of the Directive have direct effect irrespective of whether or not they have been introduced into UK legislation and taxpayers are entitled to rely on this direct effect in the event of a dispute with the tax authorities. "There is an instance where the UK Government has not yet transposed the relevant part of European law into UK law for the benefit of charities. This where, in accordance with Annex H of the Principal EU VAT Directive, corporate sponsorship income could remain outside the scope of VAT where the only benefit which the charity gives the sponsor is the passive use of its name and logo in publicity.

7.10 Solar panels

The VAT treatment on the initial installation of solar panels for renewable electricity and the receipts from resulting payments for the Feed-In-Tariff and for the Export Tariff was clarified in 2012 by HMRC as follows:

1. If the building is listed and a solar panel is fixed to the roof this can be an approved alteration to a listed building and zero rated for VAT purposes [but note section 4.5.4 regarding the withdrawal of this zero rating].

2. If the building is not listed but qualifies as a relevant charitable building then 5 per cent reduced rate will apply.

3.. If the building does not qualify under 1. or 2. the supply is standard rated.

4. Selling of unused electricity back to the grid is a business activity subject to VAT at 20 per cent. So if a charity is VAT registered it would need to account for output tax, or if not registered would have to count the income towards its taxable turnover for VAT purposes.

7.11 Postal services

Royal Mail services that are covered by the Universal Service Obligation or are under price control are exempt from VAT. This includes postage stamps for general use. From April 2012 however, VAT was been added to all bulk mailing services.

It is possible for charities to use Downstream Access (DSA) services.

DSA providers have an agency agreement with Royal Mail that allows customers to retain VAT exemption for almost all of the transactions. The services in question are subject to price control, so they are likely for the foreseeable future to continue to benefit from exemption, unless and until there are further EU changes.

Under the agreement, the DSA provider can act as the charity's agent and secure Royal Mail final mile delivery services on the charity's behalf (by taking the mail to regional hubs). This means that the charity will only pay VAT on the upstream element (collection and sorting by the DSA) with no VAT charged on the 'downstream' element (the final mile delivery by Royal Mail). The downstream element is where most of the cost lies.

7.12 VAT and salary sacrifice schemes

Following the Court of Justice of the European Union case – *Astra Zeneca UK Ltd v. HMRC* [2010] EUECJ C-40/09, output tax must be accounted for on benefits supplied via salary sacrifice schemes from 1 January 2012.

There has been a phased introduction for contracts which postdate 1 January 2012.The earliest of the three events listed below triggered VAT needing to be accounted for on arrangements extending beyond 31 December 2011:

- The date that a fixed term agreement expires or the fixed number of salary sacrifice payments are completed
- The date of an employee's annual salary /benefits review
- The date of any other review or renegotiation that leads to a change in the provision of benefits under a salary sacrifice agreement or to a change in an employment contract

8 Import duties

Those who import goods from outside the Customs Union of the EU will normally have to pay import duty and VAT. However, some goods can be imported free of duty and VAT if they are imported by a charity or certain other types of qualifying organisation and providing that there is no commercial intent by the donor.

8.1 Scientific instruments

Establishments such as universities, medical schools and research laboratories can obtain relief if they are mainly involved in education or scientific research. Import reliefs apply to a range of goods including scientific instruments and apparatus, spare parts and tools for maintaining eligible instruments.

Approval must be sought from HMRC's National Import Reliefs Unit (NIRU). It will issue a certificate and a copy, and the original must be presented at the port or airport when the goods are imported.

Relief can be claimed on goods imported by post: the sender should write clearly on the package and Customs declaration "SCIENTIFIC INSTRUMENTS: RELIEF CLAIMED".

8.2 Donated medical equipment

Relief is available to a hospital department or medical research institution on instruments and apparatus intended for medical research, establishing medical diagnosis or carrying out medical treatment, spare parts, components and accessories specifically for eligible instruments and apparatus and tools for maintaining eligible instruments.

The goods must be donated by a charitable organisation or private individual or purchased with funds provided by a charitable organisation or with voluntary contributions.

As with 8.1, approval must be sought from HMRC's NIRU.

8.3 Donated goods for the needy

Goods qualifying for relief under this section are basic necessities for "needy people", goods to be used or sold at charity events for the benefit of needy people, or equipment and office materials to help run an organisation for the benefit of needy people.

8.3.1 Basic necessities for needy people
These are goods to be distributed free of charge to meet the immediate needs of needy people: food, medicines, clothing, blankets, orthopaedic equipment and crutches.

8.3.2 Goods to be used or sold at charity events for the benefit of needy people
Most goods used or sold at charity events qualify for relief provided that:

- the charity events are run to raise funds for the benefit of needy people;
- the charity events are normally not held more than four times a year by any one organisation;

- the goods were received free of charge from a person or organisation established outside the EU Customs Union; and
- there was no commercial intent on the part of the donor.

8.3.3 *Equipment and materials to help run an organisation to benefit needy people*

Service industry machines, tools and equipment, office materials, and fixtures and fittings qualify for relief provided they are received:

- free of charge from outside the EU;
- without any commercial intent on the part of the donor; and
- solely to help run the organisation and carry out charitable and philanthropic aims for the benefit of needy people.

The following goods are *not* eligible for relief from VAT:

- alcoholic products, including alcohol-based perfume;
- tobacco and tobacco products;
- coffee and tea;
- motor vehicles other than ambulances; and
- items associated solely with worship such as statues and pulpits.

HMRC may limit the quantities or kinds of goods imported to avoid any abuse or distortion of competition.

8.4 Goods to help with disasters in the EU

There are special procedures for dealing with the goods to help with disasters within the EU and HMRC's National Advice Service can give full details. The concession does not include relief on materials and equipment intended for rebuilding disaster areas.

As with 8.1, approval must be sought from HMRC's NIRU.

8.5 Goods specially designed for the education, scientific or cultural advancement of disabled people

The following are included in the relief:

- any goods specially designed to be of educational, scientific or cultural help to people who are blind or partially-sighted;
- any goods specially designed to give educational, employment or social help to people with physical or mental disabilities; and
- spare parts, components, tools and accessories intended for such goods.

It does not include non-specialised goods imported for subsequent adaptation to make them suitable for use by disabled people.

As with 8.1, approval must be sought from HMRC's NIRU.

9 Income tax and corporation tax

9.1 Overview of income tax and corporation tax

UK charities constituted as charitable trusts are liable to income tax, whereas those constituted as companies (or treated as companies for tax purposes) are liable to corporation tax. With the enactment of the Corporation Tax Act 2010 and the Income Tax Act 2007 exemptions and permitted investments are now broadly the same for both types of charitable entity.

9.2 Overview of charity reliefs

Charities are given exemption from the following:
- profits or gains arising in respect of rents or other receipts from an estate, interest or right in or over any land (whether situated in the United Kingdom or elsewhere);
- distributions from Real Estate Investment Trusts;
- investment income (both UK and overseas income), including company distributions;
- non-trading gains on intangible fixed assets (including royalties);
- income from public revenue dividends on securities which are in the name of trustees, to the extent that the dividends are applicable and applied only for the repair of –

(i) any cathedral, college, church or chapel, or

(ii) any building used only for the purposes of divine worship;
- trading profits where the trade is exercised in the course of the actual carrying out of a primary purpose of the charity or where the work in connection with the trade is mainly carried out by beneficiaries of the charity;
- profits from a lottery, providing it is promoted and conducted with a lottery operating licence,
- income from fundraising events, and
- non-charitable trade profits and miscellaneous income which qualify to be treated as "small-scale".

There are additional exemptions specific to each tax regime required to recognise different income types peculiar to income tax or corporation tax. However, it is beyond the scope of this document to include an exhaustive list of exemptions.

9.3 Non-charitable expenditure

9.3.1 Definition

A UK charity qualifies for a number of tax exemptions and reliefs on income and gains and on profits from some activities. A charity can only claim these tax exemptions and reliefs if, in broad terms, in some cases the charity uses the money it receives for its own charitable purposes or in other cases for general charitable purposes. There is no requirement to apply the income/gains/profits to specific projects, neither is there a fixed timescale over which the funds must be spent and it is quite permissible to use the funds for the general administrative purposes of the charity.

"Non-charitable expenditure" is expenditure incurred by a charity which is not incurred exclusively for charitable purposes. If non-charitable expenditure is incurred there will be a potential tax liability for the charity: see 9.3.2 below.

Losses incurred in relation to non-primary purpose trading is also treated as non-charitable expenditure.

Expenditure not incurred exclusively for charitable purposes includes:

- payments that are made to an overseas body where the charity trustees have not taken reasonable steps to ensure that the payments will be applied for charitable purposes; and
- any investments or loans that are not regarded as qualifying investments and loans.

9.3.2 *Impact of non-charitable expenditure*

A charity which incurs non-charitable expenditure will, in most cases lose its exemption from tax on an equivalent amount of its income or gains which would otherwise have been eligible for the charity tax reliefs.

For example, if the amount of non-qualifying expenditure is £100 and the amount of income/gains of the charity otherwise eligible for the charity tax reliefs is £150, then the charity will become liable for tax on £100. This means that for every pound of non-charitable expenditure, a charity potentially loses its tax exemption on an equivalent pound of income.

A charity can decide which sources of income and gains will effectively lose exemption but it must provide this information within 30 days of being notified by HMRC that the non-qualifying expenditure rules are applicable. If the charity does not specify a source then HMRC will do it for the charity. So, for example, as UK dividend income is relievable income a charity may wish to choose that type of income first as no further tax would be payable on it.

If the non-charitable expenditure for an accounting period is more than the charity's otherwise relievable income and gains for that period, the excess is set against the remainder of the charity's total income and gains (including for this purpose, non-taxable donations and legacies and other similar receipts). If there is still an excess it is carried back to the immediately preceding period, where it is treated as being non-charitable expenditure of that period.

This process is repeated until there is no longer any excess non-charitable expenditure or the period to which the excess is being carried back ended more than six years before the end of the year in which the non-charitable expenditure was actually incurred.

9.3.3 *Payments overseas*

Where a charity makes a payment to an overseas body, current tax legislation requires the charity to able to show that it has taken the steps that HMRC considers are "reasonable in the circumstances" in order to ensure that the payment will be applied for charitable purposes. If it has not done so, HMRC "may not be able" to treat the payment as charitable expenditure.

According to HMRC's detailed published guidelines for charities, the charity trustees must be able to describe the steps they have taken, explain how those steps ensured charitable application of funds, demonstrate that those steps were reasonable and produce evidence that the steps were, in fact, taken.

When considering whether the steps taken by the charity were "reasonable in the circumstances", HMRC will have regard to:

- the charity's knowledge of the overseas body; and
- previous relations with the overseas body; and
- past history of the overseas body; and
- the amounts given in both absolute and relative terms

When reviewing payments made to overseas bodies HMRC will generally ask the charity trustees to provide information about:

- the person or persons to whom the payment was given;
- for what charitable purpose it was given;
- what guarantees or assurances have been given by the overseas body that the payment will be

applied for the purpose for which it was given;
- what steps the trustees took to ensure the payment will in fact be applied for charitable purposes; and
- what follow-up action the trustees took to confirm that payments were applied properly.

The HMRC guidance goes on to state that the steps to be taken will depend upon the nature of the expenditure.

In HMRC's view, trustees are expected to make adequate enquiries to find out such information as is reasonably available about the overseas body and establish what evidence will be provided or made available by that body to show that the payment(s) will or have been applied for charitable purposes. The nature of the steps will depend upon the scale of operations and the size of the sums involved.

For example, in the case of small one-off payments, an exchange of correspondence between the charity and the overseas body will normally be sufficient. Where possible, the correspondence should be on headed paper and it should give details of the payment and the purpose for which it was given; and provide confirmation that the sum has or will be applied for the purpose given.

The current HMRC guidance includes worked examples illustrating the above.

9.3.4 *Investments and loans*

Making investments is not generally regarded as expenditure. Consequently, investments will not usually be caught as non-charitable expenditure nor, therefore, crystallise a tax charge. However, if a charity makes a non-qualifying investment or loan it will be treated as non-charitable expenditure for the purposes of the tax legislation and subject to the restrictions as described above.

Qualifying investments include:
- authorised trustee investments including wider-range investments (but, for example, excluding mortgages of freehold and leasehold property), for example. These include National Savings Certificates and deposits or shares in a designated building society;
- investments in common investment funds and similar funds established for the exclusive benefit of charities or any class of charities;
- investments in common deposit funds or similar funds established for the exclusive benefit of charities or any class of charities;
- any interest in land (other than one held as security for a debt);
- shares or securities listed on a recognised stock exchange;
- investments in unit trusts, or shares in open-ended investment companies;
- bank deposits on which a commercial rate of interest is paid (unless this forms part of an arrangement under which the bank makes a loan to another person, such as back-to-back loans);
- a loan or other investment (including a mortgage) as to which HMRC is satisfied is made for the benefit of the charity and not for the avoidance of tax by the charity or some other person. The charity must make a claim to this effect.

Qualifying loans (or in the case of charitable trusts approved charitable loans) are:
- loans made to another charity for charitable purposes only;
- loans to beneficiaries of the charity made in the course of its for charitable activities;
- money placed on current account with a bank (unless this forms part of an arrangement under which the bank makes a loan is made to another person such as back-to-back loans);
- any other loan as to which HMRC is satisfied is made for the benefit of the charity and not for the avoidance of tax by the charity or some other person.

Therefore the basic rule for investments and/or loans by charities (excluding such items listed above, for example land and normal stock exchange investments) is that in order to avoid a tax liability in the charity on the amount of the investment/loan it must be for the benefit of the charity and not for the avoidance of tax by the charity or some other person.

It is not possible to apply to HMRC for advance clearance that any particular loan or investment would satisfy the above conditions. Therefore, in the first instance, the charity must decide for itself whether or not the particular investment or loan qualifies. Where a charity has been requested to complete a tax return it must self-assess whether or not the investment and/or loan in question meets the qualifying conditions. However, even if the investment/loan is thought to meet the necessary conditions HMRC may still make enquiries.

According to HMRC's published guidelines an investment or loan will normally be "for the benefit of the charity" where it is commercially sound by reference to the circumstances prevailing at the time it was made.

HMRC adds that there is no one test of commercial soundness; and each case must be viewed on its own facts. However, where a loan or investment:
- carries a commercial rate of interest;
- is adequately secured; and
- is made under a formal written agreement which includes reasonable repayment terms,

HMRC will normally accept that the investment or loan is for the benefit of the charity.

Where one or more of the three factors above is not present, HMRC may ask the charity for full details of the investment or loan and for the reasons why it was considered to be for the benefit of the charity. For example, a charity lending to its wholly-owned subsidiary may not be able to obtain normal security. In that case, HMRC may ask to see the borrower's business plans, cash-flow forecasts and projections of future profits which informed the charity's decision to make the investment or loan.

9.4 Fundraising income

9.4.1 Payments for use of a charity's logo

Where the logo came into existence prior to 1 April 2002, a one-off payment is charged to tax as miscellaneous income. For annual payments exemption is available if the payments must are made under a legal obligation, recur each year and are a pure donation in the hands of the charity. (i.e, without the charity having to do anything in return.)

Where the logo came into existence on 1 April 2002 or later the treatment of the income depends on whether the logo is classed as a trading or non-trading asset. If the charity is passively receiving income from the company without publicising the use of the logo then this is likely to be regarded as a non-trading asset and the income exempt from tax.

9.4.2 Affinity credit cards

Treatment for tax purposes is likely to be similar to that for VAT purposes – see 7.7 for an explanation of this.

9.4.3 Business sponsorship

The tax treatment of payments received by charities under sponsorship arrangements will depend on the nature of the arrangement. If the charity does not provide goods or services in return for payment, sponsorship payments will normally have the character of charitable donations rather than trading income in the charity's hands. The fact that the business sponsor takes steps to publicise or exploit the affinity with the charity will not change the treatment of the payments in the hands of the charity, unless the charity also publicises the affinity itself.

If the charity provides some goods or services in return for the sponsorship payments they may be treated as trading income and subject to tax. An example of trading income is references to a sponsor which amount to advertisements. HMRC Charities regard a reference to a sponsor as an advertisement if it incorporates any of the following:

- large and prominent displays of the sponsor's logo,
- large and prominent displays of the sponsor's corporate colours, or
- a description of the sponsor's products or services.

For example, a company name and logo inserted in the corner of a project report would not be considered to be advertising. However, if the name and logo were substantially and widely displayed throughout the report that would be regarded as advertising.

9.4.4 Sale of donated goods

Sale of donated goods is the realisation of the value of a gift. For this reason it is not regarded as a trade for tax purposes. This is so even where the donated items are sorted, cleaned and given minor repairs. If the goods are subjected to significant refurbishment or to any process which brings them into a different condition for sale purposes than that in which they were donated, the sale proceeds may be regarded as trading income and subject to tax. For example, where donated cloth is made into garments for sale this will amount to a trade.

9.5 Income from property

A charity is exempt from tax on income arising in respect of rents or other receipts from land or property that it holds for charitable purposes provided that the income is applied for charitable purposes only. This exemption includes, for example, profits from letting residential property (whether or not furnished) and also commercial property (such as offices or shops). The exemption does not generally extend to income derived from additional services such as catering or conferencing activities.

The above exemption applies to income from both UK and overseas property.

The exemption does not, however, apply to property trading unless that trading activity is in the course of the actual carrying out of a primary purpose of the charity. A possible way of mitigating any potential tax liability for the charity is to ensure that such an activity is carried out in a wholly-owned trading subsidiary of the charity, with any profits arising being Gift Aided to the charity.

If a charity sells land/buildings and the sale includes a provision for the charity to share in future profits from the development of that land, the profits received will potentially be chargeable to tax. [This is explained further in section 9.7.2].

9.6 Trading

9.6.1 What is trading?

UK tax legislation defines "trade" as including "every trade, manufacture, adventure or concern in the nature of trade": The difficulty with this definition is that (as well as being somewhat circular) it is very wide-ranging and extends to activities which may not ordinarily be thought to be trading activities.

Charities often fail to appreciate that they are conducting a trading activity. There is a common misconception that, because an activity is being conducted by a charity and any surpluses are being applied for charitable causes, a trading activity does not exist. From a direct tax perspective, however, it is the nature of the *activity* as opposed to the *organisation* carrying out the activity that governs whether or not a trade exists. Many of the tax cases relating to the existence of a trading activity have relied on the "badges of trade" principles. These principles provide indicators against which it can be judged whether or not an activity amounts to a trading activity:

- a profit-seeking motive;
- the existence of similar trading transactions;
- the number and frequency of transactions;
- the method of finance;
- the interval between purchase and sale;
- the selling organisation;
- the method of acquisition;
- changes to the asset before sale; and
- the nature of the asset.

It is not necessary for all of the above factors to be present to determine that a trading activity exists, but they do provide a general guide.

9.6.2 Primary-purpose trading

9.6.2.1 The public benefit test

For exemption from corporation tax on trading profits charities must ensure that the profits are derived from a trade exercised in the course of the actual carrying out of a primary purpose of the charity (or where the work in connection with the trade is mainly carried out by beneficiaries of the charity – see 9.5.3). A charitable purpose is one which appears in the list below and is for the public benefit:

- the prevention or relief of poverty;
- the advancement of education;
- the advancement of religion;
- the advancement of health or the savings of lives;
- the advancement of citizenship or community development;
- the advancement of the arts, culture, heritage or science;
- the advancement of amateur sport;
- the advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity;
- the advancement of environmental protection or improvement;
- the relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantage;
- the advancement of animal welfare;
- the promotion of the efficiency of the armed forces of the Crown, or of the efficiency of the police, fire and rescue services or ambulance services; and
- other purposes which are recognised as charitable under existing law or may reasonably be regarded as analogous to any of the above.

It should be noted that this is the list of charitable purposes in in section 3(1) of the Charities Act 2011. For the purposes of tax reliefs, *HMRC applies the tests in the 2011 Act even where the charity is registered in Scotland or Northern Ireland.*

Examples of primary-purpose trading are:

- provision of educational services by a charitable school or college in return for course fees;
- sale of goods manufactured by disabled people who are beneficiaries of a charity for the disabled;
- a charitable art gallery or museum holding an art exhibition in return for admission fees;
- a residential care charity providing residential accommodation in return for payment;
- sale of tickets for a theatrical production staged by a theatre charity; and
- sale of certain educational goods by a charitable art gallery or museum.

It is conceivable that HMRC will seek to charge tax on a trading activity which, while it might be considered to be a charitable activity, is actually undertaken by a charity that does not have the power to conduct such activities.

Ancillary primary-purpose activities are those which are so closely aligned to the main trade that it is accepted that they are themselves of a primary purpose: for example, the sale of food and drink in a restaurant or bar by a theatre charity to members of an audience.

9.6.2.2 Mixed primary and non-primary-purpose trading

The law provides that "where a trade is exercised partly in the course of the actual carrying out of a primary purpose of the charitable company and partly otherwise, each part shall be treated as a separate trade (for which purpose reasonable apportionment of expenses and receipts shall be made)".

Charities may find that they are carrying out trading activities which only meet the primary purpose definition in part. In such circumstances, a charity must split the turnover from the trading activity between the primary and non-primary components and it is also necessary to allocate the expenses (both direct and indirect) to the two different activities. The legislation provides that there should be a reasonable apportionment of expenses.

9.6.2.3 Consequences of non-primary-purpose trade

If a non-primary-purpose trade is profitable, the charity will have a corporation tax charge on the taxable profits (as adjusted for any tax disallowable expenditure and relief available under the capital allowances regime).

If a non-primary-purpose trade is loss-making, the loss will be regarded as being non-charitable expenditure. This would normally mean that tax exemption is not available on that amount of the charity's income. However, if the non-primary-purpose trade has been carried out on a commercial basis with a view to the realisation of a profit but has realised a loss in a particular period as a result of adverse trading conditions, the trading loss can be set off against the income that is brought into charge by the operation of the rules on non-charitable expenditure.

If, however, the charity cannot demonstrate that the non-primary-purpose trade was conducted on a commercial basis the tax loss cannot be used to offset the income that has lost its exemption – thereby leaving the charity with income on which corporation tax is chargeable.

9.6.2.4 Use of subsidiaries and Gift Aid

It is common practice for a charity to establish a trading subsidiary company to undertake an activity which is not regarded as being a primary-purpose trading activity. By allowing a separate company to undertake the activity the charity is able to avoid a charge to corporation tax on any profits arising. However, it is not only non-primary-purpose trades that are conducted via a subsidiary company – for VAT reasons, other tax planning possibilities might provide a better overall outcome if certain activities are ring-fenced in a subsidiary company. Additionally, the Charity Commission requires the use of a trading subsidiary in any case where there would be a significant risk to the assets of the charity if it were to carry on non-primary-purpose trading itself.

A trading subsidiary does not benefit from most of the charitable tax exemptions and is therefore taxable on its profits under normal corporation tax principles. However, it is usual for the subsidiary company to pay all of its profits to the parent charity as a Gift Aid donation, thereby eliminating any corporation tax liability in the company. The receipt of the Gift Aid donation is not taxable in the hands of the charity. Provided that the trading subsidiary is wholly owned by one or more charitable organisations, it has up to nine months after the end of its accounting period to make its Gift Aid payment to the owning charities, allowing plenty of time to calculate the level of taxable profits in the company. Note that this only applies to subsidiaries wholly owned by a charity or group of charities (see 16.2.7).

Charities need to be aware that the amount of taxable profit of the subsidiary may exceed the accounting profits. This is due to the impact of disallowable expenses such as depreciation. Consequently, charities may be faced with accepting that the subsidiary will encounter cash-flow problems from time to time or incurring some tax liability in the subsidiary. This is because the Gift Aid payment required to eliminate any tax liability may exceed the net cash generated from its trading activity.

Gift Aid payments should be made as a payment of money from the company to the charity. The company and charity should avoid sharing one bank account so that this transfer can be seen to have taken place.

9.6.3 Trades carried out by beneficiaries

There is also an exemption from tax on trading activities where "the work in connection with the trade is mainly carried out by beneficiaries". It is not envisaged that charities would generally have to rely on this narrow exemption, since a trading activity that falls under this provision would also usually be a primary-purpose trading activity. However, the exemption does cater for the possibility that where the work is mainly carried out by beneficiaries the activity need not be of a primary-purpose nature.

The common examples of "beneficiary trades" include students at a catering college operating a college restaurant or an agricultural college where the students might operate a farm shop. The legislation also recognises that a charity's beneficiaries may not be able to undertake a trading activity in their own right and therefore the exemption will still apply provided it can be shown that the greater part of the trade is carried out by the beneficiaries.

9.6.4 Small trade concession

Since 2000 charities have been able to undertake small-scale non-primary-purpose trading activities within the charity without incurring a tax charge. This avoids the need to form a trading subsidiary company for small levels of trading activity. The exemption applies where the turnover from the non-exempt activities does not exceed the annual threshold or where there was a reasonable expectation that the turnover limit would be breached.

The turnover limit is £5,000 or, in circumstances where the turnover from the non-primary-purpose trade exceeds that figure, 25 per cent of the charity's incoming resources subject to a maximum of £50,000. This limit applies to all non-primary-purpose trading activities in any one year. "Incoming resources" for these purposes means the total receipts of the charity as shown in its statement of financial activities including grants and donations, legacies, investment income and income from trading activities.

Once the turnover threshold has been breached the entire trading profits are subject to tax, so that if a charity receives £60,000 of non-primary-purpose trading income the entire resultant taxable profits from that trading activity will be subject to tax.

There is also a "reasonable expectation" test. This means that if the total turnover of taxable trading does exceed the above limits, profits may still be exempt if the charity can show that, at the start of the relevant accounting period, it was reasonable for it to expect that the turnover would not exceed the limit. This might be because:

- the charity expected the turnover to be lower than it turned out to be, or
- the charity expected that its total incoming resources would be higher than they turned out to be.

HMRC will consider any evidence that the charity may have to satisfy the reasonable expectation test. For example:

- the charity may have carried on the activity for a number of years and may therefore be able to show that the turnover increased unexpectedly compared with earlier years,

- the charity might have started carrying out the trading activity during the year in question and might be able to show that the turnover was higher than it forecasted, or
- the charity's total incoming resources might be lower than it forecast, for example, because the charity did not receive a grant for which it had budgeted.

The type of evidence needed to demonstrate the levels of turnover and incoming resources which were expected might include:
- minutes of meetings at which such matters were discussed,
- copies of cash flow forecasts,
- business plans and previous years' accounts.

9.6.5 Cost allocation

Because charities are now required to consider whether any of their costs (both direct and indirect) are to be allocated to non-primary-purpose trading activities or passed to their trading subsidiaries the question of cost allocation is becoming increasingly important.

There are no formal requirements as to how a charity must allocate its costs other than that it must be on a reasonable basis. Suitable bases could be an apportionment of costs based on floor area where different trading activities occupy discrete floor areas or an allocation by reference to the amount of time spent by staff in dealing with a particular activity.

Charities are expected to have sufficiently detailed accounting systems to be able to identify the expenditure which has to be allocated between the various activities or entities.

9.6.6 Cost of goods and services provided at undervalue

Charities may find that within their trading activities they receive goods or services for either nil cost or at undervalue. It is possible that suppliers will not charge full market value for goods supplied to a charitable trading activity or that advisers are willing to work for no fee or at a reduced level of fee.

When computing the profits of a trading activity a charity can deduct the notional costs of such goods or services. The deductions should be calculated on a reasonable basis and should reflect the market price at which the charity could have been expected to have been charged for the goods or services. An example given by HMRC is if a celebrity acts as a volunteer waiter at a gala dinner, the notional cost would need to be restricted to the going rate for the employment of a waiter, not that of the celebrity.

The deduction of notional costs can be very beneficial where a charity has conducted a non-primary-purpose trading activity via the charity and wishes to establish the level of taxable profits in cases where the small trades threshold has been exceeded.

The ability to deduct notional costs does not extend to trading subsidiary companies.

9.6.7 Lotteries

There is an exemption for lottery profits provided:
- the lottery is an exempt lottery (within the meaning of the Gambling Act 2005 or
- the lottery is promoted in accordance with a lottery operating licence within the meaning of Part 5 of the Gambling Act 2005, or
- the lottery is promoted and conducted in accordance with the relevant Northern Ireland gaming legislation.

In addition, the profits must be applied to the purposes of the charity only. (*For lottery duty see 17.3.*)

9.7 Investment income

9.7.1 UK dividends

Many charities hold investments in the form of shares etc and receive income in the form of dividends. This income is exempt from income / corporation tax provided that the income is applied to charitable purposes.

9.7.2 Foreign dividends

There is an exemption for foreign dividends such that no UK tax arises on the receipt of income from overseas securities providing that the income is applied to charitable purposes. However, the UK tax system, while not seeking to tax foreign dividend income, will not give relief for foreign withholding taxes suffered by charities. Charities need to ensure that their investment advisers are instructed to monitor the level of overseas withholding taxes and to apply for reduced rates of withholding taxes offered under the terms of the double taxation treaties where applicable (see 18.1).

9.7.3 Other investment income

Other forms of investment income received by charities such as interest income, income from authorised unit trusts and income from non-trading gains on intangible fixed assets are also exempt from tax provided that the income is applied to charitable purposes.

9.8 Non-exempt income

9.8.1 General

Prior to the rewrite of corporate tax legislation in 2009, miscellaneous income not specifically exempted was within the scope of corporation tax. Such income was referred to by a generic title "Schedule D VI".

There is now a specific charging provision for most of the categories of income to which it may be relevant (and for the most part these are of little relevance to charities). However, charities need to bear in mind that any profit which is not specifically exempt from corporation tax is potentially taxable. In particular, charities need to be aware of the possibility that they may be taxable on any receipts, even on a one-off basis, if they are not capital receipts and within the scope of the capital gains exemption.

One of the most common forms of such income for the charitable sector is underwriting commission. This will give rise to a tax charge unless it is within the £50,000 maximum limit for small scale trading activities.

9.8.2 Disposal of property

Charities can find themselves with particular problems where they dispose of property subject to an overage clause. An overage clause is where the present owner will profit from any development gain even if no longer owning the land. There is a charge to corporation tax or income tax in some circumstances where gains of a capital nature are obtained from disposing of land.

The legislation is an anti-avoidance measure that was brought in to prevent profits from certain land transactions which were in essence trading transactions from being taxed as though they were capital gains tax transactions. The anti-avoidance legislation is widely drafted and charities often find that they are caught if they participate in what is commonly referred to as a "slice of the action" contract. Such contracts allow the charity (as landowner who holds the land or property as an investment) to benefit from a share in the proceeds of any subsequent development by the purchaser. Typically, the charity would receive a sum at the time of disposal plus an agreed percentage of the sales proceeds for each building subsequently sold by the developer.

From the charity's perspective, by entering into such a contract it is able to share in the proceeds of the developer's trading activity. However, as the charity has not undertaken any trading activity in its own right it cannot be assessed under the normal rules for trading profits and, therefore, the share in the proceeds is a capital receipt derived from the disposal of an asset. The tax that is due under these sections is not capital gains tax (which would ordinarily be covered by the charitable exemption for this tax). Neither is the tax covered by other specific tax reliefs available – and the gain is therefore taxable.

The tax liability is not simply the amount received multiplied by the appropriate tax rate. The legislation provides for a restriction on the amount of the profit that can be assessed under corporation / income tax and takes out of the charge so much of the gain as is attributable to the period before the intention to develop the land was formed. In other words, part of income does not arise solely as a result of the development activity and therefore remains within the charge to capital gains tax (and thus probably within the exemption from capital gains).

It is therefore necessary to agree with the District Valuer the value of the land as at the date the intention to develop first arose; however, it is not going to be possible to do this while the transaction is in the planning stage. The result is that the charity in question is not going to have any certainty about its expected tax liabilities until agreement has been reached with the District Valuer and the total value of the contingent consideration is known.

9.9 Capital allowances

Tax relief in the form of capital allowances can be claimed on the cost of certain capital expenditure and set against the taxable profits of a trade or business activity. The most common forms of allowances are those given on items of plant and machinery, including motor vehicles.

For charities that engage only in primary-purpose trading activities or property investment businesses there is no need to consider the capital allowances regime because the profits from such trading activities are exempt from tax.

However, if capital expenditure is incurred by a trading subsidiary, the capital allowances regime can be relevant because the accounting profits of the company will contain a charge for depreciation which is not deductible for taxation purposes and must instead be replaced with a claim for capital allowances. This will therefore need to be dealt with before the charity calculates the profits for the purposes of the Gift Aid transfer to the parent charity.

9.10 Transfer pricing

Since 2004, UK tax legislation has required large groups of companies to recognise all transactions between group companies on an arm's length basis or to adjust the results of such activities for UK taxation purposes. Before that date UK/UK transactions had been exempt from the transfer pricing rules. A "large" group is one having more than 250 employees or turnover over €50 million and gross assets of over €43 million. The rules allow exemption from the transfer pricing regulations for small and medium-sized enterprises in most circumstances.

Transactions between charities and their trading subsidiaries (if falling within the definition of a "large" group) could be affected. However, HMRC acknowledges that funding of trading subsidiary companies and transactions between charities and trading subsidiaries are governed by guidance issued from the Charity Commission and it is expected that charities will adhere to this guidance.

It is expected that charities providing loan finance to subsidiary companies will not advance interest-free loans but will charge interest at a commercial rate. It is also expected that a charity will charge its trading subsidiary for indirect expenses incurred on its behalf (for example, staff time and other general overheads) but it is not expected that the charity should seek more than reimbursement of its costs from the trading subsidiary. If the charity seeks a mark-up on its costs it will be held to be carrying out a trading activity and these profits may not fall within the available tax exemptions.

HMRC manuals state that charities may find themselves within the transfer pricing regulations if they have entered into arrangements with their subsidiary companies that are not in accordance with the Charity Commission guidelines, or in instances of tax avoidance.

9.11 Worldwide debt cap

The worldwide debt cap rules introduced in Finance Act 2009 were part of a package of measures brought in to reform the taxation of foreign profits. In broad terms, the new rules are designed to limit the deduction for financing costs of a UK company such that they do not exceed a group's external financing costs on a worldwide basis. They came into force for periods of account beginning on or after 1 January 2010. These rules only affect large groups of companies (defined as groups having more than 250 employees; or turnover over €50 million and gross assets of over €43 million).

HMRC introduced a "gateway test" for groups to determine whether or not they are affected by these new rules. If a group passes the gateway test, it is not obliged to monitor the position any further. The gateway test works as follows:

- if the net debt of all UK companies within a group exceeds 75 per cent of the worldwide gross debt of the group, then further considerations of the detailed rules are required;
- if the UK debt is 75 per cent or less of the worldwide gross debt no further action is required.

The gateway test has to be applied each year and it is quite conceivable that a group could meet the test in one year but not in a subsequent year.

For groups affected by the worldwide debt cap rules, the basic rule is that if the "tested expense amount" (broadly speaking the net financing costs of the UK companies) exceeds the "available amount" (the gross financing costs of the worldwide group) the excess net UK financing costs are disallowed.

It is not uncommon for a charity to have a subsidiary trading company funded by interest-bearing loans from the parent charity. Without the introduction of some special provisions the interest costs borne by the trading company could potentially be disallowable, because the interest income received by the parent charity is not regarded as financing income for the worldwide debt cap rules (because the income is not subject to taxation) and is disregarded for all purposes of the worldwide debt cap legislation.

However, there is a provision which allows the interest costs of a trading subsidiary to be disregarded where the loan on which the interest is being charged was advanced by a charity. For these purposes, a charity is defined as "any body of persons or trust established for charitable purposes only".

10 Capital Gains Tax

10.1 Overview

Capital gains tax ("CGT") was introduced on 6 April 1965 and is levied on the chargeable gains arising on disposals of chargeable assets made by individuals and trustees. Companies do not pay CGT but are charged to corporation tax on their chargeable gains.

In its simplest form, the calculation of a chargeable gain is by reference to the difference between the disposal proceeds and the acquisition cost.

10.2 Relief for charities

Charities will often hold assets such as land and property or investments which are chargeable assets and which, when sold, may realise a capital gain or a capital loss.

Charities are exempt from CGT if the gain accrues to a charity and is applied for charitable purposes. This includes use of funds for the general administrative purposes of the charity.

10.2.1 Loss of charitable status

Trustees can find themselves with a potential charge to CGT in certain circumstances where property ceases to be subject to charitable trusts.

10.2.2 Temporary loss of charitable status

Specific tax problems can arise where land or buildings used for charitable purposes are held on terms under which the property may revert to the donor. This again could result in a potential charge to CGT; but there is a concession which allows for any CGT to be discharged or repaid providing charitable status is re-established within six years of the original reversion date.

10.3 Capital payments to a UK-resident charity from an offshore trust

In 1998 HMRC clarified the tax position for charities in receipt of capital payments from offshore trusts. HMRC now accepts that capital payments from an offshore trust can benefit from CGT exemption provided the capital payment is applicable to and applied for charitable purposes.

10.4 Investment in an overseas resident company

Subject to *de minimis* limits (a holding of less than 10 per cent), a participator (broadly, a shareholder) in an overseas resident company which would be a close company (generally, a company controlled by five or fewer participators) if it were resident in the UK is assessable on a part of any chargeable gain made by the company provided that at the time the gain accrues the person is resident or ordinarily resident in the UK. In summary, this means that gains accruing to a non-resident close company are attributed to shareholders.

HMRC takes the view that a gain accruing to a charity does not qualify for the general CGT exemption and therefore certain charities could find themselves with an unexpected tax charge on a deemed gain from an overseas investment. The tax would become payable under the deeming provisions even if no payment were received from the overseas investment.

Investment in an overseas investment fund will further complicate matters because funds often take the form of partnerships which invest in corporate vehicles rather than operating as a company in their own right. When considering the 10 per cent limit the participator must include all other UK-resident partners so that if together they reach the 10 per cent limit they will all be subject to this anti-avoidance legislation. In practice, this may prove impossible to monitor as the identity of the other partners will not be known to the charity investor – let alone their tax residence status.

11 Stamp Duty Land Tax

11.1 Overview

Stamp duty land tax ("SDLT") was introduced with effect from 1 December 2003: at the same time, stamp duty was abolished. SDLT is a tax on land transactions that requires the taxpayer to self-assess the SDLT liability. The tax applies to any transaction in land: defined as "the acquisition of a chargeable interest in land". For the purposes of SDLT, an acquisition encompasses a surrender, release, or variation, as well as the creation of a chargeable interest. The term "chargeable interest" is widely defined, being "an estate, interest, right or power in or over land in the UK; or the benefit of an obligation, restriction or condition affecting the value of any such estate, interest, right or power".

Residential		Non-residential or mixed	
Chargeable consideration	Percentage	Chargeable consideration	Percentage
Not more than £125,000	0%	Not more than £150,000	0%
More than £125,000 but not more than £250,000	1%	More than £150,000 but not more than £250,000	1%
More than £250,000 but not more than £500,000	3%	More than £250,000 but not more than £500,000	3%
More than £500,000 but not more than £1 million	4%	More than £500,000	4%
More than £1 million but not more than £2 million (from 22 March 2012)	5%		
Over £2 million from 22 March 2012	7%		
Over £2 million (purchased by certain persons including corporate bodies) from 21 March 2012	15%		

Certain transactions are exempt from SDLT; of particular relevance to the charitable sector these include gifts where there is no chargeable consideration, such as a gift of property left under the terms of a will.

There is also no SDLT liability in cases where a registered social landlord grants a lease either containing an indefinite term or which is terminable by notice of one month or less to one or more individuals provided the grant results from arrangements between the registered social landlord and a housing authority where the authority nominates the tenants.

11.2 Charity relief

Charities are granted relief from SDLT. This relief extends to charitable trusts, defined as a trust where all of the beneficiaries are charities or a unit trust scheme where all of the unit holders are charities.

The relief is available provided two conditions are met:
- The land must be held for qualifying charitable purposes either being used:

(a) in furtherance of the charitable purposes of the purchaser or those of another charity; or

(b) as an investment with the profits derived from the land being applied to the charitable purposes of the purchaser.

- The transaction was not entered into for the avoidance of tax by the charity or any other person.

11.3 Problem areas

Charities need to be aware of the potential SDLT liabilities where the entire land / building is not to be retained for charitable purposes. There is no partial exemption from SDLT: the transaction is either fully exempt or fully chargeable. Therefore, the transaction will either qualify for the relief or it will be liable to SDLT at the appropriate rate. However, where the charity intends to hold the "greater part" of the land for qualifying purposes, the transaction will be exempt from SDLT. The "greater part" is taken to mean that 51 per cent or more of the monetary value of the land is being retained by the charity.

Trading subsidiary companies do not benefit from any exemption from SDLT and therefore, wherever possible, land should be purchased by the charity. Transfers of property from a charitable company to a trading subsidiary may qualify for SDLT group relief, meaning that no SDLT is chargeable on the transfer, but careful structuring may be needed to achieve this successfully.

11.4 Withdrawal of relief

SDLT relief is withdrawn if within three years of the date of the original transaction the purchaser ceases to be established for charitable purposes or the subject matter of the transaction is held for non-charitable purposes. SDLT will become chargeable:

- on the amount that would have been chargeable in respect of the original transaction were it not for the application of the charity relief in the first instance; or
- on an appropriate portion of the SDLT if a derived interest is held.

There are also withdrawal provisions if the original exemption from SDLT was based on the "greater part" of the transaction being retained for charitable purposes. In cases where full SDLT relief was granted on the original acquisition but the charity subsequently disposes of part of the property, SDLT relief will be withdrawn on the appropriate proportion. If a charity acquires a building and intends to hold 90 per cent for ongoing charitable purposes, full SDLT relief will be granted on the initial acquisition and subsequently, if a 10 per cent share is disposed of within three years of the original acquisition, 10 per cent of the SDLT relief will be clawed back.

12 Stamp Duty Reserve Tax

12.1 UK equities

Stamp Duty Reserve Tax ("SDRT") is paid on the purchase of shares and unit trusts. It is paid at a flat rate of 0.5 per cent based on what was paid for the shares, not on what the shares are worth.

Charities and certain other charitable organisations are exempt from UK stamp taxes on the purchase of chargeable securities. Where a stock transfer form or other transfer document (for example, a Letter of Direction) is used, this must be submitted to HMRC together with a formal claim for relief. Where a purchase is settled through CREST, then Flag "S" should be used and the HMRC Charities (formerly Inland Revenue FICO) or Charity Commission reference number should be entered in the Charity ID field.

12.2 Overseas equities

Certain overseas jurisdictions apply transfer taxes similar to SDRT. These include Ireland (1 per cent), Hong Kong (0.2 per cent), South Africa (0.25 per cent) and Greece (0.3 per cent). There is no specific relief from stamp duties on purchase of Irish, Hong Kong or Greek shares by a charity.

12.3 Common Investment Funds

Common Investment Funds ("CIFs") are open to investors which are charities in the UK

A CIF is treated as a charity in its own right; and therefore an in-specie contribution of UK chargeable securities (that is to say, a contribution its actual form rather than first transferring it into cash) to a CIF attracts no liability to SDRT. Nor will a cash contribution attract any SDRT liability; and the corresponding issue of units in exchange for the cash will have no implications as a result of an exemption from the Schedule 19 SDRT regime that is applicable to Open Ended Investment Companies ("OEICs") and certain unit trusts.

In-specie distributions of UK chargeable securities from a CIF to an investor will be exempt from SDRT since the relevant "purchasing" investor would necessarily be a charity. As above, given that CIFs are outside the scope of Schedule 19 SDRT, cash distributions have no UK SDRT implications.

13 Business rates and Council Tax

13.1 Business rates

The rules on non-domestic rates in Scotland and Northern Ireland differ slightly from those for England and Wales. This section sets out the rules for England and Wales.

Business rates apply to non-domestic property and are payable to the local authority or local council by the occupier.

13.1.1 Property wholly or mainly used for charitable purposes

Charity ratepayers are granted a mandatory 80 per cent relief from non-domestic rates where the property is wholly or mainly used for charitable purposes by that charity or by that charity and other charities. A distinction is drawn so as to exclude from relief use for the purpose of getting in, raising or earning money for the charity

In order to benefit from the mandatory exemption from business rates it is important to understand the meaning of "wholly or mainly used for charitable purposes". Case law suggests that "mainly" probably means "more than half"; but there is a certain amount of ambiguity about this and the interpretation may vary from local authority to local authority. It is sometimes argued that "mainly" in fact means more than 75 per cent. Charities may have to try to negotiate this with their local authority. Although not a case involving rates it may be useful to quote *Fawcett Properties Ltd v Buckingham County Council* [1961] AC 636, where mainly is deemed to mean "more than half".

A head office and property used for management and administration would be sufficient to qualify, but not a property carrying on business to earn money for a charity. Where a charity rents out its property, it is not used for charitable purposes unless it is renting out its property to fulfil its charitable purposes.

A local authority can also give discretionary relief of up to the whole of the balance. This applies to charities and other not-for-profit bodies whose main objects are either charitable or philanthropic in another way, religious, or concerned with education, social welfare, science, literature or the fine arts. The discretionary relief is also available where the property is wholly or mainly used for recreation by a non-profit club or society. In practice, the extent of any relief varies from one local authority to another. Where a discretionary relief has been granted and the billing authority changes its mind, it must give notice to the occupier one year in advance. The revocation will have effect at the end of a financial year.

Charities which own empty property are not liable to rates for that property so long as it appears that the property will next be used for charitable purposes. Once factories and warehouses have been empty for six months and other commercial property for three months full rates become payable. However, where the ratepayer is a charity and it appears that when next in use the property is likely to be used for charitable purposes, a mandatory relief of 90 per cent is available.

There could be a problem of increased rates for a charity's vacant investment property, as the next use is likely to be occupation by a non-charitable tenant. Similarly, if a charity has vacated the property to prepare for its sale, full rates are likely to become payable after 3 months. In such cases the charity may wish to consider whether it would be better to continue to use the property for its charitable purposes, for example for storage, in order to continue to benefit from mandatory relief.

13.1.2 Places of public religious worship

A property in England and Wales that is a "place of public religious worship" in wholly exempt from business rates under Schedule 5 of the Local Government Finance Act 1988, as amended. It qualifies if:

- it belongs to the Church of England or the Church in Wales; or
- it is registered and certified as a place of worship under the Places of Worship Registration Act 1855; or
- it is a church hall, chapel hall or similar building used in connection with a place of worship.

In Scotland, under section 22 of the Valuation and Rating (Scotland) Act 1956, as amended, churches, church halls, and other places of worship are entered in the Valuation Roll for property tax but are wholly exempt from payment.

"Worship" need not necessarily involve the worship of a Supreme Being; for example, Buddhist temples qualify as places of worship.

A building will also be exempt to the extent that it is occupied by the organisation responsible for the conduct of public religious worship and it is used to carry out administrative or other activities in relation to the organisation or the conduct of public religious worship at such a place or it is used as offices for the purposes of the organisation. The valuation officer and the local authority can challenge the valuation on a claim for exemption: see, for example, *Glenwright (VO) and Durham City Council v St Nicholas PCC* [1988] RA 1 Lands Trib.

There have been several cases about precisely what constitutes a "place of worship" for the purposes of the exemption. In *Ebury (VO) v Church Council of the Central Methodist Church* [2009] (LC) (17 July 2009), where two rooms within a church which were used as a coffee shop and bookshop run by church volunteers it was held that they were "used in connection with" a place of public worship and therefore attracted the statutory exemption. On the other hand, in *Registrar General (R v, ex parte Segerdal & Anor)* [1970] 3 WLR 479 an appeal to require the Registrar General to register a chapel of the Church of Scientology under the Places of Worship Registration Act 1855 was dismissed on the grounds, *inter alia*, that the ceremonies conducted in the chapel could not "be properly described as constituting worship".

In addition, in order to qualify for the exemption the building must be a place of *public* worship. It has been held that Mormon temples do not qualify for the exemption because they are not open to the public at large but only to Mormons in good standing: see *Church of Jesus Christ of Latter-Day Saints v Henning (VO)* [1964] AC 420 and *Gallagher (VO) v Church of Jesus Christ of Latter-Day Saints* [2008] UKHL 56 (30 July 2008). At the time or writing, *Gallagher* had been appealed to the ECtHR: see *Church of Jesus Christ of Latter-Day Saints v United Kingdom* 7552/09 [2011] ECHR 733 (12 April 2011).

Note that where the exemption is allowed it is extended to church halls, chapel halls or similar buildings used in connection with a place of public worship.

13.2 Specific situations and cases

Historic houses. In *Hoare & Anor v National Trust* [1998] EWCA Civ 1525 (13 October 1998) it was held that two loss-making historic homes could have a nil assessment for business rates purposes. The reason given for this was that the cost of maintenance and repair could deter a potential tenant.

Trading subsidiaries. Premises occupied by a trading subsidiary will not be eligible for mandatory rate relief, but some local authorities are willing to grant a discretionary relief. Where parts of premises are occupied by both the charity itself and a trading subsidiary, only the part occupied by the charity qualifies for mandatory relief, although in practice some local authorities accept an argument that the charity is occupying the whole premises and using them mainly for charitable purposes. This generally depends on what the trading subsidiary is doing, but considerations such as the floor space used or turnover can also be relevant. In order to avoid this problem, a number of charities make sure that the charity rather than the trading subsidiary owns its shops.

Charity shops. If a charity shop is wholly or mainly used for the sale of goods donated to a charity and the proceeds of sale of the goods are applied for the purposes of a charity, then the property will be treated as wholly or mainly used for charitable purposes. Where the shops sell a mixture of donated and bought goods, the charity would need to look at the proportion of donated goods as against bought goods and keep on the right side of the "*mainly* used for the sale of goods donated to the charity" test. Shops run by trading subsidiaries of charities are not eligible for mandatory rate relief.

Lettings for charitable purposes. Charities are not entitled to relief for properties let on normal commercial terms. If the property is let for a charitable purpose then the case is different. For example, where a charity for ex-servicemen allows a disabled ex-serviceman to occupy one of its houses, that occupation is treated as use for a charitable purpose. A more unusual example was a car park operated by a charity whose objects were to provide employment for ex-servicemen. The car park was manned by ex-servicemen and therefore eligible for the relief.

Service occupancies. A "service occupancy" is the situation in which housing is occupied by a charity's employees – and it can be complex. As a general rule, property is "domestic" if it is used wholly for the purposes of living accommodation and therefore is only eligible for relief if the persons living in it are eligible for relief themselves. If, however, it is essential to the performance of the duties of the occupying employee that he or she should occupy a particular property, then where this is a result of a contractual obligation the occupation for rating purposes is treated as that of the employer and not of the employee.

This is also the case where it is not essential for the employee to live in a particular property or within a particular perimeter but doing so enables the employee better to perform his or her duties. The key is that there should be an express term in the contract that that person shall live there.

Disabled beneficiaries. Where a property is used as a facility for training, housing or "keeping suitably occupied" persons who are disabled or who have been suffering from an illness or for welfare services for disabled persons, then the property can be exempt from non-domestic rates. This is not the case where a workshop is attached to a disabled person's home and used for the purposes of his business. There are a number of limitations to this exemption and it is therefore important to look carefully at the case law. A person is "disabled" if he or she is blind, deaf or dumb, suffers from mental disorders of any description or is substantially permanently handicapped by illness, injury, congenital deformity or any other disability.

If charities try to use parts of their buildings for "quasi-commercial" purposes, they risk contaminating their relief. For example in the case of a church this might mean losing the total exemption under the Places of Worship Registration Act and being downgraded to the 80 per cent charitable relief. But such cases are fact-sensitive: see *Ebury (VO) v Church Council of the Central Methodist Church* [2009] (LC) (17 July 2009).

13.3 Council Tax

Domestic property is defined as property used wholly for the purposes of living accommodation and includes the property itself and gardens, outhouses, storage premises, and garages if they are used for domestic purposes. It also includes almshouses, accommodation for the elderly or mentally ill and accommodation for charity staff. It does not include short stay or self-catering accommodation or time shares.

People who live in domestic properties must pay council tax unless they are eligible for some form of rebate. There is no longer a specific relief for charities. The key is therefore to consider:
- who is liable for the tax (sometimes it might be the charity); and
- who lives in the property and what reliefs are available to them.

The tax will usually be paid by the resident of the property. If there is no resident, then the owner will be liable. This can happen if a charity has been left a property under a will, or simply where a charity owns rental properties as an investment or for the purposes set out above and these are temporarily empty.

There are other situations where the charity would be liable for the tax:
- where the property is a residential care home, a nursing home or a hotel; see below regarding exemptions;
- a dwelling inhabited by a religious community whose principal occupation consists of prayer, contemplation, education, the relief of suffering or a combination of those activities;
- a property occupied by a minister of religion from which he performs his duties; and
- a property occupied by employees for the purpose of their employment.

Certain people qualify for exemptions, including those who are in detention, the severely mentally impaired, persons for whom child benefit is payable, students, student nurses, apprentices or youth training trainees, people living in hostels or night shelters and patients in nursing homes or other forms of residential care. Where a person's sole residence is a hospital (whether operated by the NHS or, military, air force or naval unit) or an establishment providing medical treatment that person will also be exempt. Certain staff will also be exempt including those living in care homes provided that they carry out 35 hours per week of care. Properties occupied entirely by students or other exempt people will be exempt from council tax; but those exemptions do not apply to the partners or spouses of such exempt people unless they qualify in their own right. Therefore, if a non-qualifying spouse or partner lives on the premises with the qualifying person liability for council tax will arise.

There is also a provision for charitable residential properties and properties owned by a disabled person which have been substantially adapted for special needs to transfer down one band below the normal band for that property.

13.4 Possible opportunities for reducing the rating bill

If the charity is liable for rates the key question is whether the property could be classed as "non-domestic property" because a charity is entitled to some mandatory and discretionary reliefs on such property. Non-domestic properties include offices which are occupied by a charity but do not include properties such as residential nursing homes.

If a charity is liable for rates it is worth investigating the exemptions available to the residents to ensure that rates are not being paid where they are not due. Given that this can change depending on who is living in the property, the situation should be monitored regularly.

14 PAYE - Income Tax and National Insurance

14.1 Overview of PAYE

PAYE ("Pay As You Earn") is the system that HMRC uses to collect Income Tax and National Insurance Contributions ("NICs") from employees' pay as it is earned. If an employee earns above a certain threshold, the charity as an employer must deduct income tax and NICs from the employee's pay for each pay period and pay employer's NICs. The charity must then pay over these sums to HMRC. The charity has a legal obligation to operate PAYE on the payments that it makes to an employee if his or her earnings reach the National Insurance Lower Earnings Limited ("LEL"). For the tax year 2012-13 this is £107 a week, £464 a month or £5,564 a year.

The charity should use the employee's tax code and National Insurance category letter to work out how much Income Tax and NICs to deduct from the employee's pay and how much Employers Class 1 NICs the charity owes on the employee's earnings. HMRC must have received payment by the 19th of each month (or the 22nd if payments are made electronically).

PAYE is applied to all payments that an employee receives as a result of working for the charity, including:

- salary and wages;
- overtime and shift pay;
- tips – unless they are paid directly to the employee (where tax due is the employee's responsibility) or they come from an independent tronc (an arrangement for the pooling and distribution to employees of tips, gratuities and/or service charges in the hotel and catering trade – in which case you must tell HMRC who the troncmaster is so that it can set up a PAYE scheme for the tronc.);
- bonuses and commission;
- certain expenses, allowances paid in cash;
- statutory sick pay;
- statutory maternity / paternity or adoption pay;
- lump sum and compensation payments – such as redundancy unless they are exempt from tax; and
- some non-cash items such as cash vouchers and premium bonds.

As well as deducting Income Tax and NICs from the employees' pay, for each period the charity might use the PAYE system to deduct:

- student loan repayments;
- employees' pension contributions;
- payments under an attachment of earnings order;
- repayment of a loan made by the charity to the employee; or
- payments under Give as You Earn if the charity is operating such a scheme.

The charity will need to provide the employee with a payslip at or before the date of payment. This can be in either paper or electronic format but it must show certain items, including:

- the employee's gross pay;
- all deductions and the purpose for which they are made; and
- the net ("take-home") pay.

At the end of each tax year the charity must provide the employee with a summary of his or her income tax, NICs and other deductions on Form P60. This must be in paper format.

A charity has to pay over income tax and NICs each month. However, if the charity's average monthly payments of income tax, the deductions from sub-contractors, student loan deductions and NICs for the current tax year are likely to average less than £1,500 a month, the charity can choose to pay quarterly rather than monthly. The tax quarters end on 5th July, 5th October, 5th January and 5th April, which means that cleared electronic payments are due on 22nd of the month on which the quarter ends or on 19th if paying by cheque.

There is a special arrangement for faith-groups agreed by HMRC under which a local religious centre (for example a parish church) can report payments made if it does not operate a PAYE scheme: see HMRC's PAYE Manual *PAYE23030 – Employer records: employer types: local religious centres (LRCS).* In April 2013 HMRC will be introducing a new way of reporting PAYE: Real Time Information (RTI). RTI means that employers will be required to tell HMRC about PAYE payments at the time they are made as part of their payroll process. Payroll software will collect the necessary information and send it to HMRC online. Most employers will be legally required to report payroll information in real time from April 2013, with all employers obliged to do so before October 2013. HMRC will tell you when your charity needs to make this move.

14.2 Employment v self-employment

Income tax and NICs only need to be accounted for on payments to employees and payments to officers of companies. If payments are made for contracts for services (ie to those who are self-employed) as opposed to contracts for service (ie to those who are in the charity's employment) then there is no need to account for income tax and NICs. Therefore, before making any payment to an individual the charity needs to determine his or her employment status.

14.3 What are the factors for determining employment status?

In deciding whether a person is in business on his or her own account or working under the control of another person as an employee, a variety of factors are relevant. The following is a list of the main ones:

Factor	Comment
Control	The higher the degree of control that the charity exercises over the individuals – what they do, where they do it, when they do it and how they do it – the more likely they will be employees.
Personal service	If the individual can substitute another person to carry out his or her work that is strong evidence of self-employment.
Equipment	An employee would not generally have to provide his or her own equipment.
Financial risk	Could the individual lose money from the arrangements? If so, this is an indication of self-employment.
Basis of payment	Employees are often paid a fixed wage or salary weekly or monthly. Independent contractors are often paid a fixed sum for a particular job.
Mutuality of obligation	If the engager is obliged to pay remuneration and the worker is obliged to provide services, that is an indication of employment.
Holiday pay, sick pay and pension rights	Unlikely to be paid to a self-employed contractor.
Part and parcel of the organisation	Is the individual treated on a day-to-day basis the same as the charity's employees? If so, he or she is more likely to be an employee.

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Factor	Comment
Right to terminate a contract	A power to terminate an engagement for a reason other than a serious breach of contract by giving notice of a specified length may be indicative of a contract of employment.
Opportunity to profit from sound management	If speed and efficiency and the reduction of overheads can benefit the worker, this may be an indication of self-employment.
Personal factors	If the worker provides services to lots of other charities or businesses this would be an indication of self-employment.

None of these factors are conclusive in their own right and whether or not someone is an employee cannot be determined by running down a check-list or adding up the number of factors pointing toward employment and comparing that result with the number pointing toward self-employment. It is a matter of evaluating the overall picture that emerges from a detailed review of all the facts of the particular case. The HMRC website includes an Employment Status Indicator into which a charity can input the relevant data to see whether or not a particular individual is likely to be regarded as an employee. However, it should be noted this merely gives HMRC's opinion, which is not necessarily the correct legal position.

Directors and any other office holders are regarded as employees and therefore subject to PAYE on any payments received. For example, PAYE will apply to fees or an honorarium paid to a chairman of a grant committee unless the committee is a short-term structure established for a specific purpose after which it will be disbanded and the office or post ceases to exist.

If the charity pays an individual's company it would not generally have to deduct income tax and NICs. The charity in this case needs to ensure that the contract for services is also with the company. It should be noted that in some circumstances the individual's company will have to account for income tax and NICs under the IR 35 regulations; but this is an issue for the service company not for the charity. However if the company is engaged as a corporate director or other office holder and the individual performs that role it is likely that the individual will be considered to be a shadow director or office holder and therefore income tax and NICs will have to be deducted by the charity.

Where a charity pays an agency to provide workers it is important to understand the nature of the agency agreement. An agency contract is one where a worker contracts to undertake work with a third party (which may, but need not be, a traditional employment agency) to undertake work for a client (ie the charity) of the agency. There is no contract between the charity and the worker, so the worker cannot be an employee of the charity. Similarly, the contract between the agency and the worker will usually be on terms to ensure that it is not a contract of employment. In these circumstances specific legislation can apply which means that the services of the worker are, for income tax purposes, treated as if they were duties of an employment held by the worker. As such, it is treated as employment income and the payer (ie the agency) is required to deduct income tax.

Similar legislation applies in connection with NICs. Where this applies the worker is treated as an employed earner for class 1 NICs purposes. The agency also has to account for Employer's NICs. It is important to confirm at the outset the contractual relationship with the agency.

14.4 Educational charities

It is considered likely that a part-time teacher or lecturer whose engagement covers a complete academic term or longer will have similar terms and conditions to a full-time teacher or lecturer. Such part-time teachers or lecturers are likely to be employees and income tax will need to be deducted. A visiting teacher or lecturer who gives an occasional talk or a short series of talks which are not part of the core curriculum will normally be self-employed.

Situations in between the two extremes need to be considered case by case on the basis of the general principles discussed above.

It should be noted that until 6 April 2012, the NICs position was slightly different. There were regulations in place to treat teachers and lecturers as employees for NICs purposes even if not treated otherwise as employees. This applied where the teacher, lecturer, or instructor taught in an "educational establishment" if he or she taught in the presence of the students (except in the case of the Open University) and was paid by the education authority or by the person (for example, a charitable school) who provided the education. This special treatment does not apply from 6 April 2012.

14.5 Arts and culture charities

Actors, ballet-dancers, opera-singers, musicians and other performance artists may be employees or self-employed.

Most artists are engaged to perform particular parts, the performer having a whole series of separate engagements in different media making up his or her performing life. Currently these engagements are separated by periods of "resting". As such, HMRC generally accepts performing artists to be self-employed and income tax is not required to be deducted.

There are, however, exceptions and income tax may need to be deducted where the artist is engaged.
- for a regular salary to perform in a series of productions over a period; or
- in such roles as may be from time to time stipulated by the engager, with a minimum period before termination of the contract.

This would apply, for example, to members of some orchestras or opera, ballet or theatre companies.

There are special NICs regulations applying to "entertainers". An entertainer means a person who is engaged as an actor, singer or musician or in a similar performing capacity. One needs to determine whether or not the person receives a "salary". It is a salary if the payment:
- is made for services rendered;
- is paid under a contract for services;
- where there is more than one payment, is payable at a specified period or interval; and
- is computed by reference to the amount of time for which work has been performed.

Artists engaged for just one or two days including "key talent" artists are, however, generally excluded as they are usually contracted to appear in productions for which the remuneration is not directly calculated according to the period for which they are assigned to the production. If the regulations apply then Class I NICs needs to be accounted for on the payments.

Designers, directors and choreographers could also be employees or self-employed. HMRC will accept that they are self-employed where they are engaged for a specific production and:
- the engagement is for a limited period which normally ends soon after the opening of the production; and
- they are paid both a fee and a royalty (often dependent on box office receipts).

14.6 Foreign entertainers

Tax at the basic rate may need to be withheld on performance fees and expenses paid to non-UK-resident performers (entertainers and sportsmen or sportswomen) for appearances including at charity fundraising events.

Tax need not be deducted if total payments made to the performer or an associate of the performer do not exceed £1,000 in any tax year.

Tax may be deducted at a rate less than the basic rate if the charity and the performer make a written agreement with HMRC to account for tax on an amount equal to the performer's actual liability, ie after allowing for deductible expenses. Such an agreement must be made at least 30 days before the payment is made. Tax accounted for in this way is not processed through the PAYE system but dealt with separately with HMRC's specialist unit

14.7 Benefits in kind

If the charity provides anything other than pay to employees or officers that may count as an expense or benefit. Common examples of expenses and benefits include the provision of accommodation, company cars, health insurance, travel and entertainment expenses and childcare.

The charity's tax, NICs and reporting obligations differ depending on the specific expenses and benefits that it provides to its employees. In general, one of the following five requirements will apply in each instance:

- at the end of the tax year it should report the items on the employee's form P9D or P11D and – where a P11D is completed – pay Class 1A NICs on it;
- the charity treats the expense or benefit as if it were normal earnings, adding its value to the employee's other earnings when working out income tax and Class 1 NICs using usual payroll procedures;
- the charity adds the item's value to the employee's earnings for Class 1 NICs purposes only (not for income tax) through the payroll, then at the end of the tax year the charity should report it on the employee's form P9D or P11D;
- the charity has no tax or NICs to pay but at the end of the tax year it should report the item on the employee's form P9D or P11D; or
- the charity has no reporting requirements and no tax or NICs to pay.

The type of expense or benefit that the charity provides is not the only thing that affects the tax, NICs and reporting requirements. The way in which the charity provides a benefit can do so as well. For example:

- if the charity arranges and pays for medical insurance for an employee, the charity should report it on form P11D and pay Class 1A NICs at the end of the tax year;
- if the employee arranges the medical insurance but the charity pays the insurer directly for it, then Class 1 NICs will be due (through the payroll) and the charity should report it on P9D or P11D;
- if employees arrange and pay for their medical insurance but the charity reimburses them, then that payment counts as additional earnings and the charity will have to deduct and pay both income tax and Class 1 NICs using its usual payroll procedures.

There are a number of different forms that a charity may need to use to tell HMRC about expenses and benefits that they have provided to their employees. The following list provides an overview:

- P11D – in general the charity should complete this at the end of the tax year for company directors and for employees earning at a rate of £8,500 or more: file by 6 July.
- P9D – a simpler equivalent of form P11D, generally used for employees earning less than £8,500. No Class 1A NICs are due on items reported on form P9D: file by 6 July.
- P11D (b) – use this to declare the charity's total Class 1A NICs liability to the end of the tax year. This total is calculated using the P11Ds that it has completed: file by 6 July.
- P46 (Car) – for telling HMRC when provision of car benefit to an employee begins or changes: file at the end of the quarter in which the change takes place.
- P11 – expenses or benefits that go through the charity's payroll should be recorded on form P11 in the usual way. The charity does not need to file this form with HMRC but it will need the figures from it when filing forms P14 and P35 at the end of the tax year.

The benefits-in-kind legislation generally applies to all directors and to all "higher paid" employees. The definition of "higher paid" is, however, very old and covers anyone who earns more than £8,500 a year. Thus, a person who works full-time on the statutory minimum wage of £6,19 an hour is likely to be "higher paid" for these purposes. In calculating whether the employee has breached the limit the *value of the benefit* itself must be included.

Directors are generally always subject to the benefit rules even if they receive less than £8,500 a year. This, however, is not the case for directors of charitable companies. They will only be subject to the rules if they earn £8,500 or more a year.

Some benefits are taxable even for lower-paid employees (including directors of charitable companies). These include:

- some relocation expenses;
- cash payments made to third parties on the employee's behalf;
- gifts in kind on which there is a second-hand value;
- any benefits that could be turned into cash;
- vouchers and credit cards; and
- provision of accommodation.

14.8 Dispensation

The charity can apply for a dispensation – a notice from HMRC that removes the requirement to report expenses and benefits on forms P11D or P9D. Also, if an item is covered by a dispensation it means that the charity does not have any tax or NICs to pay on it. The charity can apply to HMRC for a dispensation – using form P11DX – to cover expenses or benefits for which the employee is entitled to a full tax deduction. This includes many routine business expenses and benefits. This means that employee business travel should be shown on form P11D unless a dispensation is in place. Note that where a mileage amount paid to an employee is less than the HMRC official rate an employee can claim tax relief on the difference.

14.9 Settlement agreements

The charity may be able to pay tax on behalf of an employee by entering into a PAYE Settlement Agreement ("PSA"). This is a scheme available to make a one-off payment to HMRC for income tax and NICs due on three categories of expense and benefit:

- minor items;
- irregular items; and
- items on which it is impractical to operate PAYE or to value for P9D/P11D purposes.

The crucial point with a PSA is that, effectively, the employer meets the tax cost as opposed to the employee – who would otherwise have to meet the tax through the P9D/P11D system. As the employer is meeting the tax on behalf of the employee the amount has to be grossed up for income tax (ie the expense is treated as a net amount after tax), with the result that more tax is payable to HMRC than if the employee met the cost himself. Class 1B National Insurance is also payable. A PSA is therefore not tax-efficient; but it is convenient for employees and is therefore often used by employers.

The amounts to be included in a PSA must be agreed with HMRC before:

- in the case of items that would otherwise be included on forms P9D/P11D: 6 July following the end of the tax year to which it relates;
- in the case of items on which income tax and Class 1 NICs would be payable: in the tax year of the PSA and before the employers stop deducting income tax and NICs.

The tax and Class 1B National Insurance is payable by 19 October (or 22 October in the case of some electronic payments) following the tax year to which the PSA relates.

This means that employee business travel should be shown on form P11D unless a dispensation is in place. Note that where a mileage amount paid to an employee is less than the HMRC official rate an employee can claim tax relief on the difference.

14.10 Provision of accommodation

A person is potentially liable to tax if he or she is provided with accommodation by reason of employment. The charity may simply pay a contribution to living accommodation, in which case it would normally be treated as salary, subject to income tax or NICs.

If, instead, the charity owns or leases the property in its own name and provides the accommodation, a benefit arises on three basic elements:

- the rental value;
- an additional charge where the cost or value of the accommodation (including any improvements by the charity) exceeds £75,000; and
- a further charge with respect to repairs, heat and light and other similar expenses connected with the property or with the provision of furniture for the property.

The potential annual value of a UK property is normally the 1973 gross rateable value or, if greater, any rent actually paid – in spite of the fact that domestic rates were abolished in Scotland from 1989 and England and Wales from 1990. The benefit is reduced to the extent that the employee makes good by making a contribution. HMRC's current definitions are set out in EIM11434: *Living Accommodation: Meaning of Annual Value for United Kingdom Properties.*

A potential additional charge will arise on any additional benefits relating to the property such as council tax, water rates, cleaning and telephone being met by the employer.

No taxable benefit will apply in a number of cases:

- dwellings that are not the main home of the people living there;
- residential care homes, nursing homes, mental health nursing homes and hostels;
- dwellings in which domestic servants live and which are not also occasionally occupied by their employers;
- dwellings occupied by a number of people who do not form a single household;
- buildings occupied by a religious community devoted to prayer, contemplation, education or the relief of suffering; or
- most dwellings occupied by a minister of religion where the church owns the property and pays the council tax in its own name.

The exemption to accommodation being taxable applies where it is provided because:

- it is necessary for the proper performance of duties;
- it is customary for such an employment and it enables better performance of duties; or
- it is to deal with a special security threat.

If the accommodation falls within one of the above exemptions there is a cap placed on any other related taxable benefits:

- heating, lighting and cleaning of premises;
- repairs, decoration and maintenance; and
- the provision of furniture, equipment or other items to the extent that they are for normal domestic occupation.

The cap is 10 per cent of the net earnings of the employment.

14.11 Furniture

The employee will normally be taxed each year on the provision of furniture by the employer on a sum equal to the greater of:
- 20 per cent of the market value of the asset at the time when first applied (for the first five years); or
- the annual rental or lease charge.

Any additional costs of providing the furniture must be added to the taxable benefit.

14.12 Telephone costs

The provision of a telephone will normally be fully taxable though the cost of genuine business calls (but not of rental) could be deducted from the taxable benefit. There is, however, an exemption for where the employer is a subscriber (but not the reimbursement of the employee's telephone costs) when:
- there is a clear business need for the employer to provide the employee with a telephone, for instance if making or receiving telephone calls from the home are vital and a central part of the employee's duties; and
- the employer has procedures to monitor, control and minimise the cost to him or her of private use; and
- the employer has no intention of rewarding the employee.

HMRC gives examples as to when this exemption may apply:
- ministers of religion, where there is a need for contact with the parishioners and congregations 24 hours a day;
- teleworkers, where a telephone line at home is provided for remote computer working or telephone business;
- employees such as live-in care workers of residential homes for the elderly or disabled or hospices whose daily duties may require contact with the emergency services or the relatives of the residents they care for.

Mobile phones – there is no charge to tax on:
- one mobile phone provided to an employee, or
- any line rental or the cost of any private calls for that phone paid for by the employer unless it can be converted into money by the employee

14.13 Volunteers

A person who does voluntary unpaid work for a charity will not normally be engaged under a contract of employment. The reimbursement of any expenses incurred by voluntary workers in doing the work of the organisation will not give rise to liability to tax. This includes the expenses of travel between home and the place where the work is done and meal costs that would not have been incurred had they not volunteered.

If expenses are paid that do more than reimburse the costs incurred or are at a scale rate that cannot reasonably be regarded as merely a reimbursement of what they spend, the voluntary workers may be receiving remuneration for their services. In that case the payments will be taxable as employment income.

15 Working overseas

15.1 UK-resident or ordinarily resident

Many charities have staff working overseas. It needs to be determined if the individual is or will be UK-domiciled, UK-resident or UK ordinarily resident.

Currently the main rule of residence is the 183-day rule which provides that an individual is a UK tax resident for any tax year (6 April – 5 April) in which he or she spends 183 days or more in the UK. A person is in the UK for a day if he or she is present at midnight. The exception is where an individual is a passenger in transit through the UK between two places outside the UK. Where this is the case, a day travelling through the UK in transit does not count as a day spent in the UK.

An individual is ordinarily resident in the jurisdiction in which that person usually resides. According to HMRC, it is possible for an individual to be ordinarily resident in the UK even in a year in which he or she is not resident (for example, in the case of someone who usually lives in the UK but has gone abroad for a long holiday and does not set foot in the UK during that year).

Where an individual leaves the UK to take up full-time employment abroad under a contract of employment which covers at least one full tax year, under HMRC's practice he or she is treated as non-UK-resident from the date of departure.

A non-UK-resident needs to ensure that any visits made to the UK are:
- fewer than 183 days in a tax year; and
- average fewer than 91 days a tax year.

Days spent in the UK through exceptional circumstances (for example, illness) are normally ignored in determining whether or not the 91-day test has been triggered.

No duties of the employment (other than incidental duties) should be performed in the UK. "Incidental duties" will include short visits to receive instructions or training. However, any mainstream employee duties should be avoided. For example, even the sending of a single work e-mail from the UK creates the risk of UK residency.

Where an individual leaves the UK under the full-time employment abroad route explained above, he or she is treated as non-resident from the day after the date of departure. Where an individual leaves the UK either permanently or for a period of not less than three years, then again that person is treated as non-resident from the day after the date of departure from the UK, provided that on departure that person is not ordinarily resident in the UK.

15.2 Proposed changes to UK residency

HMRC is currently consulting on introducing a statutory residency test. Broadly it is proposed that one looks at the number of days spent in the UK and five ties to the UK being:
- Family tie – exists if spouse, civil partners, their common-law equivalents or minor children (with exceptions) are in the UK
- Accommodation tie – exists if accommodation in the UK is available to him or her for a continuous period of 91 days and they spend at least one night there in the year.
- Work tie – he or she works in the UK for 40 days or more in year

- 90-day tie – he or she has spent 91 days or more in the UK in either or both of the previous two tax years
- Country test – he or she spends more days in the UK in the year than in any other single country

Under the proposals it is intended that it will be more difficult for someone leaving the UK to cease to be UK resident. The proposed bands are as follows;

Days spent in the UK	Number of UK ties sufficient to be UK resident	
Thresholds	Arrivers	Leavers
Fewer than 16 days	Always non-resident	Always non-resident
16-45 days	Always non-resident	4 or more
46-90 days	4	3 or more
91-120 days	3 or more	2 or more
121-182 days	2 or more	1 or more
183 days or more	Always resident	Always resident

HMRC is also proposing to abolish the concept of "ordinarily resident".

If the proposals are implemented then they will come into force on 6 April 2013.

15.3 UK domicile

Every individual has a domicile. Legitimate children at birth acquire their father's domicile as their domicile of origin, provided that the parents are married and the father is alive at the date of birth. Where these conditions are not satisfied the children acquire their mother's domicile as their domicile of origin.

Individuals over the age of 16 may change their domicile. To change his or her domicile, an individual must both physically reside in the new jurisdiction and also intend to reside there permanently or indefinitely. Where individuals abandon their domicile of choice, their domicile of origin reverts until such time as they acquire a new domicile of choice.

A married woman's domicile is determined as for any other adult individual. Prior to the Domicile and Matrimonial Proceedings Act 1973, a married woman's domicile followed that of her husband as a domicile of dependence. Following the passing of that Act, a woman who married before 1 January 1974 continues to retain her husband's domicile as a domicile of choice until she acquires a new domicile of choice.

(It should be remembered that for some other purposes – such as intestacy and succession – a person may be regarded as domiciled in England and Wales, in Scotland or in Northern Ireland rather than merely as domiciled in the United Kingdom.)

15.4 Tax planning

The charity and employee need to ensure that:
- the employment contract is for more than one tax year; and
- the employee's interim visits to the UK are less frequent than as detailed above.

If employees continue to be UK-resident or ordinarily resident they will continue to be subject to UK income tax on all their earnings (even if those earnings are for overseas duties) unless they are not UK domiciled. In that case, they would still be taxed on UK earnings but could elect to be taxed only on "chargeable overseas earnings" to the extent that they are remitted into the UK. "Chargeable overseas earnings" are earnings from a foreign employer for duties performed outside the UK. However, the remittance basis is a very complex area of tax law and specific advice should be sought as it will only be beneficial in some circumstances.

Where individuals cease to be UK-resident or ordinarily resident in the UK they will have no liability for their overseas duties but will still be liable for UK tax on their UK duties. However, incidental UK duties can be disregarded for UK tax. Incidental duties include:

- visits to the UK to report to the employer or to receive fresh instructions; and
- training in the UK by an overseas employee so long as the total time spent in the UK for training is not more than 91 days in a year and no productive work is done in the UK in that time.

Examples of duties *not* regarded as incidental include attendance at directors' meetings in the UK.

It is likely that if working abroad the employee will be subject to overseas tax. Specific advice will need to be sought. If the earnings are also subject to UK tax, a tax treaty may provide that the individual will only be taxed in one jurisdiction. Otherwise, any foreign tax can be deducted from any UK tax payable – but this cannot lead to a refund of UK tax.

On leaving the UK the employee should complete Form 85. The charity should continue to deduct tax in the normal way through the PAYE system. However, HMRC may well then issue an "NT" PAYE code which effectively means that no income tax will need to be deducted.

15.5 National Insurance

Treatment for the purposes of National Insurance depends on the country in which the employee is working. Countries can be divided into three groups:

A. Working in the European Economic Area (EEA): Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Gibraltar, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, The Netherlands, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and Switzerland.

The employee pays social contributions in the jurisdiction where he or she works. However, if the work is expected to last for less than 24 months, the employee would normally continue to pay UK NICs instead. The charity should apply for this treatment before the employee leaves.

Where an employee normally works in two member states at the same time, he will be subject to contributions in either:

- The member state in which he resides, if:
  - he pursues a "substantial amount of activity" there; or
  - he is employed by various employers whose registered office or place of business is in different member states; or
  - he is employed by an employer established outside the member states.
- The member state in which his sole employer has its registered office or place of business, if he does not pursue a substantial amount of activity in the member state in which he resides.

Where it is intended that an assignment in another member state will last longer than two years, it is possible to apply for contributions to be paid in the home member state if that is in the interests of the employee for a period of up to five years.

B. Working in Social Security Agreement countries Barbados, Bermuda, Canada, Israel, Jamaica, Japan, Jersey and Guernsey, Isle of Man, Republic of Korea, Mauritius, Philippines, Turkey, United States of America and the former republics of Yugoslavia where not members of the EEA

The employee pays social security in the jurisdiction where he or she works. However, UK NICs continue to be paid instead if:
- the individual is employed in the UK; and
- is posted to the Reciprocal Agreement country to work; and
- the posting is for no more than the posting period permitted by the relevant country.

C. Not working in any of the countries listed in A and B above:
Class 1 NICs contributions must be paid for the first 52 weeks during which the employee is there if:
- the employer has a place of business in the UK;
- the employee remains ordinarily resident in the UK for NICs purposes; and
- the individual immediately before starting the employment abroad was resident in the UK.

Otherwise no NICs will be due. It should be noted that there is no exemption from foreign social security.

An employee is ordinarily resident in the UK for NICs purposes if he or she:
- normally lives here, apart from temporary or occasional absences; and
- has a settled and regular mode of life here.

An employee may be ordinarily resident in:
- a place from which he or she is temporarily absent; or
- (in some circumstances) two places at once.

The employee could choose to continue to pay NICs voluntarily, even if not obliged to do so, in order to protect entitlement to UK benefits such as the state pension.

15.6 Travel expenses for overseas employment

Where certain conditions are met, employees can claim tax relief for travelling to their overseas employments. Equally, if the charity reimburses the expenses no taxable benefit will arise on the benefit if the same conditions are met.

The relief is available for the cost of travelling to take up the overseas engagement and for the cost of returning to the UK at the end of that engagement. Where travel is partly for business purposes and partly for private purposes, an apportionment has to be made. To qualify for this relief, all the following conditions must be met:
- the duties of the employment must be performed wholly outside the UK;
- the employee must be resident and ordinarily resident in the UK; and
- the employee must be domiciled in the UK if the employer is a foreign employer.

Duties performed in the UK are treated as performed abroad if the performance of those duties is merely incidental to the performance of overseas duties.

Relief can also be due for travelling between employments abroad provided the following conditions are met:
- the employee is obliged to incur and pay travel expenses;
- the travel is for the purpose of performing employment duties at the destination;
- the employee has performed duties of another employment at the place of departure;
- the place of departure, or the destination, or both, are outside the UK;
- the duties of at least one of the employments are performed wholly or partly outside the UK;

- the employee is resident and ordinarily resident in the UK; and
- if the employer is a foreign employer the employee is domiciled in the UK.

In such cases, relief is given for the cost of travel between the different places where the duties are performed, so long as at least one of those places is outside the UK. Again, an apportionment is made where the purposes of the travel are mixed.

Tax relief for UK employees can be claimed by an employee who is UK-resident and ordinarily resident. The cost, however, must be reimbursed by or on behalf of the employer. There are various cases set out by HMRC but a key factor is that the absence abroad must be wholly and exclusively for the purpose of performing the overseas duties

Where an individual is working abroad for a continuous period of at least 60 days, tax relief may be due in respect of family travel costs. The relief is only available where the cost is paid or reimbursed by the employer. Tax relief is available for up to two return journeys each tax year for the employee's spouse or civil partner and any child under 18. This relief is for travel costs only. No deduction is available for board and lodging (including hotel costs) or other subsistence costs for the family members.

There is a concession to exempt from tax as a benefit in kind the costs of a spouse or civil partner accompanying the employee for reasons of the employee's ill-health. The concession applies where such an employee goes abroad for business purposes and "although fit to carry out his duties at his normal place of work, takes his wife with him because his health is so precarious that he cannot undertake foreign travel unaccompanied".

15.7 Accommodation and subsistence costs

The special rules relating to overseas travel extend the availability of tax relief on board and lodging and other subsistence costs for certain individuals whose duties are performed wholly abroad. There are no special rules for those who work only partly abroad though such expenses can also be relieved if incurred wholly, exclusively and necessarily for the employment.

All the following conditions must be met:
- the employee must be resident and ordinarily resident in the UK;
- he or she must hold an employment the duties of which are performed wholly outside the UK;
- the cost must be reimbursed by or on behalf of the employer;
- the board and lodging must be provided to enable the employee to perform the duties of the employment; and
- the employee must be domiciled in the UK if the employer is a foreign employer.

15.8 Scale rates

Employers may use the benchmark rates published by the Foreign and Commonwealth Office when paying accommodation and subsistence expenses to employees whose duties require them to travel abroad without the need for the employees to produce expenses receipts. The rates can be found in the HMRC internet library at /www.hmrc.gov.uk/employers/emp-income-scale-rates.htm. Accommodation and subsistence payments at or below the published rates will not be liable for income tax or NICs. Therefore, employers may reimburse subsistence costs using these scale rates if they so choose or may instead reimburse actual costs if preferred. Employees reimbursed at less than the scale rates may only claim additional relief based on actual expenses incurred.

In all cases, these amounts are in addition to incidental overnight costs.

16 Donations

16.1 Overview of tax relief for charitable donations

Under current UK tax rules, donors are afforded a variety of differing tax reliefs for charitable donations. The rules offer donors tax relief on charitable donations for income tax, capital gains tax and inheritance tax.

16.2 Gift Aid

16.2.1 Background

Under the Gift Aid scheme, charities may reclaim basic-rate tax from monetary donations received from UK tax payers. The current Gift Aid scheme was introduced in 2000 and it means that donations of whatever value fall within the scheme and qualify for tax relief.

Suppose a donor makes a charitable donation of £100. The charity will receive the donation of £100 and because the donation is deemed to have been paid under the deduction of basic-rate income tax, the charity can reclaim £25 from HMRC (being £100 /80 x 20).

For a three-year period from 6 April 2008 to 5 April 2011 charities were also entitled to a further three pence for every pound donated. This "transitional relief" was introduced to adjust for the fall in basic-rate tax (from 22 per cent to 20 per cent). This means that for every £100 donated under Gift Aid, a charity will receive £28,21, so the total value of the donation is £128,21.

Claims for transitional relief must be made within two years of the end of the charity's accounting period / tax year compared with four years for normal Gift Aid. A separate claim is not required as HMRC will automatically calculate the transitional relief when making a Gift Aid repayment. It works like this: the donor gives, say, £100, the charity claims basic-rate tax on the gross gift from HMRC (20 per cent of £125, ie £25); the transitional relief is £3,21 and the charity receives £128,21 in total.

So for charitable companies with a 31 March 2013 year end, any back claims for donations:
- for normal Gift Aid for the year to 31 March 2009
- for transitional relief for the year to 31 March 2011

should be made by 31 March 2013 to HMRC Charities

The equivalent dates for charitable trusts are that any back claims for donations:-
- for normal Gift Aid for the year to 5 April 2009
- for transitional relief for the year to 5 April 2011

should be made by 5 April 2013.

The donor is treated as having made a grossed-up donation payment of £125 which can be deducted from his or her taxable income. If the donor is a basic-rate taxpayer there is no further tax relief due to the donor but if the donor is 40 per cent taxpayer, then additional tax relief of 20 per cent (being the difference between the current higher rate of income tax of 40 per cent and the current basic rate of tax of 20 per cent) can be claimed *by the donor,* not by the charity.

Donors taxable at 50 per cent (45 per cent from 6 April 2013) will get relief on the difference between the basic rate and their highest rate on the gross gift. If a donor gives £100 cash, the gross gift is £125. The higher-rate relief on this is 30 per cent, or £37.50.

Economically, it therefore costs a 50 per cent donor £62.50 to make a gift worth £125 to the charity. Or more simply, it costs the donor £50 to make a gift worth £100 to charity.

If the gift is large enough to reduce taxable income to below the 50 per cent threshold some of the gift will attract relief at 30 per cent and some at 20 per cent.

16.2.2 Conditions

For a Gift Aid payment to be valid certain conditions have to be fulfilled:
- it should be payment of a sum of money;
- it should not be subject to any repayment conditions;
- it cannot be made under the payroll giving scheme;
- it cannot be conditional on the charity acquiring property from the donor or anyone associated with the donor; and
- any benefits associated with the gift must be within specific permitted parameters.

16.2.3 Declarations

The donor must make a Gift Aid declaration to the charity relating to the gift. The declaration can be given in writing or orally, by means including electronic communications such as the internet, e-mail, mobile telephone and text message. The declaration can be given at the time when the donation is made, in advance of making the donation or within four years of having made the gift. The declaration must provide the following:
- full name (initial and surname are acceptable);
- full home address (house number or name and postcode are acceptable)
- the name of the charity that the donor wishes to support;
- details of the gifts that are to be covered by the declaration; and
- confirmation that the donor wishes to treat the gift(s) as Gift Aid donations.

Donors need to understand that they must pay at least as much UK Income Tax and/or Capital Gains Tax (in the year in which they donate) as the amount that will be claimed by the charity. So this should also be stated clearly on the Gift Aid declaration. New guidance issued by HMRC in 2012 included a requirement that this statement should also refer to the amount claimed by any other charities to which the donor gives. HMRC stated that it would continue to accept Gift Aid claims on donations made using forms based on previous wording until 31 December 2012. HMRC also assured the Church of England that it would continue to accept Gift Aided donations made in envelopes printed with the superseded wording until the charity's supplies of envelopes ran out.

At the same time as issuing this guidance, HMRC updated their model Gift Aid declarations.

There is no requirement for a Gift Aid declaration to be signed, nor does it have to be dated except where a donor makes reference to donations made from a specific date.

It is permissible for spouses and persons living together to make a joint declaration on the same form providing that full details of both parties are given.

The donor must make a payment by cash, cheque, direct debit, credit or debit card, postal order or standing order. Gift Aid Donations can be made in sterling or any foreign currency. When calculating claims the charity must convert foreign currency into sterling at the rate on the date when the donation was made. Gift Aid cannot apply to a transfer of assets, a donation in kind or to a loan write-off.

16.2.4 Donor benefits

Certain benefits can be provided to a donor by a charity. So long as the value of the benefits does not exceed the permitted limits, the gift can still qualify as a Gift Aid donation. The rules relating to the provision of benefits extend not only to benefits to the individual donor but also to anyone who is connected with the donor. For these purposes, a donor is connected to:

- the donor's husband, wife, civil partner or linear relative (for example son, daughter, parent, grandparent, or grandchild);
- any linear relative of the donor's wife, husband or civil partner; or
- a company under the control of the donor or under the control of any of the above.

A benefit is defined as an item or a service that is provided by the charity or a third party to the donor (or anyone connected to the donor) in consequence of making the donation. A donation cannot qualify for Gift Aid if the value of the benefits exceeds the following limits:

EITHER	**Donation**	**Permitted benefits value**
	Up to £100	25 per cent of the donation
	£101 – £1,000	£25
	Over £1,000	5 per cent of the donation

OR the value of the benefits plus the value of any benefits received from earlier donations made to the same charity within the same tax year exceeds £2,500 (increased from £500 for donation later than 6 April 2011).

Where a benefit to a donor would be available to a member of the public at a specified price, the benefit value will generally be the price to the public (less any reduced price payable by the donor). In situations where there is no comparable open market price, the charity must work out how much someone would be prepared to pay for the item or services, for example by looking at similar commercial transactions. Where a benefit is attendance at an event that is not open to the public (so that there is no ticket price), that benefit should be valued by dividing the cost to the charity of staging the event by the number of people at the event.

Where a benefit is given in return for a life membership subscription, the benefit is derived by estimating the value of all the benefits that will be received over the first ten years of the membership. Where the benefit is a discount on goods or services of which an individual donor may or may not take advantage, the valuation can be based on the average take-up of the benefit by the donors of the charity.

16.2.5 Gift Aid claims by charities

Following the Finance Act 2010, in order to take advantage of tax reliefs including Gift Aid charities will need to meet the definitions of a charity in the law of England and Wales and be established for charitable purposes as set out in the Charities Act 2006. Under Schedule 6 Finance Act 2010 they must also be managed by "fit and proper persons". HMRC has produced detailed guidance on the meaning and implications of this new test.

Once recognised by HMRC as a charity for tax purposes, HMRC will allocate a charity tax reference number for use on all correspondence and claims. The charity will need to nominate someone to be an authorised official and/or someone to be a nominee. This means that they can sign repayment claim forms and/or receive money on behalf of the charity.

In March 2011 HMRC introduced a new R68(i) – Gift Aid and tax repayment claims form, which replaced all previous claim forms. This instantly calculates the correct amount of Gift Aid a charity can claim, helps avoid common errors and means that HMRC can process the claim faster.

16.2.6 HMRC audit

HMRC only makes limited checks before paying Gift Aid claims to avoid delays, so HMRC officials test the accuracy and validity of a proportion of claims in more detail by auditing them. Charities may therefore be selected for audit and details of how this works are given in the detailed Gift Aid Guidance on the HMRC website.

Auditors will check records supporting a tax repayment claim including donation records, Gift Aid declarations and banking / cash records. This will usually involve reviewing the charity's accounting records, systems and procedures. During the course of an audit they may also identify other potential tax risks – such as non-charitable expenditure, PAYE and VAT issues.

On the day the audit ends, the auditor will go through what has been reviewed and the results of the review. The same information will be included in a letter to the charity summarising the audit findings and what action the charity may need to consider. If the auditors find that less tax has been claimed than was due they will help the charity to make a further repayment claim.

If the auditors cannot substantiate a tax repayment claim and too much has been paid to the charity, they will explain the problem and the formal process to recover the tax. A summary of the amounts of tax recoverable for all relevant years and a computation of interest due will be provided together with, where appropriate, the basis for any penalties that the auditors believe are due.

Retention of Records
A charitable company must keep Gift Aid declarations and records until six years after the end of the accounting period they relate to. A charitable trust should keep them until the later of:
- six years after the end of the tax year they relate to, and
- 12 months after you make your Gift Aid repayment claim for that tax year.

Note that previous HMRC guidance stated that the four-year time limit for making claims also applied to the retention of records. *This was incorrect;* but if a charity, before January 2012 followed this guidance and destroyed records between four and six years old it will not be penalised.

16.2.7 Corporate Gift Aid
Companies are entitled to tax relief for qualifying charitable donations made to charities. The donations are paid gross without the deduction of income tax. The donations are deductible from the company's total profits in the year in which the donations are made. The amount of the deduction is limited to the amount that reduces the company's total taxable profits to nil: the payment of a charitable donation cannot create or augment a company's loss for tax purposes.

This means that charities do not reclaim tax from HMRC in respect of company donations.

The rules on benefits offered to corporate donors are the same as the benefit limits for individuals described above.

In the case of a company owned wholly by a charity or a group of charities, the company is able to claim a tax deduction for Gift Aid payments made within nine months of the year end. This avoids the need for a trading subsidiary company having to estimate its level of taxable profits and pay the required level of charitable donations before the year end.

16.2.8 Guidance
Detailed guidance notes explaining the Gift Aid scheme are available on HMRC's website where there is also a Gift Aid toolkit broken down into 12 helpsheets.

16.2.9 The position of deeds of covenant
Prior to 1990 tax relief for charitable donations was only available via a formal deed of covenant which had to be capable of exceeding three years. Payments by individuals and companies under a deed of covenant were paid after the deduction of basic-rate tax. The charity was able to reclaim the basic-rate tax from HMRC. Strictly, a deed of covenant was an outright gift. In practice, in the case of membership charities HMRC accepted that the provision of membership benefits of up to 25 per cent of the payment (maximum £100) did not prejudice the tax position. Also, certain admission rights were not treated as consideration for the purposes of deeds of covenant.

Since 6 April 2000 there is no longer a separate tax relief for individuals or companies for payments made under a deed of covenant. All payments from that date fall under the Gift Aid scheme. As a transitional measure, charities were not required to obtain a signed Gift Aid declaration form for donors who had entered into a deed of covenant prior to 6 April 2000.

For any deeds of covenant executed after 6 April 2000 a charity must also ensure that the donor has signed a valid Gift Aid declaration form. It is possible to incorporate the requirements of both a deed of covenant (providing some degree of certainty as to future levels of income) and a Gift Aid declaration form into the same document.

16.3 Particular situations

16.3.1 Charity auctions

HMRC accepts that at a charity auction individuals may be willing to pay substantially more than an item is worth in order to support the charity concerned. The basic requirements of Gift Aid still apply, including the benefit rules.

For items that are freely available and have a retail price, the benefit for Gift Aid purposes is the retail price. If an auction item is not openly available, such as an item owned by a celebrity, its value for Gift Aid purposes is the price paid for it at the auction. The value of services offered which are not usually available to buy, such as babysitting for an evening will also be 100 per cent of the amount given with none of the sum available for Gift Aid.

If the value of the item exceeds the permitted benefit limits for Gift Aid, the donor can treat the auction payment as being payment for the item and any excess can be treated as a donation. However, the excess payment can only be treated as a donation if the item is capable of being purchased separately and if the donor is aware of the value of the benefit at the time of the auction at the time of the auction and is aware, at the time they make a successful bid, that the item could be purchased separately and for what price. HMRC also say that charity and the donor should keep evidence of this arrangement – for example an exchange of letters..

16.3.2 Sponsored events

It is possible for individual sponsors to elect for their sponsorship monies to be treated as Gift Aid donations. It is usual for charities to a design a sponsorship form (containing the standard Gift Aid declaration wording prominently on each page) which contains a column that can be ticked by the sponsors to indicate that they wish their sponsorship amount to be treated as a Gift Aid donation. The form must also contain the information mentioned in 16.2.3 on Gift Aid declarations.

16.3.3 Membership subscriptions

It is possible in certain circumstances for membership subscriptions to be paid under Gift Aid. HMRC will accept that the membership subscription payment may qualify as a Gift Aid donation providing the payment does not:

- secure more than membership of the charity (see 16.3.4 below); and
- secure any right to the personal use of any facilities or services provided by the charity.

In terms of valuing the benefits for Gift Aid purposes, newsletters or magazines distributed by charities to provide their members with a regular update about the charity's work can be excluded.

16.3.4 Allowing access to view charity property

The right of admission is disregarded as being a benefit for the purposes of the Gift Aid rules providing certain conditions are fulfilled, in particular:

- the donation must be at least 10 per cent more than the general public cost of admission; or
- the donation made must allow the donor or the donor and his family access for a 12-month period.

Gift Aid can apply to a 'family ticket' donation providing a qualifying right of admission is given to the donor and their family. The right of admission does not have to be used by all of the family members at the same time.

16.3.5 Gift Aid on donated goods

As Gift Aid only applies to gifts of money, donations of goods for sale do not qualify for Gift Aid. However, a charity can offer to act as an agent for supporters and sell goods on their behalf. If the supporter then donates the sale proceeds, that can qualify for Gift Aid.

There are a number of detailed requirements and implications set out in the detailed guidance on Gift Aid on the HMRC website. Some commercial organisations have developed software to deal with the scheme. HMRC recommends that charities contact it to discuss their plans before implementation.

Note also that these arrangements can also have VAT implications. If a charity offers to act as an agent without making a charge, that is a non-business transaction and therefore outside the scope of VAT. So the charity will not be able to claim back the input VAT on either the direct costs of providing the service or on any associated overheads. This differs from the sale of donated goods which is a zero-rated supply for VAT purposes, so any input tax suffered by a VAT registered charity can be offset against these supplies.

It was announced in the 2012 Budget that the Government would work with the charity sector to simplify the administration of Gift Aid in the context of charity shops and the outcome of this work is awaited.

16.4 Gift Aid Small Donations Scheme (GASDS)

From April 2013, charities which receive small cash donations of £20 or less will be able to apply for a "Gift Aid style" repayment without the need to obtain Gift Aid declarations for those donations. The amount of small donations on which the new repayment can be claimed will be capped at £5,000. The scheme will apply to donations collected and banked in the UK. Payments under the scheme are not repayments of tax but are funded from public expenditure.

The details set out here reflect the Small Charitable Donations Bill published in June 2012 but it is possible that changes may be made before it becomes law.

Claims will be based on a tax year irrespective of the structure of the charity and must be made within one year of the end of the tax year in which the small donations are collected. Donations must be pure gifts although small tokens of negligible value such as lapel stickers will be allowed. The donations must be in cash only (not by cheque or debit card) collected and banked in the UK. Higher rate tax relief will not be available. Gifts made under Gift Aid or payroll giving are not eligible nor are donations used for non-charitable or non-qualifying purposes. Membership subscriptions are not eligible.

In order to be eligible to make claims under the GASDS in respect of small donations made in a particular tax year a charity must have been in existence (or a CASC registered as a CASC) for at least two complete tax years and have made at least two compliant Gift Aid exemption claims in the previous four tax years. The minimum period to qualify for the new Scheme is therefore two years – provided that the charity or CASC makes a compliant Gift Aid exemption claim in each of those two tax years.

Charities that incur a penalty under Gift Aid or the GASDS will be excluded from making claims under the GASDS for the tax year in which the claim giving rise to the penalty was made, and the following two tax years, but Gift Aid exemption claims made in those tax years will still count in determining eligibility in subsequent years.

A charity must make Gift Aid exemption claims on donations received in the same tax year in order to make a claim to a top-up payment under the GASDS. The total Gift Aid donations must be at least ten per cent of the amount of the small donations on which top-up payments are claimed – so in order to claim against the maximum of £5,000 of small donations the charity will need to have made a successful Gift Aid claim on £500 of donations in the same tax year.

There will be special rules in certain circumstances to increase the maximum amount of small donations on which top-up payments can be claimed by some charities. If a charity runs charitable activities in a community building, the maximum limit is increased from £5,000 of small donations by up to a further £5,000 for small donations collected in each community building.

Charities that are connected with one another will share between them the maximum £5,000 limit on which small donations may be claimed. However the additional allowance due to a connected charity that runs charitable activities in a community building will not be affected.

Most of the legislative machinery for administering the scheme will be provided for in regulations. The regulations are intended to mirror the administrative provisions in the Taxes Acts that are used to administer Gift Aid exemption claims.

16.5 Gifts of shares and property

Individual donors have been able to obtain income tax relief on gifts of shares and securities since 6 April 2000. The tax relief was extended in 2002 to cover a gift of land. Corporate donors are similarly able to enjoy tax reliefs on gifts of shares, securities and land.

The tax relief is available where a donor gives or sells a qualifying investment to a UK charity at less than market value. The donor must give or sell his or her entire interest in the investment.

16.5.1 Qualifying investment

For the purposes of the tax relief, a "qualifying investment" is any of the following:

- shares or securities listed on a stock exchange;
- shares or securities dealt on any designated market in the UK – currently the Alternative Investment Market (AIM) or PLUS-quoted market;
- units in an authorised unit trust;
- shares in an open-ended investment company;
- holdings in certain foreign collective investment schemes; or
- a qualifying interest in land – subject to specific rules.

16.5.2 Considerations for the donor

Gifts of shares or property qualify for the general capital gains exemption on disposals to charity. (A loss on disposal to a charity will not be an allowable loss for the donor). In addition income tax/ corporation tax relief may be available.

The amount of the income tax / corporation tax relief to be claimed by the donor is calculated as the net benefit to the charity plus any incidental costs incurred by the donor in making the gift, less any consideration or other benefit received in consequence of giving or selling the investment. The net benefit to the charity is generally taken to mean the market value of the investment. There are differing detailed statutory tax rules for determining market value, and these vary according to the type of investment.

If the charity is subject to an obligation to any person such that:

- it is reasonable to suppose that the disposal of the qualifying investment would not have been made in the absence of the obligation; or

- the obligation is connected to the charity receiving the qualifying investment or a related investment, the market value of the qualifying investment will be reduced by the aggregate of the related liabilities of the charity resulting from the exercising of the obligation.

Individual donors are able to claim a deduction against their income assessable to income tax via their self assessment tax return, enabling them to claim tax relief at their highest marginal rate. Corporate donors claim the tax deduction as a charge on income against the company's taxable profits.

For individual donors the tax implications of making a gift of shares or property or, alternatively, selling the assets and then making a Gift Aid donation are very different. Under a gift of shares or property the entire tax relief is enjoyed by the donor, whereas if the assets are sold and then a Gift Aid donation is made only the higher-rate tax relief will be enjoyed by the donor. However, the latter route may be advantageous where the asset stands at a loss, since the donor would be able to realise an allowable capital loss if the asset were sold and the proceeds applied by way of a Gift Aid donation.

Note also that when a donor gives an asset away to a charity or sells it to a charity for less than its initial cost, the donor is treated as making no gain or loss for Capital Gains Tax purposes, so will not have to pay any Capital Gains Tax.

For corporate donors there is no distinction in tax terms between a gift of assets and a Gift Aid donation.

16.5.3 Considerations for the charity

Gifts of shares and property do not fall within the Gift Aid scheme. The tax relief is designed to incentivise donors to give assets to charities and there is no further tax that can be reclaimed from HMRC. Once a charity has received a gift of shares or property it is up to the charity to decide whether to retain the asset or to dispose of it.

It is important for charities to understand the tax positions of their donors in order to understand whether a gift of shares or property is more appropriate than a Gift Aid donation.

A charity can ask a donor to sell the investment on its behalf – in these cases it is essential to retain the evidence to demonstrate that the gift to the charity took place before the realisation of the investment on its behalf, so as to show that the donor was acting as the nominee or agent of the charity at the time of disposal.

16.6 Inheritance Tax

Inheritance tax ("IHT") was introduced in 1984 replacing Capital Transfer Tax, which having been introduced in 1975 had imposed a tax charge on the gift of assets during the taxpayer's lifetime. The basic principle of IHT is that a tax charge arises on the reduction in the value of an individual's estate as a result of a transfer of an asset from the estate. Some transfers are referred to as "potentially exempt transfers", since no IHT charge will arise providing the donor survives for seven years after making the gift.

There is a specific exemption from IHT where assets are given to charities. The legislation further defines "given to charities" to mean assets that are given "if it becomes the property of charities or is held on trust for charitable purposes only". The IHT exemption applies equally to lifetime gifts and gifts on death.

If an individual receives a legacy and chooses to pass this on to a charity it may be appropriate to effect the transfer as a deed of variation within two years of the date of death. Under a deed of variation the gift is treated as if it had been made by the deceased person and can therefore benefit from the general charitable exemption.

A reduced rate of IHT applies where 10 per cent or more of a deceased's net estate (after deducting IHT exemptions, reliefs and the nil rate band) is left to charity. In those cases the current 40 per cent rate will be reduced to 36 per cent. The new rate came into effect on 6 April 2012.

The total amount left to charity by the testator is compared to a "baseline" amount to decide whether or not the estate qualifies for the 36 per cent rate. The "baseline" for the purposes of the test will be the value of the estate charged to IHT after deducting all available reliefs and exemptions and the nil-rate band but excluding the charitable legacy itself. The estate qualifies for the 36 per cent rate if the amount left to charity is equal to 10 per cent or more of the baseline.

A person's estate for IHT purposes includes not only the assets that the deceased owned directly immediately before his or her death and may be disposed of under the terms of the will (the 'free estate') but also certain other assets and property. These include jointly-owned assets which pass automatically to the surviving joint owner, interests in certain types of trust (settled property), and some other assets which the individual gave away during his or her lifetime while continuing to derive a benefit (gifts with reservation of benefit). In these cases the estate will be divided into three components: the survivorship component (ie property which passes automatically to a surviving joint owner), the settled property component (eg life interests in trusts), and the general component (all property not included in one of the other components). The 10 per cent test will be applied to each component individually and the 36 per cent rate of IHT will apply to any of the components that pass the test. Note that it is possible to merge one or more components to gain the maximum benefit from the reduced rate.

In April 2012 HMRC produced new guidance and an IHT reduced rate calculator relating to this change. The Inheritance Tax reduced rate calculator will help to work out whether or not an estate will qualify to pay the reduced rate of tax.

16.7 Payroll giving

The payroll giving scheme was originally introduced in 1986. The scheme allows employees and pensioners the opportunity to make either regular or one-off donations to charities of their choice by a direct deduction from their salary. This gives employees immediate tax relief at their marginal rate of tax.

There is no upper limit to the level of donations that can be made through the payroll giving scheme and individuals are not restricted in the UK charities that they can support.

A payroll giving scheme operates by an employee authorising the employer to deduct the charitable payment from his gross pay. The donation is then passed by the employer to a Payroll Giving Agency ("PGA"). The PGA has the responsibility to distribute the monies to the charities nominated by the employees within sixty days of receiving the funds from the employer organisation.

An employer wishing to establish a payroll giving scheme for its employees should contact an approved PGA. Details of the approved agency charities can be found on the HMRC website. The precise details of the scheme and its practical operation will be agreed between the employer and the PGA. (It is also possible for an employer to establish its own PGA to handle the charitable donations of its employees.) Although various options are available, the most common arrangement is where the employee agrees to give specified amounts to named charities out of each wages or salary payment.

Charities that receive donations under a payroll giving scheme do not claim any additional tax refund. This reduces the administrative burden because there is no additional paperwork to complete. The donations are received directly from the PGA by the charity nominated by the donor and this will usually give the charity increased certainty over its income. Charities receive the same level of donation, subject to the administration fee charged by the PGA, as if they had received a donation under Gift Aid; but they do not have the responsibility of maintaining detailed records of their donors and charitable gifts.

The main benefit to a donor making charitable donations via a payroll giving scheme is the immediate tax relief at the time of making the donation. The donor, if a higher-rate tax payer, does not need to complete a self-assessment tax return to claim his or her higher-rate tax relief.

In 2011 the Government announced its intention to explore how to increase the take up of Payroll Giving. In April 2012, Chloe Smith, the then Economic Secretary to the Treasury, said this:

"Payroll giving provides a sustainable and predictable income stream for charities, and I have asked my officials to work with Cabinet Office to seek out ways to improve take-up. We know that we have to do much more to raise awareness of the scheme and ensure that awareness leads to action. Together with the charity sector and with employers we need to change behavioural attitudes to embed giving, in this case payroll giving, as the social norm".

16.8 Tainted charity donations

Anti-avoidance measures known as the "substantial donors legislation" was introduced with effect from 22 March 2006. It was designed to restrict a charity's tax exemption where it entered into certain transactions with donors that allowed the donor to extract value from the charity (whether in cash or in any other form.) Any transactions caught under the legislation was regarded as non-charitable expenditure in the hands of the charity.

The substantial donor rules will continue to apply until 1 April 2013 to transactions with substantial donors who made donations before 1 April 2011.

New legislation to replace the substantial donor rules, known as the "tainted charity donation rules" was introduced in 2011; it adopts a "purpose test" approach and focuses on "tainted charity donations".

The tainted charity donation rules refers to financial advantages to a person linked to the donor. Where a donation is deemed to be "tainted" the donor will lose tax relief on the donations.

Guidance and examples have been drafted and at the time of writing are being checked prior to issue.

16.9 Other giving by businesses

Businesses can get tax relief on gifts of trading stock: items manufactured or sold in the course of trade. When companies give away an article they usually include the market value of the gift as a trading receipt when calculating profits for tax purposes. Where such articles are given to a charity nothing is included as a trading receipt. In that way they get relief for the cost of the article in calculating the taxable profits of the trade.

In the case of gifts of machinery or plant used in the course of trade they can claim capital allowances by treating the gift as having been disposed of at nil value for capital allowances purposes (rather than at market value as would otherwise be the case). The total capital allowances given in respect of the article will be equal to its cost.

There is a relief for business from corporation tax for gifts of medical supplies and equipment made for humanitarian purposes. This operates by giving a deduction from trading profits where they would not otherwise be allowable as wholly and exclusively for the purposes of the company's trade. A deduction is also allowed for any costs of transportation, delivery or distribution incurred by the company in making the gift.

16.10 Gifts of art

At some future date to be determined, an individual giving a pre-eminent object to the nation will be entitled to tax relief. The object must be wholly and beneficially owned by the donor. The relief will be 30 per cent of the agreed value of the object. The donor can choose whether to take the relief against income tax or against capital gains tax or a mixture of both. The relief can be spread over up to five years starting with the year in which the donor's offer of the object was registered under the scheme.

The provisions for gifts of pre-eminent objects to the nation by companies give a reduction in a company's corporation tax liability of 20 per cent of the agreed value of the gift. The reduction will be applied to the company's corporation tax liability in the year in which the company's offer of the object was registered under the scheme.

The definition of a pre-eminent object mirrors the definition used for the purposes of the IHT Acceptance-in-Lieu scheme. The decision as to whether or not an object falls within that definition is for Ministers.

At the time of writing the commencement date for the scheme had not been decided.

17 Other UK taxes

17.1 Climate Change Levy

Climate Change Levy ("CCL") is designed to encourage businesses to reduce energy consumption or to use energy from renewable sources. It applies to supplies of electricity, natural gas supplied by a gas utility, petroleum and hydrocarbon gas in a liquid state and solid fuels.

Users of energy from these sources must pay the CCL. The levy is imposed at the time of supply and is included in energy bills. Suppliers of the services collect the tax. The levy is applied as a specific rate per nominal unit of energy and increases broadly in line with inflation each April. The rates for 2012-13 are as follows:

Commodity	Normal rate
Electricity	0.509 pence per kilowatt hour (kWh)
Gas supplied by a gas utility or any gas supplied in a gaseous state that is of a kind supplied by a gas utility	0.177 pence per kWh
Any petroleum gas or other gaseous hydrocarbon supplied in a liquid state	1.137 pence per kilogram
Any other taxable commodity, eg coal	1.387 pence per kilogram

There are various exemptions and a reduced rate in certain circumstances. Small quantities of fuel and power (*de minimis*) can be treated as being for domestic use even when they are supplied to a business and therefore not subject to the levy. The current *de minimis* levels as set out by HMRC are as follows:

If the supply is of ...	the *de minimis* amount is…
Coal or coke	a supply of not more than one tonne held out for sale as domestic fuel (that is, domestic grade fuel).
Piped gas	a supply by the same supplier at a rate of not more than 4,397 kilowatt hours per month of gas of a kind supplied by a utility or petroleum gas, to one customer at any one of the customer's premises. This quantitative limit applies whether the bill is based on a meter reading by either the supplier or the customer or on an estimate.
Metered electricity	a metered supply to a person at any premises where the electricity (together with any other electricity provided to him at the premises by the same supplier) is provided at a rate not exceeding 1,000 kilowatt hours per month. This quantitative limit applies whether the bill is based on a meter reading by either the supplier or the customer or on an estimate.
Unmetered electricity	an unmetered supply to a person where the electricity (together with any other electricity provided to him by the same supplier) is provided at a rate not exceeding 1,000 kilowatt hours per month.
Liquid Petroleum Gas in cylinders	a supply containing any number of cylinders, each of which is less than 50 kilograms net weight.

If the supply is of …	the *de minimis* amount is…
Liquid Petroleum Gas in bulk	a supply of LPG not in cylinders to a customer at premises that have a tank capacity of not more than two tonnes. Storage tanks are not filled to the limit of their holding capacity for safety reasons. The capacity is therefore to be calculated based on the maximum quantity that tanks can safely hold, as certified by the tank provider.

Supplies to charity users for non-business purposes are excluded from CCL. The definition follows that of VAT, so "non-business" will mean carrying out charitable objectives such as the relief of poverty, sickness or infirmity or other activities beneficial to the community such as the advancement of education, religion, nature conservation and the support of the arts.

For business activities, the levy is due unless the *de minimis* limits apply. This will therefore affect activities such as:
- premises used for the sale of donated goods;
- the hiring of charity-run buildings (for example, village halls), and
- premises used for the provision of membership benefits by clubs, associations and similar bodies.

Where supplies are made to a charity whose premises are put partly to non-business charity use:
- if this is at least 60 per cent of the total use, the whole supply can be treated as such and not subject to levy; or
- if less than 60 per cent of the total use, levy will need to be applied to that portion that does not qualify for relief

A supplier of fuel and power for mixed use should obtain from the charity a VAT certificate declaring what percentage is, or will be, put to domestic or charitable non-business use for each of the premises supplied and apply relief from CCL on this basis.

17.2 Insurance Premium Tax

Insurance Premium Tax ("IPT") is a tax on general insurance premiums. There are two rates:
- a standard rate of 6 per cent (increased from 5 per cent on 4 January 2011); and
- a higher rate of 20 per cent (increased from 17.5 per cent on 4 January 2011) for travel insurance and some insurance for vehicles and domestic/electrical appliances.

The following categories of insurance are exempt from IPT:
- reinsurance;
- life assurance, permanent health insurance and all other "long term" insurance except medical insurance;
- commercial aircraft and some associated liabilities;
- commercial ships and some associated liabilities;
- lifeboats and lifeboat equipment;
- foreign or international railway rolling stock and some associated liabilities;
- export finance;
- commercial goods in international transit;
- the block insurance policies held by Motability which covers all disabled drivers who lease their cars through the scheme;
- risks located outside the UK; and
- the Channel Tunnel.

For the purposes of the exemption, a lifeboat is a vessel used, or to be used, solely for rescue or assistance at sea. "Lifeboat" includes conventional lifeboats and other vessels used solely in connection with life-saving activities at sea. Lifeboat equipment is defined as anything used, or to be used, solely in connection with a lifeboat and it includes carriage equipment, tractors, winches and hauling equipment used solely for the launching and recovery of lifeboats. "Lifeboat equipment" does not include boathouses and slipways.

The exemption does not extend to policies covering rescue craft to be used on inland waterways, lakes and reservoirs. Policies which relate to the construction of lifeboats are also not exempt from IPT. The exemption does, however, extend to new, completed lifeboats not yet used but to be used for rescue at sea and to policies relating to lifeboats used for training personnel in rescue at sea (but not to vessels which are not lifeboats, even though they may be used to train personnel in lifesaving skills).

Block insurance policies held by Motability, under which all those disabled drivers who lease their vehicles under the Motability scheme are insured, are exempt. The exemption does not extend to disabled drivers generally.

17.3 Lottery Duty

Lottery Duty is a charge on the taking of a chance or ticket in a lottery that is promoted in the UK. At present, the National Lottery is the only lawful lottery paying duty in the UK because most lotteries are exempt from the duty. The current rate of duty is 12 per cent of the price paid on taking a ticket or chance in a lottery.

17.3.1 Exemption

Exemptions from Lottery Duty include the following:

- Lotteries promoted by an exempt entertainment, for example a bazaar, fête, sporting or athletic event or dinner, which covers lottery tickets sold at events such as football club annual dinners and Brownie fundraising events. No more than £500 can be used from the proceeds of the lottery to buy prizes, but the value of donated prizes has no limit. Tickets must only be sold at the event. These types of lottery do not require the charity to register with their local authority.
- Private lotteries where the sale of tickets is confined to members of a society, people on the society's premises, people who all work on the same premises, or people who all live on the same premises. This would cover things like office sweepstakes and office party raffles. All the proceeds must be either spent on prizes or the activities of the charity. These types of lottery do not require the charity to register with their local authority.
- Lotteries promoted by a charitable society supporting athletic sports or games, cultural activities, or another purpose which is not for private gain or a commercial undertaking.

To qualify as a lawful lottery which is exempt from duty a lottery must comply with conditions set out in the Gambling Act 2005. Members of the public can buy tickets and the lottery is widely promoted to get the maximum possible number of participants. All lotteries have to be registered with the local authority or the Gambling Commission.

18 Overseas taxes

18.1 Overseas withholding taxes for charities

When a payment is made to a party in another country, the laws of the payer's country may require withholding tax to be applied to the payment. International withholding taxes may be required for:

- financing, ie dividends or interest;
- the use of intellectual property, ie royalties and licence fees;
- consultancy fees and management fees; and
- rental of real estate, and other payments connected with real estate.

Withholding tax is the amount of tax withheld by a party making a payment to another and then paid on to the taxation authorities. The amount the payer deducts may vary, depending on the nature of the product or service being paid for. The purpose of withholding tax is to facilitate or accelerate collection by collecting tax from payers rather than a much greater number of payees and by collecting tax from payers within the jurisdiction rather than from payees who may be outside the jurisdiction. It may also be used to counteract tax evasion and tax avoidance.

The payee is typically assessed to tax on the gross amount with the possibility of using that withholding tax to offset part or all of the overall tax liability of the entity. Therefore, withholding taxes can be particularly sensitive for tax-exempt entities such as charities which are typically unable to use any withholding tax suffered to offset a UK tax liability (as they are unlikely to have any such liability).

A double taxation treaty (see 18.2) may reduce the amount of withholding tax required from the statutory rate to the treaty rate, depending upon the jurisdiction in which the recipient is resident for tax purposes.

18.1.1 Recovery of withholding tax

In certain circumstances the charity will need to file a tax return or other claim form in the source country in order to recover the tax overpaid. Procedures and time limits for refund claims vary considerably.

There have been cases considering whether or not withholding taxes have been illegally imposed due to discriminatory treatment of tax authorities when a domestic and overseas entity are compared. Charities may wish to consider potential claims for withholding taxes suffered if no such tax would have been applied on payments to a domestic charity.

18.2 Double Taxation Treaties

Double Taxation Treaties ("DTTs") are conventions between two countries that aim to eliminate the double taxation of income or gains arising in one territory and paid to residents of the other. They work by dividing the tax rights which each country claims by its domestic laws over the same income and gains. The UK has one of the largest networks, with more than 100 DTTs.

Despite attempts at harmonisation, very few DTTs are identical. However, they commonly include some or all of the following provisions:

- they define which taxes are covered and who is a resident and therefore eligible for benefits;

- they reduce the amounts of tax withheld from interest, dividends, and royalties paid by a resident of one country to a resident of the other country;
- they limit the tax imposed by one country on the business income of a resident of the other country to that on the income from a permanent establishment in the first country;
- they define circumstances in which the income of individuals resident in one country will be taxed in the other country, including salary, self-employment, pension and other income;
- they provide for exemption of certain types of organisations or individuals; and
- they provide procedural frameworks for enforcement and dispute resolution.

The stated goals for entering into a treaty often include reduction of double taxation, eliminating tax evasion and encouraging cross-border trade efficiency.

Certain DTTs have charity-specific provisions but not all. In the case of charitable Common Investment Funds ("CIFs"), they generally benefit from the extensive tax treaty network developed by the UK and attain the same treaty rights as Open Ended Investment Companies ("OEICs") and authorised unit trusts. One notable exception is the US, where dividend income received by a foreign private foundation is subject to a withholding tax rate of 4 per cent as compared to the standard 15 per cent.

19 Community Infrastructure Levy (CIL)

19.1 Background

Community Infrastructure Levy ("CIL") is a tax levied by a local authority on the carrying out of a "development" in England and Wales. Its objective is to levy a charge on developers in order to fund expenditure on local infrastructure. The detailed provisions are set out in the Planning Act 2008 and the Community Infrastructure Levy Regulations 2010.

19.2 Introduction of CIL by the local authority

Although a local authority is able to charge CIL there is no requirement that it should do so. It is therefore possible that CIL will never be imposed in some local authority areas, or at least not for some time.

However, in the current economic climate and given the restrictions on the use of planning gain agreements (often called Section 106 Agreements) after April 2014, many local authorities are now looking to introduce CIL sooner rather than later. As at 21 September 2012, however, only six local authorities had approved charging schedules in place and were operating the levy. Rates for residential, retail and commercial uses ranged from £0 to £125 per square metre.

19.3 The charging schedule

CIL cannot be charged by a local authority unless a "charging schedule" is in force on the day planning permission for a CIL liable development (see below) is granted. A charging schedule is a local authority document which sets out how CIL in the area will be calculated. It must be published on the local authority's website (and a hard copy must be available for inspection).

The charging schedule must contain information such as the rate(s) of CIL, where the rate(s) will apply (the rate(s) will then be index-linked by reference to the construction costs index published by the Royal Institute of Chartered Surveyors (RICS)) and when the charging schedule will take effect.

There may be differential rates of CIL by reference, for example, to the intended use of the development but the rate(s) must, among other things, aim to strike an appropriate balance between raising CIL and the potential effects of CIL on the economic viability of development across the local authority area (including, in the case of a London borough council, having regard to the rate(s) of CIL rates set by the Mayor of London).

The Regulations set out a consultation procedure, aimed at transparency and public involvement, governing the way in which a local authority may introduce a charging schedule. For example, the local authority must consult various bodies, including voluntary bodies whose activities benefit the local authority area, and invite them to make representations.

19.4 What is a "development" for the purposes of CIL?

A "development" for CIL purposes is "anything done by way of or for the purpose of the creation of a new building" or "anything done to or in respect of an existing building" or "the change of use of any building previously used as a single dwelling house to use as two or more separate dwelling houses". A "building into which people do not normally go" and a "building into which people go only intermittently for the purpose of inspecting or maintaining fixed plant and machinery" is not a "development" for CIL purposes.

CIL is charged on the increase in gross internal area. There is no CIL on existing internal area which is to be demolished and which is in lawful use when planning permission is granted.

Not included in the CIL calculation are buildings which do not comprise a "development" (see above), or for which planning permission is granted for a limited period. Also not included is a new build or enlargement of gross internal area of less than 100 square meters (except where the development will comprise one or more dwellings).

This means that CIL will not be levied if a building is replaced with a new one or where there is a change in the use of a building and there is no overall increase in floor space. Similarly, there is no CIL where the increase in total gross internal area of the building is less than 100 square metres except, as mentioned above, where the development will comprise one or more dwellings.

19.5 Liability to pay CIL

A liability to pay CIL can be assumed. Thereafter the assumption of liability may be withdrawn, by anyone, before development commences. Additionally, an assumed liability can be transferred to another person after commencement of development but before the 60 day payment window has expired.

If no-one assumes the liability to pay CIL, the liability is apportioned by the local authority between each "material interest" at the commencement of the development, based on open market values (assuming that the development has been completed). A "material interest" means the freehold or a lease which has more than seven years to run when planning permission first permits development.

The obligation to pay CIL is triggered on commencement of a development and ceases on death (if the deceased assumed liability to pay CIL) before development commences. If the liability to pay CIL is assumed, the standard payment period is 60 days following the intended commencement date of the development. However, the local authority can have an instalment policy if it wishes, in which case CIL will be payable in accordance with that policy.

If the liability to pay CIL is not assumed, CIL must be paid in full on the intended commencement date of the development.

Payment of CIL can be made in cash or in kind. If payment is made in kind, the local authority may accept payments of land (including existing buildings or structures) if certain conditions are met, for example, an agreement to make the land payment is entered into before development is commenced.

19.6 Charitable relief from CIL

There is a mandatory relief from CIL for a charity owning a material interest if the development is to be used wholly or mainly for a charitable purpose of the charity in question or of that charity and another charity (or charities). According to guidelines issued by the Department for Communities and Local Government (DCLG): "There is no statutory definition of [the wholly or mainly test], however the courts have held 'mainly' to mean 'more than half.'". If the development is unoccupied, it is still eligible for this relief.

There is no mandatory relief if that part of development to be used for charitable purposes will not be occupied or under the control of a charity, or if the material interest is owned jointly by a charity and a non-charity, or if the relief would be State Aid [see 19.10 below].

However, even if the above State Aid condition is not met, the local authority may, if discretionary charitable relief is available in the local authority area in which the development will be situated, allow the relief provided that the exemption does not constitute a State Aid that needs to be notified to and approved by the European Commission.

There is another form of discretionary charitable relief (relief for investments) if
- discretionary charitable relief is available in the local authority area in which the development will be situated
- the charity owns a material interest, and
- the whole or greater part (see above) will be held by a charity (or jointly with another charity or charities) as an investment from which profits applied for charitable purposes (whether of the claimant charity or of that charity and other charitable institutions).

However, there is no relief for investments if:
- the charity intends to occupy part of the development for "ineligible trading activities"; or
- the material interest is owned jointly by a charity and a non-charity; or
- if relief would be a notifiable State Aid which must be approved by the European Commission.

"Ineligible trading activities" means trading activities other than the sale of goods donated to the charity where the profits are applied for the claimant charity's charitable purposes.

Charitable relief from CIL must be claimed in a prescribed form and must be received by the local authority before the development commences. The local authority must notify the claimant in writing of its decision on the claim and the reasons for the decision as soon as practicable and, where the relief is granted, the amount of relief granted. Note that the claim will lapse if the development is commenced before the local authority has notified the charity of its decision on the claim and a commencement notice must be submitted before the development commences. Finally, the claim must be made before the local authority withdraws discretionary charitable relief.

The Regulations also include a relief for social housing which is intended to cover certain types of housing use by both charitable and non-charitable developers.

19.7 Clawback of charitable relief

Charitable relief is withdrawn if:
- within 7 years from the commencement of the development the owner of the material interest "ceases to be eligible" for charity relief; or
- the whole of the material interest in the land in respect of which charitable relief was granted is transferred to a person not eligible for charity relief; or
- the lease eligible for relief is terminated before the end of its term and the owner of reversion is not eligible for charitable relief.

If charitable relief is withdrawn, the local authority must be informed of the disqualifying event within 14 days and CIL is payable by the owner of the material interest immediately before the disqualifying event in question.

On withdrawal of charitable relief, the "relevant person" is liable to pay an amount of CIL equal to the withdrawn relief. The "relevant person" means the owner of the an interest in land in respect of which charitable relief was granted immediately before the disqualifying event occurs.

19.8 Discretionary relief for exceptional circumstances

An "exceptional circumstances" discretionary relief allows the local authority to offer relief from CIL where certain conditions are met. Such, relief may be granted where:

- the local authority has made relief for exceptional circumstances available in its area
- there is an agreement under section 106 Town and Country Planning Act 1990 (a "section 106 agreement") has been entered into in respect of the planning permission which permits the development;
- the local authority considers that the cost of complying with the Section 106 agreement is greater than the CIL liability of the development; and
- the local authority considers that to require payment of CIL would "have an unacceptable impact on the economic viability" of the development.

The local authority must also be satisfied that to grant relief would not be notifiable State Aid requiring approval of the European Commission.

19.9 How will CIL be spent?

Money raised through CIL can only be spent on supporting development by funding the provision, improvement, replacement, operation or maintenance of local and sub-regional infrastructure.

According to CLG guidelines, "infrastructure" includes transport, flood defences, schools, hospitals, and other health and social care facilities; and the wide definition allows CIL to be used to fund a very broad range of facilities such as play areas, parks and green spaces, cultural and sports facilities, district heating schemes and police stations and other community safety facilities. This gives local communities flexibility to choose what infrastructure they need to deliver their development plan.

Note that CIL cannot be used to deliver affordable housing.

In London, CIL can only be spent to fund roads or other transport facilities, including Crossrail, to ensure a balance between the spending priorities of the boroughs and of the Mayor..

19.10 State Aid

Legislation for new tax reliefs is being drafted with a condition that the relief will not be available if it is State Aid. This first appeared in the CIL legislation (for which see above); until then reference to State Aid was merely to confirm that State Aid did not apply, as in the case of Research and Development reliefs. As a matter of EU law, tax reliefs are illegal if they constitute a State Aid, so the inclusion of this condition in UK tax relief legislation seems to be superfluous.

State Aid is the giving of financial advantage from a public body or a publicly-funded body to certain undertakings which has the potential to distort trade between EU member states and to distort competition. The State Aid regime is contained in various articles of the EC Treaty, regulations, guidelines and frameworks; and the European Commission has extensive powers to monitor, to control and to prohibit forms of State Aid and must be notified of schemes that involve State Aid. The concept of State Aid is very broad and can potentially include certain tax exemptions or reliefs.

Smaller charities may be able to take advantage of the *de minimis* rule for State Aid, which allows for aid of up to €200,000 in total to be provided in any three-year period. There is a requirement to inform the recipient (ie the charity) that the aid being given is *de minimis* and to keep records of aid given for ten years.

In April 2012 the European Commission issued a further regulation which increases the *de minimis* amount of permitted State Aid for services in the general economic interest to €500,000. Therefore, providing a charity has not received any *de minimis* aid in the last three years and providing it can substantiate that the exemption from CIL was indirectly to support services in the economic interest it may be able to utilise the €500,000 *de minimis* limit.

20 Cross-border giving

Before the Finance Act 2010 HMRC did not allow reliefs for any charitable organisations that were established outside the UK even if such organisations were charitable according to the laws of the UK.

The Finance Act 2010 extended UK charitable tax reliefs to certain organisations in the EU, Norway and Iceland that are equivalent to UK charities. In order to qualify, those entities need to meet the definitions of a charity in the law of England and Wales (not under the law of Scotland or of Northern Ireland even if based in those jurisdictions, because taxation is not a devolved matter) and must be established for charitable purposes *only* as set out in the Charities Act 2011. They must also be registered with any charity regulator in their home country with which the law requires them to register and be managed by "fit and proper persons". The legal requirement initially applied only to Gift Aid but was extended from 1 April 2012 to all other tax reliefs.

The EU Treaties provide for the free movement of capital between Member States and freedom of establishment; and it is therefore a breach of those provisions for a Member State to refuse tax deductions on gifts to charitable bodies within other Member States simply on the basis that they are not established in the Member State in question

- In *Centro di Musicologia Walter Stauffer v Finanzamt München für Körperschaften* [2006] EUECJ C-386/04 (14 September 2006), where an Italian foundation claimed tax relief in Germany on rental income arising from property which it owned in Germany. The German tax authority was held to be in breach for refusing to grant the tax exemption which would have been available to a domestic charity because the claimant charity was based abroad.

- In *Hein Persche v Finanzamt Lüdenscheid* [2009] EUECJ C-318/07 (27 January 2009), a German donor claimed relief on a gift to a Portuguese charity and, as in Stauffer, the German tax authority refused to grant the tax relief which would have been available had the charity been German because it was based abroad; as in Stauffer, the Grand Chamber of the CJEU declared this to be in breach of EU law.

Following these CJEU cases, the burden is on the taxpayer to prove that the organisation would be charitable in the Member State in question, but for its establishment elsewhere; and if the taxpayer can prove this the authority must consider the evidence presented.

The application of these rulings is slightly complicated in practice by the fact that they are not accepted by all EU countries, although some Member States have gradually been adopting the principles over the past couple of years. In addition, just because a charity is recognised as a charity in one Member State that does not mean that it must be accepted as such in each Member State. The charity must be deemed charitable under the rules of the country in which the tax relief is being sought; and the only element which is discounted is the actual establishment of the charity in another EU state.

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The Charity Tax Group (CTG) has over 400 members of all sizes representing all types of charitable activity. It was set up in 1982 to make representations to Government on charity taxation and it has since become the leading voice for the sector on this issue. CTG has persuaded successive Governments to introduce a range of tax reliefs and has also campaigned successfully to protect existing concessions, saving charities a considerable amount of money in the process. For further information about CTG please visit our website at **www.charitytax.info**

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