Under pressure

General Features | Management of taxes



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Claire Perrett and *Tessa Pudge* consider recent tax developments affecting charities

Key Points

What is the issue?

The definition of donation for gift aid purposes was subject to an interesting case (*Champions Fun Learning Centre (a charity) v HMRC*) recently which was considered by the First-tier Tribunal.

What does it mean to me?

The most relevant point for charities to take away from this case relates to whether or not a donor receives any benefit which can be linked directly or indirectly to the donation. If the answer is yes, gift aid may not be available.

What can I take away?

To avoid unnecessary challenges from HMRC for any repayment of gift aid, charities should document what donations have been received and clearly separate out donations where they can be linked to a benefit.

A registered charity can claim back tax that has been deducted on, among other things, donations. This is known as gift aid.

The tightening up of tax rules as they apply to gift aid

The definition of donation was subject to an interesting case recently which was considered by the First-tier Tribunal (FTT). In *Champions Fun Learning Centre (a charity) v HMRC* the FTT found that HMRC could not enquire into claims by a charitable company for repayment of income tax under the gift aid scheme. This was because there is no provision in the Taxes Acts for such an enquiry and so the assessments and penalties were cancelled. Notwithstanding this, it was held that payments by parents to a charity for children’s tuition were not qualifying donations because a benefit was indirectly received by the payer.

Champions Fun Learning Centre (CFLC) operates a tutoring centre in Bristol that promotes the education of children, particularly from ethnic minority backgrounds. Payments were made by the parents of the students, which CFLC treated as donations and reclaimed the associated income tax. HMRC, however, argued that the payments were not ‘donations’ since the payers received tutoring services for their children. The income tax paid therefore could not be reclaimed under the gift aid scheme. Some of the tutors volunteered their services and were reimbursed by cheque for expenses incurred on behalf of CFLC, several of whom did not bank the

cheques as a means of making an indirect donation. HMRC opened an enquiry into the company and issued an assessment and penalties for the reclaimed income tax.

The FTT examined the constitutional documents of the company and the facts surrounding the payments. There was an element of discretion over the method of donation: 15% of parents did not make any payments and some payments were made by people who did not have children attending the centre. In addition, there was only a possibility of a refund if a child did not attend tuition, but this was not guaranteed and CFLC referred to the sums as ‘suggested donations’ rather than tuition fees. The payments also amounted to less than a third of the value of the benefit. The FTT held that the issue was not the discretionary nature of the payments; it was the fact that a benefit was received as a result of the relevant payments. It agreed with HMRC that the payments did not constitute donations because the ‘donor’ received an indirect benefit. When, however, a volunteer chose not to bank a cheque from the charity in respect of expenses incurred on the charity’s behalf, this was a qualifying charitable donation from the volunteer. Issuing a cheque to reimburse the volunteer for expenses is a diminution of the charity’s resources. If that cheque is returned or not banked there is a reversal of the diminution, which amounts to a donation. The income tax reclaim relating to these donations was therefore valid. It is worth adding that the release of a debt has not usually been treated as payment of a sum of money. An FTT decision does not create a binding legal precedent and it would be wise not to rely on this part of the decision.

The FTT went on to find that the enquiry itself could not have been valid since the Taxes Acts do not make provision for an enquiry into requests for repayment of income tax (IT) suffered. There is an entitlement to repayment of IT that is treated as suffered; it is not a ‘claim’, so the provisions for enquiries into claims do not apply. Even if the enquiries had been valid, the assessments arising from those enquiries were for accounting periods that did not exist and the penalty notices were so riddled with errors that the FTT dismissed the penalties in full.

The most relevant point for charities to take away from this case relates to whether or not a donor receives any benefit which can be linked directly or indirectly to the donation. If the answer is yes, gift aid may not be available. If the answer is no, as with the volunteers in this case, it will be treated as a qualifying donation and gift aid should be available. To avoid unnecessary challenges from HMRC for any repayment of gift aid, charities should document what donations have been received

and clearly separate out donations where they can be linked to a benefit. Constitutional documentation should also be reviewed to make sure that the intention behind the donation from the perspective of the charity and donor is clear. It would also be advisable to ensure that all donors understand how the money that is being donated is being treated by the charity.

Other developments in the gift aid space

A change that will affect all trading subsidiaries of charities is the changes to FRS 102 for payments made to parent companies. These changes became mandatory for all accounting periods commencing on or after 1 January 2019. Where a charity undertakes a trading activity, this activity is usually hived down into a trading subsidiary to protect the other exempt income received in the registered charity. In the past, charities with trading subsidiaries would generally accrue for the profits of their trading subsidiaries in the year the profits are realised, with the actual payment being made within nine months of the year end.

Following an ICAEW technical paper, the payment of this accrued income will now be treated as a distribution from the trading subsidiary to its parent and, as such, has to be restricted under Company Law to the distributable reserves of the trading subsidiary. Gift aid can only be accounted for on distributions (i.e. dividends) when paid or when there is a legal obligation to pay. The directors will need to ascertain what the company’s distributable reserves position is, so assuming the distribution is not paid before the year end there is a question as to how ‘a legal obligation to pay’ is defined. Therefore where charities want to claim gift aid on the associated profits realised in their trading subsidiary, they will need to pay profits to the charity in the year, if possible, or, if later, enter into new deeds of covenant to change the gift into a legal obligation.

For completeness it should be noted that Update Bulletin 2 was published on 5 October 2018, amending the Charities Statement of Recommended Practice (SORP) for FRS102. Charities should be aware that the Bulletin provides for some significant changes to the accounting treatment relating to mergers, cash flow reconciliation and investment properties let out to other entities within the same group. Depending on its activities, there may be changes to when expenses are recognised in the profit and loss statement, but there is unlikely to be a major tax impact.

However, it is not all doom and gloom from a gift aid perspective and some minor positive changes for the taxpayer were announced in relation to gift aid in the Budget 2018, namely there will be a relaxation in respect of the administrative requirements for retail gift aid and an increase in the donation limit for Gift Aid Small Donations Scheme to £30.

Generous tax reliefs

Over the recent years, a number of new tax reliefs have been made available for arts, culture and heritage activities. These include: museums and galleries tax relief, orchestra tax relief and creative tax reliefs including film and video gaming etc. Although these reliefs have, in general, been utilised by incorporated entities, charities should be able to claim tax credits in relation to these reliefs if they qualify. This has recently been particularly useful to charities that have been able to offset any budget or grant cuts with the benefits these tax reliefs offer. Given the large number of tax reliefs now available, all charities should be reviewing the activities they undertake and consider whether all relevant tax reliefs are being claimed.

A constant niggle

An issue that comes up time and time again is in relation to income derived from land. There is a very fine line between income that will qualify for the primary purpose test of a charity and income that will not. If a charity holds land for charitable purposes, i.e. the income generated is applied for charitable purposes only then the income is exempt from tax. An example would be rental income. If a charity sells land that has been held as a capital asset any gain will normally be a capital gain and should be exempt, provided the gain is applied for charitable purposes only. However, the issue that arises is where there is a disposal with an overage element to the agreement. The overage payment will be taxed as non-primary purpose trading and not part of the gain. If it is above the de minimis level it will therefore be taxable. Charities should be aware that the non-primary purpose trading de minimis levels were increased in the Finance (No 3) Bill 2018, as shown in ***box 1***.

Image

BOX 1: NON-PRIMARY PURPOSE TRADING DE MINIMIS LEVELS

Annual charity income	Maximum non-primary purpose trading
Under £32,000	£8,000
£32,000-£320,000	25% of income
Over £320,000	£80,000

The charities space is definitely not a quiet area at the moment with tax rate changes, accounting policy updates and cases going through the UK Courts. Charities should ensure that firstly they are maximising their ability to reclaim tax that is owed to them through good internal compliance procedures, clear interaction with donors and structuring their charitable activities correctly. Secondly, and especially in the current environment, charities should ensure that they are claiming the very generous tax reliefs available.

By necessity, this briefing can only provide a short overview and it is essential to seek professional advice, as the tax treatment depends on individual circumstances.