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Consultation: Charities tax compliance

Response by the Chartered Institute of Taxation and Association of Taxation Technicians

1 Executive Summary

- 1.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 19,000 members, and extensive volunteer network, in providing our response.
- 1.2 The Association of Taxation Technicians (ATT) is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible
- 1.3 The charity sector provides a huge contribution to UK society, supporting millions of people in a variety of ways, often filling gaps left by government or commercial enterprises in the provision of services or satisfaction of needs. Further, many charities, particularly smaller ones, are run or substantially resourced by volunteers. These factors provide important context when considering the needs of charities, and any sanctions they should face for non-compliance, and particularly the knock-on effect to the recruitment and retention of trustees and donors. HMRC's Charter standards 'making things easy' and 'being aware of your personal situation' are particularly important to this sector.
- 1.4 The GOV.UK guidance for charities and tax is currently very piecemeal, linking from one piece of guidance to another. It is difficult to find a comprehensive guide to charity taxation or get behind the high-level explanations on GOV.UK to the often-necessary detail. There is a need for improved guidance, both to dispel the widespread view that charities do not pay tax, and clear examples to illustrate the application of what can be complex rules.
- 1.5 With regard to the Tainted Charity Donations (TCD) rules, we would support a closer review of condition B (option 3). However, we would not support the wholesale replacement of the TCD rules (option 1), nor removal of condition B (option 2).

- 1.6 We do not have strong views regarding the proposed changes to the charitable investment rules, because charities should not make investments other than for the benefit of the charity. However, clear guidance will be needed, both in terms of the nature of the investment, and the records to be maintained.
- 1.7 We do not consider that the non-charitable expenditure rules create a 'gap', and we do not support the changes proposed in the consultation.
- 1.8 We do not think it appropriate to withhold charitable reliefs pending submissions of a tax return. This seems excessive, considering that non-compliance might be inadvertent, such an approach would be complex, and similar measures do not exist for commercial enterprises.

2 About us

- 2.1 The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.
- 2.2 The primary charitable objective of the ATT is to promote education and the study of tax administration and practice. We place a strong emphasis on the practicalities of the tax system. Our work in this area draws heavily on the experience of our members who assist thousands of businesses and individuals to comply with their taxation obligations.
- 2.3 The CIOT and ATT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through the CIOT's Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.
- 2.4 The CIOT and ATT draw on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.
- 2.5 CIOT members and Fellows have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA' and 'CTA(Fellow)' respectively, to represent the leading tax qualification. ATT members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively

3 Introduction

- 3.1 The CIOT and ATT are pleased to respond to the HMRC consultation ('the consultation') on charities tax compliance¹. We welcome that this is being undertaken at stage 1 of the tax consultation process and look forward to contributing at further stages on any outcomes of this consultation.

¹ <https://www.gov.uk/government/consultations/charities-tax-compliance/consultation-charities-tax-compliance>

3.2 As outlined above, the CIOT and ATT are both charities and (in theory at least) might be impacted by the consultation's proposals. However, our response is prepared in accordance with our charitable objectives, and in the light of our stated objectives for the tax system, which include:

- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

3.3 We are supportive of steps to prevent the abuse of charity exemptions. However, such steps should:

- a) Recognise the unique nature of the sector; in particular the philanthropic nature of charities' activities, and that they are frequently run or substantially resourced by volunteers. This means that charities are typically risk averse, so that trustees are shielded from personal liability for the charity's liabilities, and the integrity of their income streams. HMRC's Charter standard 'being aware of your personal situation' is of particular relevance to this sector.
- b) Recognise the wider legal and regulatory framework, so that breaches of charity law are prevented through rules and action taken by the Charity Commission, rather than after-the-event measures enforced through the tax system. This is particularly relevant in relation to the non-charitable expenditure proposals outlined below.
- c) Be proportionate, so that they target the egregious behaviour illustrated by the non-compliant few, rather than increasing complexity and risks faced by the compliant many.

4 Preventing donors from obtaining a financial benefit from their donation (Questions 2-4)

4.1 The Tainted Charity Donations (TCD) rules apply where a donor enters into an arrangement with a charity or a Community Amateur Sports Club (CASC) that gives them, or someone else involved in the arrangement, a financial advantage in return for the donation. The rules exist to prevent circular transactions, such as individuals 'donating' money to a charity, obtaining tax relief on the donation, and then receiving a benefit back from the charity. The rules are based on a purpose test which considers the effects of, and circumstances in which the donor or someone connected to the donor, entered into arrangements to make the donation, and to whether the main purpose of those arrangements was to obtain a financial advantage. HMRC say that the rules have proven to be overly complex to apply to certain instances of abusive behaviour and are looking at options to tackle such arrangements without increasing burdens on charities and not targeting genuine donations.

4.2 We would not support the wholesale replacement of the TCD rules (option 1). While there is some complexity to the rules, they were themselves introduced as a replacement for the Substantial Donor rules, which were

at the time considered to be largely unworkable. The TCD rules have been in operation for around twelve years, and we would favour refinement of these rules, rather than their complete reinvention. It is far from clear that a new regime would avoid the complexity of the existing rules.

- 4.3 We would also not support removal of condition B (option 2). Condition B is a fundamental part of the TCD 'tests', and its removal (in the absence of a replacement condition) would significantly extend the scope of the TCD rules. It would also result in much-reduced certainty around their operation, and whether HMRC may challenge a donation.
- 4.4 We would support a closer review of condition B (option 3), such as some tightening of the terms of Condition B around the meaning of financial advantage. Whatever terminology is used (financial assistance or financial benefit or something else), they would need to be clearly defined, and supported with guidance and examples to illustrate whether something is, or is not, within its scope.
- 4.5 We recognise the potential tension between publishing examples of what is 'acceptable', and what isn't, but we reiterate the point that many of those responsible for a charity's tax affairs may be laymen and in need of greater support. In particular, because the rules can be complex, it should be possible to easily associate their charity's arrangements with those in published guidance, so they can quickly determine whether the rules apply to their circumstances.
- 4.6 We consider that most charities should be able to maintain records of any arrangement, such as loans or investments, they make. However, issues can arise where there is a finance 'team' of people responsible for maintaining the charity's various accounting systems. For instance, an individual responsible for dealing with recording the charity's receipts may not be aware that an outgoing payment handled by another member of the finance team is related to the income. This can often be the case in larger charities where there is a segregation of duties within finance teams to minimise the risk of internal fraud.
- 4.7 Additionally, charity guidance provides for donations of up to £10k to be made anonymously, so an individual may not know that a donation has been linked to a payment agreed by a different person. The larger the charity the more likely that there will be a finance team dealing with the various accounting aspects and this segregation of duty could lead to individuals not knowing that transactions are connected.
- 4.8 We understand that auditors and independent examiners often review in some detail related party transactions but there may not be any trigger to alert them to TCDs, thus placing the onus on the charity to ensure that they comply with the legislation.
- 4.9 Again, it should be clear in guidance what types of records should be maintained and what such records should evidence, to satisfy HMRC's Charter standard 'making things easy'.

5 Preventing abuse of the charitable investment rules (Questions 5 & 6)

- 5.1 The purpose of the charitable investment rules is to enable charities to invest excess funds to yield a financial return, allowing them to advance the organisation's charitable aims without treating the investment as non-charitable expenditure which normally restricts a charity's tax exemptions. Legislation outlines a list of 12 types of approved charitable investments for which tax relief is given on any investment-related income. When charities make investments under Type 1 to Type 11, the investment is automatically approved, and is exempt from rules on non-charitable expenditure. This includes investments in land. The final category, Type 12, exempts any expenditure made by charities for a loan or other investment to which an officer of HMRC is

satisfied, on a claim, that it is made for the benefit of the charity and not for the avoidance of tax. HMRC is considering whether to amend the rules to ensure that all approved investments and loans made by charities need to be for the benefit of the charity and not the avoidance of tax. It is intended that genuine charitable investments will not be impacted by a change of this nature.

- 5.2 The charitable investment rules have been in place for many years, and we understand that, on the whole, they work effectively. However, we agree that if abusive investment arrangements exist (such as the example cited in the consultation), steps should be taken to prevent them, although we would favour action being taken by the Charity Commission, rather than through the tax system.
- 5.3 A charity should not make investments under Type 1 to Type 11, or indeed Type 12, other than for the benefit of the charity. This can be a subjective matter, and so changing the rules has the risk of introducing additional risks and complexity. This is particularly the case through programme related and social investments, where the benefit to the charity might be less direct or substantive. Any changes to the charitable investment rules must take these factors into account.
- 5.4 There may be merit in exploring whether any changes could be limited to particular investment types, rather than all eleven. Without sight of evidence of abuse, and regarding which investment types, it is difficult for us to specify which ones. But it may be more appropriate, at least initially, to target any changes to those with the greatest risk.
- 5.5 The consultation states that *‘Whilst we are not proposing for all charities to make a claim to HMRC for Type 1 to Type 11 investments, it is expected that charities will be required, where HMRC has cause to consider the reasons behind the investment, to justify any investment they make and demonstrate how this benefits the charity.’* Because charities are risk averse – trustees (who are volunteers) can face personal liability for a charity’s debts – some form of clearance process will be necessary to ensure charities can obtain HMRC’s confirmation that an investment is for the benefit of the charity. This would be particularly important for those investments where the benefit to the charity is not (purely) a financial one, or if the investment has mixed motives. Clearly, this will require additional resourcing for HMRC (which is why applying it to specific investment types, at least initially, might be preferable). However, it is vital to provide charities with these assurances, to avoid putting further pressures on a sector which already faces significant challenges, and especially so they can continue to recruit and retain trustees.
- 5.6 In the absence of a proper clearance procedure, many charity trustees (concerned about personal liability) may have no option but to apply to the Charity Commission (and/or the Courts) for permission to undertake particular investments. This would be a significant burden for the Charity Commission (and/or the Courts) and be an expensive process. This reinforces the need either to carve-out some of categories 1 to 11 from the proposals, or to have an efficient HMRC clearance system.
- 5.7 In any event, if the government proceeds with its plans, we encourage HMRC to consider publishing examples of investments which both comply with, and fail, the charity investment rules, so charities are able to easily associate their arrangements with those in published guidance, as well as the types of evidence it would expect charities to retain. A well-managed charity should maintain records to justify its investment decisions to meet Charity Commission requirements, which are in large part set out in their guidance², and HMRC’s guidance should supplement that.

² <https://www.gov.uk/government/publications/charities-and-investment-matters-a-guide-for-trustees-cc14/charities-and-investment-matters-a-guide-for-trustees#deciding-what-to-invest-in>

6 Closing a gap in non-charitable expenditure rules (Question 7)

- 6.1 Charities receive tax relief on most types of income provided it is used for charitable purposes. However, when a charity incurs non-charitable expenditure, they lose the tax exemption on the equivalent amount of their income and a tax charge is raised against the charity's 'attributable income and gains' (the type of income or gain that is eligible for tax relief). However, HMRC note that, on certain types of donations, it is possible for the donor to receive relief for the donation, for the charity to not pay tax, and for the charity to then spend the donation on something other than its charitable purpose. HMRC is looking to review the rules around the clawback of relief, which could involve a review of the definition of 'attributable income and gains' (to consider which types of income become chargeable following non-charitable expenditure), and a review the current 6 year carry back restriction.
- 6.2 While we recognise that the current rules have been in existence for many years, they already act to 'assume' that all non-charitable expenditure is met by income that has benefited from a tax relief / exemption. There is no pro-rating across total income, or an ability for the charity to ringfence or attribute non-charitable expenditure to other income sources.
- 6.3 HMRC describe the current position as creating a 'gap', where a charity's total income and gains is greater than its 'attributable income' thus limiting the amount of the excess non-charitable expenditure which can be carried back to earlier years.
- 6.4 It appears to us that the current rules go some way to mitigating the impact of the assumption outlined above ie that that all non-charitable expenditure is met by income that has benefited from a tax relief / exemption. In the example in the consultation, it is likely that the £10,000 legacy income has financed the non-charitable loan, with the remaining £5,000 presumably funded from reserves and therefore preserving the logic that only £5,000 can be carried back against previous income.
- 6.5 We do not consider, therefore, that any 'gap' exists, and we do not support the changes proposed in the consultation.

7 Sanctioning charities that do not meet their filing and payment obligations (Question 8-11)

- 7.1 Most charities are only required to file a tax return every three years, but some charities fail to meet their obligations. Despite this, the same charity may still claim tax reliefs such as Gift Aid (and expect it to be paid). HMRC is seeking views on withholding payments of Gift Aid and disapplying other tax reliefs from charities that have fallen behind on their reporting and filing obligations.
- 7.2 There is a commonly held misconception that charities are completely exempt from tax. This is perhaps more commonly held (though not exclusively) amongst smaller charities. Therefore, even when HMRC issue a notice to deliver a return, it can often be overlooked or ignored as being a mistake or automatically generated, until a penalty notice is subsequently received for non-filing. More needs to be done to dispel this myth and educate charity staff and trustees about their obligations to file returns and the circumstances in which they are required. Again, better guidance, with familiar examples, will help improve understanding.
- 7.3 We are not aware that other areas of the tax code restrict reliefs and allowances where there has been non-compliance. We consider that any such steps would require further consultation, and considering the context

set out earlier, feel it would be an unwelcome step to first introduce such a regime in the charity (rather than commercial) sector.

- 7.4 Any steps taken to withdraw or withhold charitable reliefs could have catastrophic impacts on charities and CASCs. Many are reliant on such reliefs for cash-flow and indeed survival. Any such sanctions should be reserved for the most serious cases of repeated non-compliance and would require a period of transition so that those affected have the opportunity to make alternative financial arrangements. In any event, a series of educational letters, following by a gradual escalation of sanctions, should be considered.
- 7.5 In adopting any sanctions, consideration will need to be given to the where the charity is in regard to its three-year tax return 'cycle'. For example, if charity A is issued with a return in its third year, but fails to submit it, it might lose some of its charitable reliefs in the intervening period. Charity B, in its second year, also hasn't submitted a return (for two years) but continues to claim its charitable reliefs. That might be considered unfair on charity A. HMRC would need to ensure that any steps in this area are consistent with its Charter principles, such as 'treating you fairly' and 'being aware of your personal situation'.
- 7.6 The proposals could also introduce significant complexity, even on the assumption that entitlement to charitable reliefs would be reinstated retrospectively. In any event, some reliefs operate in 'real time'. For example, a charity purchasing advertising may be able to benefit from the VAT zero rate. It would not be feasible to restrict these sorts of reliefs if a charity is late filing its tax return or reinstate them once the return had been filed.
- 7.7 On failing to file a return within the required period, a charity is likely to incur an initial £100 late filing penalty. After receiving such a penalty notice most charities would seek to address any error by filing the return or at least contacting HMRC if they thought that no return was due. Whilst a return may have been filed late, it does not follow that there will have been a potential loss of tax within the return. If this is the case, then denying a charity a much-needed cashflow resource for a £100 penalty would seem disproportionate and unjust.
- 7.8 We do not consider that small charities should be treated any different from larger ones when it comes to dealing with their reporting obligations. It is more likely for small charities to default on filing due to a lack of knowledge and resources. However, in accordance with the HMRC Charter, their individual circumstances should be considered when determining any sanctions.
- 7.9 Whilst the £100 initial late filing penalty is unlikely to cause many charities financial hardship, one way in which charities can be 'compensated' is by ensuring that any penalty for late filing is no greater than any potential loss of tax as a result of the return being filed. This would allow otherwise fully compliant charities to learn from the experience whilst not being financially penalised.
- 7.10 Overall, and as noted above, we believe that increased education is the key to improving compliance. Simple-but comprehensive guidance, YouTube videos and educational webinars will all help increase awareness and, ultimately, compliance.

8 Other comments (Questions 12-15)

- 8.1 We were surprised to find these questions only appeared at the end of the consultation document within the 'summary of consultation questions', after the 'assessment of impacts', and were not referenced in the body

of the consultation. There is a risk that some respondents will not have noticed these questions, and if responses indicate that to be the case then further consultation should be undertaken.

- 8.2 We would reiterate our points above, that charities and CASCs are often run or substantially resourced by volunteers, and would benefit from increased education and guidance, rather than sanctions, regarding their obligations.
- 8.3 We would also like to highlight some apparent inconsistencies which have been raised with us regarding the tax rules for charities and CASCs, and would welcome the opportunity to discuss them further:
- Chapter 2 of Income Tax Act 2007 (sections 413–430) gives relief for some gifts of money to charities by individuals. Section 430(1)(d) extends the meaning of charity to CASCs. Chapter 3 of Income Tax Act 2007 (sections 431–446) gives relief for gifts of shares, securities and real property to charities. However, there is no equivalent provision to section 430(1)(d), and so the provisions in Chapter 3 do not apply to CASCs. This seems anomalous and we consider it needs reviewing.
 - Within Chapter 3, section 433(1)(a) provides relief for a disposal of the whole of the donor's interest in the land, not an undivided share of the freehold. However, section 433(4) provides relief for the grant of an interest in the land in whole or in part. It is not clear why an undivided share in the freehold does not qualify for relief, when something economically similar such as the grant of a 999-year lease in part of the land, would qualify for relief.

9 Acknowledgement of submission

- 9.1 We would be grateful if you could acknowledge safe receipt of this submission and ensure that the Chartered Institute of Taxation and Association of Taxation Technicians are included in the List of Respondents when any outcome of the consultation is published.

The Chartered Institute of Taxation and Association of Taxation Technicians

20 July 2023