

## **Written evidence submitted by the Charity Law Association**

### **Introduction**

The Charity Law Association (CLA) has over 1,000 members across the UK – mainly lawyers, but also accountants and charity professionals. It is concerned with all aspects of the law relating to charities.

This submission has been prepared by the CLA's Standing Committee on Taxation. Its members serve in a personal capacity and the views expressed in this submission should not be taken to be the formal opinion of the organisations that they represent. Similarly, the views in this paper should not be seen as constituting the opinion of CLA members as a whole.

The CLA welcomes the opportunity to respond to the call for evidence announced by the Treasury Committee on 22 July 2022. Our comments are concerned mainly with the tax reliefs that are available to charities and their non-charitable subsidiary companies.

### **Summary**

1. Over the years there have been many reviews of various aspects of the UK tax system that involve the grant of reliefs from taxation, most of which have been conducted by HMRC and/or HM Treasury, but in recent times there have been two reviews which focussed specifically on the tax treatment of charities and their supporters and a business rates review that included the reliefs available to charities.

2. The first and most significant review was the HMRC-led "Review of Charity Taxation" initiated by the Labour Government in 1999. The CLA submitted a detailed response to the consultation paper explaining the historical background to the various reliefs and their current justification, which is available on request. In October 1999 HMRC published a summary of the responses that it received, and this was followed by a number of significant amendments to the relevant legislation in the Finance Act 2000.

3. The policy aim was to reverse the decline in charitable giving in the 1990s and to provide charities with a firmer financial basis by improving the tax incentives for charitable giving. In addition to the introduction of a new relief for gifts of quoted shares and securities to charity and the removal of the cap on payroll gifts, the main changes concerned the Gift Aid scheme of relief for monetary donations. By abolishing the minimum limit for Gift Aid donations and providing for a new Gift Aid declaration process the FA 2000 measures essentially created the structure of Gift Aid relief that is in force today. Importantly, these changes did not involve any radical reform of government policy on the granting of charity tax reliefs, which has generally evolved without any political party bias.

4. The second and most recent review was initiated by an independent Charity Tax Commission, which was convened by the National Council of Voluntary Organisations (NCVO) and chaired by a former chair of HMRC. A copy of the CLA's response to this call for evidence is available on request. When the Commission published its report in 2019 it made a number of recommendations that did not involve any major reform of the various reliefs and were intended to be revenue neutral, but to date these have generally not been taken up by government.

5. Since 2015 the government has also been reviewing the structure of business rates including the reliefs available to charities. Most recently the Treasury issued a call for evidence in July 2020, to which the CLA submitted a response in favour of retaining the current rating reliefs for charities. A copy of this submission is available on request.

6. Despite repeated calls by local government bodies for the restriction of the rate reliefs available to charities we believe that the rationale for these reliefs still holds good insofar as the reliefs are conditioned on the use of the property for public benefit, as is currently the case. Moreover, unlike most businesses, charities often operate from their premises for historic reasons rather than by a choice made for business reasons, generally as a result of the trusts on which they were established (e.g. to maintain a building or collection) and which may restrict the charity's ability to dispose of its interest in the property. To date there has been no indication that the government intends to modify the current charity rate reliefs.

### **Comments on the main charity tax reliefs**

7. The values quoted for the various tax reliefs discussed below are taken from the latest available official statistics (*UK charity tax relief statistics*, HMRC, 20 July 2022).

### ***Income and corporation tax***

8. The most important of these areas is the general policy of exempting charities from income and corporation tax on most forms of income. The amount of the exemptions is generally unlimited but this applies only to traditional sources of charity income (e.g. dividends, interest, royalties and primary purpose trading), whereas newer forms of income that are classified as "miscellaneous income" are only eligible for a limited exemption which is capped at an annual amount (currently £80,000). These exemptions are conditional on the income being applied to charitable purposes and are withdrawn to the extent that a charity incurs non-charitable expenditure. The scope of the exemptions and the related restrictions are consistent with similar regimes in most other developed countries (*Comparative Highlights of Foundation Laws*, European Foundation Centre, 2021), and are generally considered to be well administered by HMRC.

9. The key principle underpinning the current tax treatment of charities is that charities should be treated equally by tax legislation. Restricting tax reliefs to certain types of charities is likely to have an adverse effect on charities and their ability to contribute to the UK's civic life. It may also see a decline in the strength and size of the charity sector and its ability to make positive contributions across public life.

10. This principle was also expressed by the CLA in its response to the Review of Charity Taxation in 1999 and the extract from that response below neatly summarises the difficulty we perceive in limiting reliefs to certain types of charity that this may prove short sighted and ultimately detrimental if it hinders the innovation the sector is capable of delivering for the public good:

*“Charity is sometimes attacked for allowing what may be called idiosyncratic gifts. But we believe that to look at the field of charity in this way is to see things in the wrong perspective. The fact that one person may be able if he so thinks fit to choose a purpose that others may not value is a worthwhile price to pay if it enables others to achieve objectives of enormous value. Sir Henry Wellcome’s will [which established the Wellcome Trust] is the paramount example of this principle. One far-sighted individual set up a gift which has changed the lives of millions throughout the world and has in the process helped to contribute more than half the funds currently applied in this country to one of the most vital of all public purposes (medical research). The public gain from encouraging such far-sighted gifts is incalculable.”*

11. Limiting tax reliefs to particular charities may also result in restricting the campaigning and awareness-raising work by charities if such activities were no longer eligible for tax relief. Given the success in recent years of charity campaigns to change policy and law, making this harder for charities to undertake could result in positive social changes occurring less slowly or even not at all.

12. While we disagree with treating charities differently for tax purposes as a matter of principle, the practical difficulties in seeking to draw lines between those charities that should receive tax relief and those that should not are likely to be immense and run the risk that they will have a distorting effect on the work of the charity sector in a way that is detrimental to the public and weakens the charity sector. One of the advantages of all charities being entitled to tax reliefs is that the definition of charity is capable of adapting over time to social and economic changes. Tying tax reliefs for charities to delivering public services would lose that flexibility and perhaps over time if government scaled back public services this would result in a further withdrawal of charity tax reliefs.

13. We have strong concerns that the introduction of selective charity tax reliefs would tend to increase government control over the sector and financial planning would be more difficult if continuing access to charity sector reliefs could not be relied on from one year to the next. Moreover, we doubt whether it would be feasible for the UK to introduce the granting of charity tax reliefs on a selective basis at the present time without raising the difficult question whether the reliefs involve the grant of state aid.

14. South Africa is an example of a country that has had a two-tier system of categorising charities for tax relief purposes since 2002, with a broader category of approved organisations qualifying for exemption from various taxes and a narrower category of organisations that entitle their donors to claim tax relief for their gifts. This system was recently examined in the course of a wider review of the South African tax system by the Davis Tax Committee, which noted that these categories had been amended on no less than five occasions to correct unintended omissions and anomalies. The Committee was sympathetic to the proposal that there should be a single category of all charities, but was unable to support the proposal in the absence of any information as to the probable revenue

costs (Report on the public benefit organisation and the tax system, The Davis Tax Committee, March 2018).

15. In terms of how charity tax reliefs should be seen two key questions are whether fiscal privileges amount to a grant of public money without democratic control, and whether they represent an inappropriate forgoing of tax by the exchequer. Our view is that charity tax reliefs recognise the public benefit provided by charity and the desirability of encouraging gifts to charity. The long history of charity tax reliefs in the UK spanning over two centuries since income tax was introduced demonstrates that parliament has determined that such reliefs should be available to organisations that qualify as charitable in order to pursue their charitable mission and that even with the advent of the welfare state, subsequent reviews of charity taxation have each concluded that it remains desirable for charities to continue to receive tax reliefs and to be treated equally for the purposes of tax legislation.

### **Gift Aid**

16. Gift Aid allows charities to claim tax relief – 25p in the pound – on gifts and donations made by UK taxpayers. If the donor is a 40 per cent taxpayer, further tax relief of 20 per cent (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 themselves (not by the charity). Gift Aid was worth approximately £1.34bn to charities in 2021-22. Higher Rate Relief was worth approximately £540m to individuals.

17. When the then Labour Government completed the last comprehensive review of charity taxation in 1999, it concluded that its preferred method of using tax reliefs to stimulate the sector was to promote the reliefs for charitable giving in general and Gift Aid in particular. The growth in value of Gift Aid tax refunds since the current system was introduced in 2000 evidences the value of this relief to the sector and recently published research commissioned by HMRC suggests that around £560 million of additional Gift Aid could be claimed by existing donors under the current rules (*Charitable giving and Gift Aid research report*, HMRC, 19 March 2018). This report also indicates that many of those that do claim the relief continue to be confused by the conditions that have to be met for a claim to be valid.

18. Relief for charitable donations in other countries is normally given by deduction from taxable income, so the effectiveness of the Gift Aid system is not directly comparable. However, there are suggestions that donors find the Gift Aid rules hard to understand and this seems likely to continue to be the case while the current system remains. The issue is complicated by several recent changes to personal taxation which have resulted in a significant increase in the number of people who pay no income tax at all; not only are they unable to benefit in the future from Gift Aid, they also face the risk of owing the tax required to cover past donations if they inadvertently fail to realise that they are no longer eligible to claim Gift Aid. This problem is likely to be exacerbated if HMRC pursues the donor for the outstanding tax; in many cases charities are willing to settle the donor's tax liability on the basis that this is expedient in the interests of the charity, but we understand that HMRC no longer feels able to accept this practice. We have one suggestion that should help to

mitigate this problem: where a donor has a spouse or civil partner allow either of them to claim the tax relief so that they can choose the best method of splitting relief for their combined donations between themselves. A relief of this kind has been in place in Canada for several years and has proved to be quite popular with donors.

### ***Gift Aid Small Donations Scheme***

19. The Gift Aid Small Donations Scheme (GASDS) allows charities to claim a gift aid-style top-up on small donations, in situations where it wouldn't be feasible to collect Gift Aid declarations, for example where a collection tin or bucket is used. Charities can claim up to £2,000 a year under the scheme (on cash donations of up to £8,000). GASDS was worth approximately £20m to charities in 2021-22.

20. This scheme is structurally different from the other areas under review because it is classified as public expenditure rather than as a tax relief. However, given that it operates in a similar manner to the tax reclaims made by charities under the Gift Aid scheme we have assumed that it is within the scope of the current inquiry.

21. We are aware that there is some dissatisfaction within the charity sector about the operation of this scheme; this may be due to a misconception that the main beneficiaries of GASDS would be smaller charities, when in fact they are more likely to be larger charities that undertake public charitable collections. Disappointment has also been expressed that the take up of GASDS to date has not been higher. This may be due to the fact that when it was introduced in 2012 its scope was restricted to cash donations up to £20; while this condition was easily met by donors putting money in a collection box, it failed to anticipate the growth in use of contactless cards to make small payments and this defect was only remedied by a 2017 amendment to the scheme. The £20 limit increased to £30 in 2019 but is still out of line with the payment limit on several contactless cards.

22. The officially stated rationale of GASDS is that "it enables charities to benefit from a Gift Aid style top up in circumstances where it is not practical or feasible to obtain a Gift Aid declaration". While the Government accepts that this may apply to contactless donations, it does not believe it to be the case for cheques, SMS donations, direct debits or other electronic payments (GASDS - Summary of responses, HMRC, 10 August 2016). If, as it appears, the Government fears that expanding the scope of GASDS risks an adverse impact on the take up of Gift Aid there seems little prospect of significantly increasing the overall sector benefit from GASDS.

23. We are concerned that there is a risk that some charity tax reliefs may not be fully utilised as the pace of digital and technological change increases. The sector is relatively well served when it comes to the development of new fundraising applications, but these platforms will not necessarily operate in a manner that is compatible with the conditions required for tax relief to be claimed on donations. We believe this concern is reflected, for example, in the low value of claims under the GASDS where the Government has insisted on its use to promote cash donations in spite of evidence that many donors, particularly younger donors, prefer to use text donations which are eligible for Gift Aid but only if the donor provides all the details required for a Gift Aid declaration to be valid.

### ***Capital gains tax***

24. Charities sometimes hold assets such as land, property or investments which when sold may be subject to Capital Gains Tax on any profit made. Charities are exempt from Capital Gains Tax if the gain accrued is both applicable and applied for charitable purposes, including the use of funds for the general administration of the charity.

25. This is an important relief both for charities and their donors. In our experience it is rare to find cases where there are problems with the operation of this relief, which we take to be evidence that it is working satisfactorily.

### ***Inheritance tax***

26. Leaving a part or an entire estate to a charity can reduce or eliminate an Inheritance Tax liability as it will not count towards the total taxable value of an estate. The Inheritance Tax rate on a partially taxable estate can also be reduced from 40% to 36%, if 10% of a 'net estate' is left to a charity in a will. Inheritance Tax relief totalled approximately £800m for individuals in 2021-22.

27. The exemption for charitable gifts both during the donor's lifetime and on death is a valuable relief that underpins the fundraising efforts of many charities. We are not aware of any evidence that the relief is not operating as it is intended.

28. It is more difficult to assess the effectiveness of the 36% rate as an incentive to charitable giving since this was only introduced in 2012 and it may be several years before the death occurs of those who have increased their charitable legacies to reach the 10% threshold. We suspect that in most cases potential donors are unaware of the relief and would not be able to determine whether they can benefit from it without expert advice. To this extent the take up of this latter relief is likely to be greatly influenced by the behaviour of the donor's advisers. We incline to the view that it is too soon to be able to reach firm conclusions on the impact of the 36% rate.

### ***Social Investment Tax Relief***

29. Individuals that invest in charities can receive a reduction in their tax bill to provide an extra incentive to socially invest. Social Investment Tax Relief works by reducing the income tax bill of an investor by 30% on shares they buy in Community Interest Companies (CICs) or loans that they provide to charities, CICs or community benefit societies.

30. As SITR was only introduced in 2014 and in practice can only be claimed in the context of what for most charitable organisations will be a relatively complex transaction, it is

inevitable that take up has been slow. Although the Government has extended the scheme to 2023, we think that at present it is too soon to draw firm conclusions about the effectiveness of this relief.

31. One important feature of SITR compared to other charity tax reliefs is that it is available to CICs, which are generally deemed by law not to be charities even if their purposes are otherwise charitable. In practice CICs are often in a better position than charities to make use of SITR as they are able to raise equity as well as debt finance.

32. A particular problem arises where the charity wishes to raise funds to finance an activity carried on by a subsidiary company. Under the current rules it is not possible for the subsidiary to directly raise finance that is eligible for SITR; instead, the investment must be made in the charity itself (which tends to limit the scope for equity finance), and the charity then has to arrange to fund its subsidiary in compliance with the relevant charity law and tax restrictions on such funding. We think it should be possible to relax the current rules to permit investment in a qualifying subsidiary company to be eligible for SITR without creating unintended avoidance opportunities.

### ***Business rates***

33. Business rates are a tax on occupancy, which any charity that owns or rents a property is liable to pay. Charities receive a mandatory relief of 80% of their business rates bill. Local authorities are able to grant discretionary relief on the remaining 20% that charities have to pay, although on average they only receive a further 2.5% relief. Business rates relief was worth approximately £2.38 billion to charities in 2021-22.

34. Property costs are generally the second largest item of expenditure for most charities (after labour costs). Unlike many commercial businesses which can function effectively with little more than an online presence, charities tend to operate on a more personal basis involving individual contact with their beneficiaries. Moreover, the properties that charities occupy may themselves be objects of public benefit insofar as they have cultural or scientific value or otherwise perform a function in the delivery of charitable services. The availability of mandatory business rates relief for premises that are wholly or mainly used for charitable purposes is therefore of great importance to charities throughout the UK.

35. We also believe that there are good reasons to support continued exemption for registered places of worship. In addition to their function as places of worship most religious buildings perform a valuable role as community buildings and their continuing financial viability would be in doubt if the current exemption were to be removed or curtailed.

### ***Value Added Tax (VAT)***

36. Irrespective of the broader structure of the tax system and the reliefs that are available to charities, the charity sector has consistently complained about the disadvantages that charities suffer under the VAT system. A recent survey of the irrecoverable VAT borne by charities estimated the annual cost to the sector to be of

the order of £1.8 billion, a sum that substantially exceeds the estimated value of the sector's VAT reliefs (*The value of VAT reliefs for the charity sector*, London Economics, 2020). Although these costs are inherent in the original design of the tax that is in force in the EU, which limited the scope for individual member states to alleviate the burden, the completion of Brexit has freed the UK from these restrictions so the government is now able to grant new reliefs or improve existing reliefs as it sees fit. However, in the past successive UK governments have cited the cost to the revenue of additional VAT reliefs as a barrier to further reform of the VAT status of charities.

37. Although charities benefit from a few reliefs from VAT on the goods and services that they purchase, the nature of the tax tends to result in their bearing a higher level of irrecoverable VAT than would be the case for an equivalent private sector provider. This is because many charities engage in activities that do not require them to charge VAT on the goods and services that they provide to their beneficiaries because the activities do not constitute a business (e.g. because they are provided free of charge or substantially below full cost) or they are exempt or zero-rated because they are considered to be provided in the public interest). Consequently, this means that the ability of charities to recover the input VAT that they have to pay on their purchases of goods and services is restricted accordingly - with the result that charities tend to have high rates of irrecoverable VAT that adds to the cost of their charitable activities. Unlike the case of commercial businesses it is usually not practicable for charities to pass these costs on to their beneficiaries.

38. Under the current VAT system this burden is only partially relieved, mainly by the various exemptions of goods and services that are provided **by** charities in the public interest and to a lesser extent by the exemption or zero-rating of limited categories of supplies that are made **to** charities. Some of these reliefs are available not only to eligible charities but also to their non-charitable trading subsidiaries, typically where the subsidiary has been established to provide goods or services that would ordinarily be expected to be provided by the charity itself but for the constraints imposed by charity and direct tax law.

39. If an online sales tax (OST) were to be introduced using similar concepts of chargeability and input tax recovery to those currently found in the VAT system we would expect to find similar effects on the charity sector. We would also expect those businesses that supply goods and services that are liable to OST to charities to pass on the costs of their OST compliance to their charity customers in the same way that they are likely to charge their other customers (whether B2B or B2C). Therefore we consider that the introduction of an OST will impose additional irrecoverable costs on the charity sector, whether or not charities are required to charge OST on their online sales.

40. We also note that charities have recently been required to incur significant costs in complying with the introduction of the Making VAT Digital system including the adaptation of their financial systems to provide the required information in the format prescribed by HMRC. If an OST (or indeed any new tax that is applicable to charities) is introduced we would expect the government to want to use a reporting system that is similarly digitally enhanced with a consequent addition to the compliance obligations of the taxpayer.



### ***Stamp Duty Land Tax***

41. Charities can get relief from Stamp Duty Land Tax (SDLT) when they buy land and property for charitable purposes. A charity can claim some relief when they buy land and property jointly with a non-charity buyer with the charity claiming relief on its share of the property. Based on the latest provisional data, SDLT Charities Relief was worth approximately £230m to charities in 2021-22.

42. As noted above, property costs are the second largest item of expenditure in the charity sector after labour costs. The exemption from SDLT (and the corresponding taxes on the acquisition of property in Scotland and Wales) is a valuable relief that we believe is working as intended.

### ***Lottery Duty***

43. Lottery Duty is a 12 per cent duty on tickets in a lottery promoted in the UK. Exemptions from Lottery Duty include non-commercial lotteries, commonly held at charity fund raising events, and small society lotteries promoted wholly on behalf of a society established for charitable purposes.

44. Most charities will qualify for the exemption of society lotteries from lottery duty and it is rare for our members to report any difficulties with the operation of this tax.

### ***Climate Change Levy***

45. The Climate Change Levy (CCL) is a tax on energy delivered to non-domestic users in the UK which aims to incentivise energy efficiency and reduce carbon emissions. Charities are exempt from the Climate Change Levy for premises where at least 60% of activities carried out are classified as non-business.

46. Most charities do not pay large amounts of CCL and it is rare for our members to report any difficulties with the operation of this tax. However, it should be noted that a particular feature of this relief is that it is generally necessary for charities to obtain the agreement of their energy suppliers that they are entitled to relief. We are aware that small charities that are not required to be registered with the Charity Commission often struggle to do so and it would be helpful if central government guidance to suppliers could clarify that mandatory relief is available to unregistered charities.

### ***October 2022***