



REVIEW OF CHARITY TAXATION CONSULTATION DOCUMENT

HM TREASURY

March 1999

CONTENTS

Foreword		
Chapter 1:	Introduction	1.1
	Government's relationship with charities	1.2 – 1.6
	Trends in giving to charity	1.7 – 1.11
	The consultation document	1.12 – 1.18
	Responding to the consultation document	1.19 – 1.21
Chapter 2:	Supporting Giving by Individuals	2.1 – 2.4
	Deeds of Covenant and Gift Aid	2.5 – 2.10
	Improving Deeds of Covenant and Gift Aid	2.11 – 2.12
	Reducing the minimum limit and allowing payment by instalments	2.13 – 2.16
	Other options for improving Gift Aid	
	Simplifying the requirement for a certificate	2.17
	Harnessing the Inland Revenue's contacts with taxpayers	2.18
	Switching higher rate tax relief from donors to charities	2.19
	UK diplomats and armed forces overseas	2.20
	A US-style relief for giving	2.21 – 2.24
	Payroll Giving	2.25 – 2.26
	Improving Payroll Giving	2.27 – 2.28
	Removing the maximum limit for donations	2.29 – 2.30
	Allowing employers to distribute donations to charities	2.31 – 2.33
	A 'kick-start' for Payroll Giving	2.34 – 2.37
	Other tax reliefs for gifts to charity	2.38
	One-off small donations through street collections, telethons, etc.	2.39 – 2.40
	Gifts of assets	2.41 – 2.42
Chapter 3:	Supporting Giving by Companies and Other Businesses	3.1 – 3.4
	Gifts of cash	3.5
	Deeds of Covenant and Gift Aid	3.6 – 3.8
	Operating a Payroll Giving scheme	3.9 – 3.10
	Gifts in kind	3.11
	Seconding staff to a charity	3.12
	Gifts of assets	3.13 – 3.15
Chapter 4:	Supporting Charity Businesses – Direct Tax	4.1 – 4.5
	The present direct tax system for charity businesses	4.6 – 4.9
	Improving the direct tax system for charity businesses	4.10 – 4.12
	Exempting the profits of small charity businesses	4.13 – 4.14
	Making things easier for charities with subsidiary companies	4.15 – 4.17
	Sponsorship and licensing the charity's name and logo	4.18

Chapter 5:	Supporting Charity Businesses and Activities – VAT and Business Rate Relief	5.1 – 5.2
	Charities and VAT	5.3 – 5.4
	Irrecoverable VAT	5.5 – 5.10
	Keeping VAT rules and reliefs up to date	5.11 – 5.15
	Reforming the VAT and direct tax treatment of fund-raising events	5.16 – 5.18
	Membership benefits	5.19 – 5.23
	Charity advertising	5.24 – 5.27
	VAT and de-registration	5.28 – 5.30
	VAT incurred on National Lottery-funded projects	5.31 – 5.32
	Charity businesses and business rate relief	5.33 – 5.37
	Other taxes	5.38
Chapter 6:	Simplifying the Tax System for Charities	6.1 – 6.5
	Improving the service	6.6 – 6.8
	Charity workers	6.9 – 6.11

FOREWORD

Charities make an enormous contribution to the life of the nation. In fields as diverse as the environment, relief of poverty, provision of health and welfare, religion, the arts and animal welfare, their services and grants help millions. Some may say that charity begins at home. But the overseas work of British charities is vital in fighting famine, providing medical and educational support, and helping eradicate poverty in the poorest countries of the world.

Millions of people give their time, their money or both to charities and other voluntary organisations. In giving, they also gain – a sense of satisfaction, the friendship and opportunities that come with volunteering, and the knowledge that directly or indirectly they are doing good.

In his recent speech to the National Council for Voluntary Organisations, the Prime Minister launched a campaign to “ignite a new spirit of involvement in the community”. We want to see a step change in people’s involvement with the broader community. Based upon the principles of the new Compact, we are building a fresh partnership between government and the voluntary sector.

This Review is concerned with one strand of the Government’s relationship with the sector: the tax system for charities. It is not Government’s responsibility to tell charities how to do their job. Our responsibility is to help create a culture of giving. That requires a tax system that will encourage more people to give more; a tax system that offers effective incentives and is as simple as possible for donors and charities to operate.

In this consultation document, we outline far-reaching proposals to modernise the tax system as it affects charities. I look forward very much to receiving your views.

**PATRICIA HEWITT MP,
ECONOMIC SECRETARY TO THE TREASURY**

INTRODUCTION

- 1.1** Charities touch the lives of millions of people – both those who benefit from their services and grants and those who support their work with their time or money. They also have a significant impact on the economic life of the country. There are approximately 300,000 charities in the UK¹ employing over half a million people and contributing £12 billion of economic activity.

GOVERNMENT'S RELATIONSHIP WITH CHARITIES

- 1.2** It is the Government's aim to create an environment in which charities can succeed. This does not mean raising money for them, or telling them how to do their work. But it requires the Government to create a framework in which charities can concentrate on their core activities. This includes a tax system which is as fair, simple and transparent as possible. And one which offers real incentives to individuals and businesses to give.
- 1.3** We are already looking at a number of issues relating to the environment in which charities operate. We understand and accept in principle the case for reform of the Trustee Investment Act, and are seeking to make progress at the earliest opportunity. And the Charity Commission have begun a systematic review of what is, and is not, charitable under the current law.
- 1.4** However, we realise that the special tax treatment that charities enjoy is of particular importance. The tax system already recognises the vital part that charities play in our national life and the work they do, both at home and further afield. Charities receive over £2 billion of tax reliefs each year, including about £1.1 billion of relief from direct tax, £200 million relief from VAT and the rest in business rate relief. These generous reliefs are important ways in which the Government support charities and encourage people to give.
- 1.5** Our aim is to create a climate of opportunity which helps charities to help themselves. We are already putting this into practice. For example, Millennium Gift Aid – which supports UK charities working on education and anti-poverty projects in the world's poorest countries – is making tax reliefs available to more people. A major media campaign – GIFT AID 2000 – will raise awareness about Millennium Gift Aid. Donors will be able to use the GIFT AID 2000 telephone line, not just to find out more about Millennium Gift Aid, but also to make their donation easily and efficiently in one telephone call.
- 1.6** Charities and the public can find the tax system complex, inconsistent and confusing. It contains two separate sets of rules – for direct tax and VAT – and it is administered by two separate Departments – the Inland Revenue and Customs & Excise. Differences in the rules for direct tax and VAT, and the need to deal with two separate Departments, can mean that the tax system imposes more burdens on charities than is necessary. We therefore want to do more to simplify the tax system for charities.

TRENDS IN GIVING TO CHARITY

- 1.7** Despite the generous tax reliefs for giving, there has been a decline in the number of people giving to charity in the past two decades. Analysis by the Institute of Fiscal Studies shows that the proportion of all households giving to charity fell from over 33 per cent in 1978 to

¹In September 1998, around 187,000 charities in England and Wales were registered with the Charity Commission. The Commission estimates that there are 80,000-100,000 other charities which are exempted or exempt from registration, such as churches, schools and museums. There are approximately 27,000 further charities in Scotland and 7,500 in Northern Ireland.

under 30 per cent in 1996. At the same time, the average size of donations from donors increased in real terms – from £2.24 a week per donating household in 1978 to £3.65 a week in 1996. So more money is coming from fewer donors.

1.8 The most significant fall is among younger households. Among those aged 20-34 the proportion giving to charity fell from 28 per cent in 1978 to 21 per cent in 1993, while among those aged over 50 the proportion giving to charity remained fairly constant. These trends are worrying. There is the potential that younger households who do not currently give to charity might not start giving, with serious consequences for the future income of charities.

1.9 We believe this makes this Review of the current arrangements in the tax system all the more important. Developing the right tax reliefs for giving will help to create a dynamic environment in which more people will be encouraged to give and in which charities can do more to raise funds. That is why the Review has focused on what more the tax system can do to halt the decline in the numbers giving to charity and encourage more people – especially young people – to give.

1.10 To help us understand more about the trends in giving, what motivates people to give and what are the barriers to giving, we will be carrying out further research, alongside the consultation process. The information from this research – and the views of charities themselves – will help us to make the right decisions to improve the tax system for charities.

1.11 The Government now want to consult on options for change designed to help charities by offering greater incentives for donors to give to charity, and by simplifying the tax system for donors and charities. In particular this consultation document looks at:

- ideas for new tax reliefs that will motivate more people to give
- ways to improve the existing tax reliefs for giving to encourage more people – and businesses – to give
- initiatives to promote awareness and take-up of the tax reliefs
- ways of making it simpler for donors and charities to use the tax system.

THE CONSULTATION DOCUMENT

1.12 In the first stage of the Review we received over 3,000 informative and helpful responses suggesting how we can improve the tax system for charities. These responses covered a diverse range of topics and came from individuals and professional advisers as well as charities themselves.

1.13 For the next stage of the Review, we now want to consult on some options for change, designed to ensure that the tax system plays its part in helping to create the right environment for charities.

1.14 In Chapter 2, *Supporting Giving by Individuals*, we explore options for encouraging more people to give through the tax system. We want to know what will work best for donors and charities and help to create a dynamic giving environment.

1.15 Business also has a major part to play in giving to charity. In Chapter 3, *Supporting Giving by Companies and Other Businesses*, we explore some options for encouraging more businesses to give their skills, expertise, equipment and profits through the tax system. We want to know how best to build on the success of the current system and encourage more businesses to give.

- I.16** Many charities are themselves involved in business, either in order to deliver their services or to raise funds. In Chapter 4, *Supporting Charity Businesses – Direct Tax*, we explore options for improving the climate for charity businesses while being fair to the commercial businesses with whom charities may compete.
- I.17** In Chapter 5, *Supporting Charity Businesses and Activities – VAT and Business Rate Relief*, we look at various aspects of the ways that the VAT reliefs work, within the context of European Community VAT law, and where improvements might be made – for example, in relation to fund-raising events.
- I.18** In Chapter 6, *Simplifying the Tax System for Charities*, we look at options for simplifying the tax system for charities, including new ways for the Inland Revenue and Customs & Excise to work together to improve the service they offer to charities.

RESPONDING TO THE CONSULTATION DOCUMENT

- I.19** This consultation document contains points for consideration on the options for change. We want to know the views of charities and other interested parties on these matters before making any decisions. Comments on any of the points for consideration in this consultation document should be sent by 31 August 1999 to:
- Windy Kwok
Inland Revenue
Room 108 New Wing
Somerset House
Strand
London WC2R 1LB
Fax: 0171 438 7134
E Mail address: kwok.ir.sh@gtnet.gov.uk
- I.20** Respondents should give details of any organisation whose views they represent. Unless respondents indicate to the contrary, it will be assumed that they have no objection to their response being made public.
- I.21** A copy of the Draft Regulatory Impact Assessment for this consultation document is on HM Treasury's Internet web-site – www.hm-treasury.gov.uk – or can be obtained from the address above.

2

SUPPORTING GIVING BY INDIVIDUALS

- 2.1** The donations that charities receive from individuals represent a vital part of the income which they need to carry out their work. Chapter 1 referred to research showing a significant drop in the number of households giving to charity, particularly among those in the age range 20-34. If that trend is not reversed it could have a serious effect on charities' ability to meet their objectives in the future.
- 2.2** The tax system has an important part to play in creating a dynamic giving environment – offering real incentives for people to give to charity. That is why there are tax-effective schemes for giving, such as Deeds of Covenant, Gift Aid and Payroll Giving. And it is why last year the Government widened the range of tax-effective ways of giving by introducing Millennium Gift Aid, which is being promoted through GIFT AID 2000.
- 2.3** The tax reliefs for giving must help charities to maximise their income from donations by encouraging high-value giving by high-income donors. But if they are to encourage more people to start giving, they must be modern, flexible and simple for donors and charities to operate. And they must be designed to appeal to all kinds of people – including the young and the lower-paid. That is why GIFT AID 2000 is focused on encouraging young people to start giving.
- 2.4** People give to charity in a variety of ways and the present system of tax reliefs reflects this. While we think it is necessary to preserve a range of options for tax-effective giving, there are gaps and overlaps in the present system, which can make it complex and confusing for donors and charities, which we want to address.

DEEDS OF COVENANT AND GIFT AID

- 2.5** The Deed of Covenant scheme has existed for many years. It involves the donor entering into a legally enforceable commitment – in a deed – to make regular, fixed donations to a charity for a period exceeding three years. There is no minimum or maximum limit on the amount that can be given. The scheme can be quite complex. For example, the deed has to comply with a number of formalities of general law, and there are some tax rules – which have been developed by the courts in judicial decisions and supplemented in statute – that can be difficult to understand and apply.
- 2.6** By contrast, Gift Aid is for one-off donations to charity. There is no legal document involved, although donors have to sign a certificate and give it to the charity. There is no maximum limit for donations, but there is a minimum limit of £250, which must be paid in a single payment.
- 2.7** Millennium Gift Aid, which was introduced in last year's Budget, is a special form of Gift Aid for donations to charities working on education and anti-poverty projects in the world's poorest countries. It is more flexible than the main Gift Aid scheme – the minimum limit for donations is £100, which can be paid by instalments. But it is time-limited – donors must make their £100 donation by the end of December 2000.
- 2.8** Deeds of Covenant, Gift Aid and Millennium Gift Aid all work in a similar way. The amount paid by the donor is treated as a 'net' amount after deduction of basic rate income tax, which the charity can claim back from the Inland Revenue. So, a donation of £1,000 is worth £1,299 to the charity (£1,000 plus basic rate income tax @ 23 per cent, £299). For donors who pay tax at the basic rate that is the end of the matter. Donors who pay tax at the higher rate can claim higher rate tax relief in their Self Assessment tax return (at 17 per cent – the difference between the higher rate of 40 per cent and the basic rate of 23 per cent). So, in the example

above, the donor could claim higher rate relief of £220.83 (17 per cent of £1,299). Donors who pay tax at less than the basic rate, or who pay no tax at all, have to account to the Inland Revenue for tax in respect of their donations so that, overall, the amount of tax relief given is correct.

2.9 Many charities like to mark their appreciation of donations by giving a token benefit in return. There are rules limiting the amount of benefits that donors can receive in return for their covenanted donations and Gift Aid donations. For Deeds of Covenant these rules have been developed by the courts in judicial decisions and supplemented in statute. They can be difficult to understand and apply. Broadly, any benefits received in return for a covenanted donation which exceed a *de minimis* limit will disqualify the donation from relief. In the case of small ordinary membership subscriptions, benefits worth up to 25 per cent of the subscription are acceptable. Under statute, the benefits of entry to view the premises of certain heritage and wildlife conservation charities are also ignored.

2.10 For Gift Aid, the rules regarding benefits are simpler to understand and apply. Benefits worth up to 2.5 per cent of the donation are ignored, provided the total benefits received from the particular charity in the year do not exceed £250. (The VAT treatment of membership benefits is discussed at paragraphs 5.19 to 5.23.)

IMPROVING DEEDS OF COVENANT AND GIFT AID

On Deeds of Covenant, charities told us:

“A large proportion of our income is received through donations made using the covenant...system. However, the covenant system is very onerous to administer and although much has been done to make it easier to operate over the last few years, it does still place a major administrative burden on our charities.”

“Deeds of Covenant are a principal source of income for parishes and it is vital that reliefs for both donors and donee charities are maintained.”

On Gift Aid, charities told us:

“...a large number of potential donors cannot afford to give up to this level (£250) but their one-off gifts should still attract tax relief.”

“Our supporters would like to see a simpler, more flexible approach, alternative to covenants that would allow varied and smaller gifts to be tax effective.”

2.11 It is clear that many respondents find the Deed of Covenant scheme complex and archaic. They have suggested that with more modern forms of regular giving – such as bank standing order and direct debit – there should no longer be a need for donors to have to make a legal commitment in a Deed of Covenant in order for these kinds of donation to qualify for tax relief. Some also said that the requirement to give for a period exceeding three years deters many potential donors, while others said they valued the commitment that donors make under this requirement. Charities commented on the problems they face in getting donors to increase the amount of their donations while the deed is still running or to renew the deed on its expiry.

2.12 The Government agree that the Deed of Covenant scheme is complex and can be off-putting for potential donors. Over the years a number of steps have been taken to simplify the way the scheme operates, but we think there is little scope for significant further improvements.

Instead, we believe that the best way of addressing many of the concerns that have been expressed about Deeds of Covenant is by improving the Gift Aid scheme so that it offers an alternative, modern, flexible relief which donors and charities find attractive and user-friendly, and which is within the reach of the vast bulk of donors and which, over time might become the preferred choice of donors and charities.

Reducing the minimum limit and allowing payment by instalments

2.13

Certain features of Gift Aid – the minimum limit for donations and the requirement for a single payment – have meant that its focus has mainly been on encouraging high-income donors to give, ruling out many potential donors who might prefer to use Gift Aid rather than a Deed of Covenant. We see considerable scope for improving the way Gift Aid works to make it attractive to many more people – especially the young and the lower-paid – and encourage them to start giving. We want to do this by making the scheme more flexible and simpler to operate.

2.14

Whilst it is too early to evaluate Millennium Gift Aid fully, we already see a strong case for extending to the main Gift Aid scheme the additional flexibilities that are built into Millennium Gift Aid, when that scheme comes to an end on 31 December 2000.

2.15

This would involve reducing the minimum limit for donations to £100 and allowing payment to be made by a series of smaller instalments over a period. In this way Gift Aid could be brought within the reach of many more people – especially the young and the lower-paid – who may not be in a position to make large one-off donations. But, of course, one-off donations of £100 or more would also qualify for tax relief. Millennium Gift Aid offers a valuable opportunity to see how such changes might work in practice and we want to hear now from charities involved in Millennium Gift Aid about how it is working.

2.16

In the future it might be possible to reduce the minimum limit even further – below £100. We would welcome views on this idea, and on where the minimum limit might be set.

Points for consideration

- (i) Would more people – especially the young and the lower-paid – be encouraged to start giving to charity if, after 31 December 2000, the minimum limit for Gift Aid was reduced to £100 and donors were allowed to pay by instalments? We would particularly like to hear from charities that are involved in Millennium Gift Aid about how it is working.**
- (ii) Would people welcome a further reduction in the minimum limit in the future? Where should the limit be set?**

OTHER OPTIONS FOR IMPROVING GIFT AID

Simplifying the requirement for a certificate

2.17

We also want to encourage more people to give through Gift Aid by making it simpler for donors and charities to operate the scheme. At present donors have to sign a paper certificate and give it to the charity. With immediate effect, the Inland Revenue are amending the certificate so that it no longer has to include the donor's National Insurance Number and tax office reference number. And we want to explore whether donors and charities would be attracted to paperless alternatives to the certificate. For example, allowing donors to send their certificates electronically by using the Internet. Or allowing charities to take details over the telephone, without the need for the donor to sign a certificate. We would welcome views on these ideas.

Harnessing the Inland Revenue's contacts with taxpayers

- 2.18** Some respondents suggested that the Inland Revenue should do more to use its contacts with taxpayers – for example through the Self Assessment tax return – to remind them that they can get relief for giving through Gift Aid. One idea put forward was that, as well as this reminder, the return should offer taxpayers the opportunity, if they made a donation before sending in their return, to get their higher rate tax relief in the year to which the return relates, i.e. the previous tax year. The Inland Revenue intend to put a reminder on the Self Assessment tax return in the future. But we want to consider further the idea of a carry-back of higher rate tax relief – we are concerned that it would introduce complexity for donors and increase the risk that they will make errors in their tax return. We want to hear from donors and charities whether they think this facility would be useful.

Switching higher rate tax relief from donors to charities

- 2.19** Some respondents suggested switching the benefit of the higher rate tax relief from the donor to the charity. We are not attracted to this because we are concerned that it would be a serious disincentive to giving by high-income donors and would have an adverse effect on the level of giving. It would also add complexity to the tax system for both donors and charities and would be very difficult to operate in practice. We do not therefore propose to take this forward.

UK diplomats and armed forces overseas

- 2.20** UK diplomats and people in the armed forces serving overseas are currently unable to make Gift Aid payments. We do not see any good reasons for continuing to exclude them from Gift Aid and propose to extend the scheme to them as soon as practicable.

Points for consideration

- (iii) Would certification by Internet and telephone make Gift Aid more user-friendly and encourage more people to give through the scheme?
- (iv) Would more people – particularly higher rate taxpayers – be encouraged to give if they were reminded about Gift Aid when completing their tax return?
- (v) Would an option to carry back higher rate tax relief to the previous tax year be useful, without adding undue complexity for donors?

A US-STYLE RELIEF FOR GIVING

- 2.21** In the United States donors make 'gross' payments to charity and claim all of the tax relief in their tax return. The US system limits the amount of tax-effective donations that can be made by an individual in any tax year to 30 per cent or 50 per cent of their adjusted gross income, depending on the type of donation and the type of organisation to which the donation is made. This contrasts with Deeds of Covenant and Gift Aid in this country, where the benefit of the basic rate tax relief goes to the charity and where there are no maximum limits for donations. Payroll Giving (see paragraphs 2.25 to 2.26) does, however, operate in such a way that all of the tax relief goes to the donor, and has a maximum limit for donations (£1,200 a year).

- 2.22** The idea of moving to a US-style relief was raised by a number of respondents. The key issue is whether moving to such a relief, where all of the tax relief goes to the donor, would encourage more people to give to charity, and would encourage them to increase the amount that they give. We received conflicting responses on whether a US-style relief would achieve

these objectives. Many respondents were concerned that people would not increase the amount that they give sufficiently to compensate charities for the loss of the benefit of the basic rate tax relief.

2.23 Moving to a US-style relief across the board would in any event not be practicable in the UK because far fewer people receive an annual tax return here. It might, however, be practicable to introduce a US-style system as a further option, alongside Deeds of Covenant, Gift Aid and Payroll Giving, for people who receive a Self Assessment tax return – such as the self-employed and higher rate taxpayers. So we want to consider whether offering a US-style relief alongside the existing reliefs would achieve the objective of encouraging more people to give more.

2.24 We propose to do more research into the likely effects of such a relief on the motivation of donors. In the meantime, we want to hear from as wide a range of donors and charities as possible whether they think such a relief would be a useful addition to the range of tax-effective ways to give to charity.

Points for consideration

- (vi) Would a US-style relief, operating as an option for donors alongside the existing tax reliefs, encourage more people to give, and encourage them to increase the amount that they give?**
- (vii) Would a further relief such as this add undue complexity to the tax system?**

PAYROLL GIVING

2.25 Payroll Giving can be used by employees (and pensioners in employers' occupational pension schemes) to give to charity. Employees can authorise their employer to deduct charitable donations from their pay. There is no minimum limit for donations, but there is a maximum limit of £1,200 a year. Because donations are deducted before Pay As You Earn tax is calculated, the employee gets all of the tax relief for the donation at his or her top rate of tax. This contrasts with Deeds of Covenant and Gift Aid, where the benefit of the basic rate tax relief goes to the charity and only the higher rate tax relief goes to the donor. And, unlike for Deeds of Covenant and Gift Aid, there is no risk that the donor will have to account for tax to the Inland Revenue in respect of the donation.

2.26 The employer passes on employees' donations to an agency charity (approved by the Inland Revenue) which in turn distributes them to the charities chosen by the employees. Unlike for Deeds of Covenant and Gift Aid, there is no need for the charities to make repayment claims to the Inland Revenue.

IMPROVING PAYROLL GIVING

2.27 As with the other tax reliefs for giving, our objective with Payroll Giving is to encourage more people to give to charity. We agree with the views expressed by many respondents that the performance of Payroll Giving has been a disappointment. In the tax year 1997/98 there were some 9,000 Payroll Giving schemes in operation, with around 370,000 people giving £27 million. That means that less than 1 per cent of employers operated a scheme and less than 2 per cent of employees gave in this way.

2.28 We believe that Payroll Giving has more potential to promote giving through the wage packet – especially by the young and lower-paid – and provide charities with a large pool of committed givers.

The Children’s Promise – a nation-wide initiative set up by Marks and Spencer and the New Millennium Experience Company – is an example of an innovative way in which Payroll Giving can be used. The scheme encourages employees to donate their final hour’s salary in 1999 to children’s charities.¹

To help employers, employees and charities to maximise the potential of Payroll Giving, we see scope to improve and simplify the scheme. And we want to consider some innovative ways of promoting the scheme.

Charities told us:

“The Payroll Giving scheme has enormous potential for the future and....maximum effort should be made to encourage more employees and companies to use this scheme.”

“Those work-forces which support particular charities should....be able to pay the money direct to the charity.”

Removing the maximum limit for donations

2.29 Some respondents suggested that the maximum limit for donations under Payroll Giving should be increased significantly, possibly linked to a percentage of earnings – say 10 per cent. Others told us that the maximum limit should be abolished altogether.

2.30 We believe that a five-fold increase in the maximum limit to £6,000 could be introduced within the structure of the existing relief. But we are considering going further than this and removing the limit altogether. Such a step would, however, require the introduction of new compliance rules to make sure that the scheme is not misused. This would include, for example, introducing rules which restrict the benefits that donors can receive in return for their donation. We would welcome views on this proposal.

Allowing employers to distribute donations to charities

2.31 Some respondents told us that employers should be able to distribute donations direct to the charities nominated by their employees, without the requirement to use an agency charity. They said that this would reduce delays in distributing donations and enable employees and their chosen charities to build a more direct relationship with each other. A few employers have already effectively done this by setting up their own agency charities. But many employers are likely to be discouraged by the administrative costs unless they can limit the range of charities that employees can nominate.

2.32 We are attracted to the idea of allowing employers to distribute donations direct to charities nominated by the employees, without the need to use an agency charity, if they wish. Under this approach, employers would be able to limit the range of charities available for nomination by employees. We think this might encourage many more employers to offer a Payroll Giving scheme. It should enable closer links between employers, employees and charities. For example, employers might develop a relationship with a number of charities, including local charities, with which their work-force can identify and in this way build closer links with the community.

2.33 However, we are aware that this proposal would restrict employees’ freedom to choose which charities they wish to support. And it would require employees to disclose their choice to their employer, which some may not wish to do. We therefore want to hear views on whether this proposal would act overall as a positive boost to Payroll Giving.

¹The telephone number for The Children’s Promise is: 0870 607 1999.

A 'kick-start' for Payroll Giving

- 2.34** We know that in some organisations Payroll Giving is being used with great success – encouraging employees to give to charity and building solid partnerships between employers, employees and charities.

NatWest Group's Payroll Giving scheme, Charity Plus, has captured the imagination of its staff. Since its launch in 1994, the number of people taking part has grown from an original base of 300 to 8,000. Donations are made to some 1,600 beneficiary charities who between them now get £1.5 million each year.

The success of the NatWest Group's scheme is due partly to enthusiastic marketing and communication of the scheme and partly to the matching of individual donations by the NatWest Group. In 1999 NatWest will match all donations up to £10 per person per calendar month.

Staff find it easy and tax-effective to donate in this way and are attracted to the idea that, through employer-matching of their donation, they can also direct a small part of what NatWest does for the community to the charities they themselves want to support.

- 2.35** It is good practice for employers to match their employees' donations through Payroll Giving, as the example above illustrates. Employers can already get tax relief for such donations as an allowable expense of their business or through Gift Aid. In addition, they can get tax relief for the costs of administering a Payroll Giving scheme. And, if they sponsor the agency charity's costs, they can get relief for those costs as well.

- 2.36** We want to encourage more employers to offer a Payroll Giving scheme to their employees. And we want to build on the kind of best practice highlighted in the example above to ensure that employers, employees and charities together make the most effective use of the scheme. Many respondents said that there needs to be a publicity campaign to increase awareness and take-up of Payroll Giving. We think this is a good idea and we would be interested in the Inland Revenue joining in partnership with employers and charities in such a campaign. As part of any campaign, the Inland Revenue could also look at ways of harnessing its existing contacts with employers and employees through the Pay As You Earn system to promote Payroll Giving. And we could look at ways of spreading best practice, perhaps with the support of some of the organisations which are using Payroll Giving so successfully.

- 2.37** Allied to a publicity campaign involving the Inland Revenue, employers and charities, we are considering introducing a special supplement of, say, 10 per cent of the amount given to charities through Payroll Giving for a limited period of, say, two or three years. This could provide a real 'kick-start' for the new, more generous scheme – encouraging more employers and charities to promote the scheme, and more employees to give through it. We think that this sort of initiative would extend giving through the wage packet – especially by the young and lower-paid – and provide a lasting increase in the number of people giving in this way.

Points for consideration

- (viii) Would charities, employers, donors and agency charities welcome the abolition of the maximum limit for Payroll Giving donations, even if it was necessary to introduce new compliance rules to prevent abuse of the scheme? Would this encourage more people to give more under the scheme?**
- (ix) Would employers welcome the proposal that they should be able to deal direct with a range of charities without the need to use an agency charity? What are the views of everyone on whether the advantages of this step would outweigh the disadvantages?**

- (x) Would employers and charities be interested in joining in partnership with the Inland Revenue in a campaign to 'kick-start' Payroll Giving?
- (xi) Would a time-limited special supplement of 10 per cent for two or three years, alongside such a campaign, encourage more employers and charities to promote the scheme and more employees to give through the scheme?

OTHER TAX RELIEFS FOR GIFTS TO CHARITY

- 2.38** In addition to the reliefs from income tax for giving, there are reliefs from Inheritance Tax and Capital Gains Tax for gifts to charity. Bequests, legacies and lifetime gifts to charity – whether in cash or in assets – are generally exempt from Inheritance Tax. And gifts of assets to charity do not give rise to chargeable gains for the purposes of Capital Gains Tax.

ONE-OFF SMALL DONATIONS THROUGH STREET COLLECTIONS, TELETHONS, ETC.

- 2.39** The present system does not give tax relief for all donations by taxpayers. In particular, most donors and charities are unable to claim relief for spontaneous, one-off, small donations given through street collections, telethons, etc. Some respondents were concerned about this and suggested that charities should be able to claim back tax in respect of all such donations by taxpayers. Others wanted the Government to compensate charities for the fact that they could not get tax relief for these donations.

- 2.40** We do not think it would be practicable to introduce a tax relief or a compensation scheme for all spontaneous, one-off, small donations given through street collections, telethons, etc. Nor do we think that these would lead to a long-term increase in giving. We do not therefore propose to take these ideas forward. However, the proposals above for improving Gift Aid should go some way to closing the gap in the present system by allowing more small donations to qualify for tax relief.

GIFTS OF ASSETS

- 2.41** While there are comprehensive Inheritance Tax and Capital Gains Tax reliefs for gifts of assets, the present system does not give income tax or corporation tax relief for the cost of most gifts of assets. (But see paragraph 3.14 for gifts of trading stock and equipment by businesses to certain charitable causes.)
- 2.42** Some respondents suggested that there should be an income tax relief for the costs of assets given to charity. We are not attracted to this. We think there would be real difficulties in arriving at objective valuations of paintings, collections of papers and many other kinds of asset. And we are mindful of the abuse that has been seen in other countries that have such reliefs. At paragraph 3.15, however, we announce a proposal to extend the existing relief for donations of trading stock and equipment by businesses.

3

SUPPORTING GIVING BY COMPANIES AND OTHER BUSINESSES

- 3.1** In 1996/97 total support for charities from the top 500 corporate donors was over £305 million, a rise of nearly 11 per cent on the previous year¹. The total corporate donations made under the Gift Aid scheme in 1996/97 was nearly £205 million, a rise of over 21 per cent on the previous year².
- 3.2** The Government want to encourage more businesses to give their skills, expertise and resources to help charities. The tax system has an important part to play in providing incentives for businesses to give to charity and in making it as easy as possible for them to do so. That is why there is a range of options for tax-effective giving by businesses, whether for donations of cash, or for secondments of staff, or for gifts in kind.
- 3.3** We also want to encourage more businesses to promote giving among their employees. There are incentives in the tax system to encourage employers to do this. They can get tax relief for the costs of operating a Payroll Giving scheme and sponsoring a Payroll Giving agency charity. And they can get tax relief for any ‘matching’ donations they make to charity.
- 3.4** The existing tax reliefs for businesses are almost comprehensive, so in many ways the challenge now is to encourage more businesses to take advantage of the reliefs already available to them. There is, however, room for some further improvements to make it even easier for businesses to give more. At paragraph 3.15 we describe a change we are introducing now. Indeed, many of the options for change in the previous chapter, on giving by individuals, apply equally to giving by businesses.

GIFTS OF CASH

- 3.5** Companies can already get full tax relief for gifts of cash to charity. Some donations by businesses – especially those made by large companies – can be treated as allowable expenses of the business and deducted when computing the profits of the business for tax purposes. In these circumstances there is no need to use a Deed of Covenant or Gift Aid, or to deduct basic rate income tax from the donations. Businesses can also get tax relief for gifts of cash under the Deed of Covenant and Gift Aid schemes.

DEEDS OF COVENANT AND GIFT AID

- 3.6** The Deed of Covenant and Gift Aid schemes, as they apply to individuals, are explained at paragraphs 2.5 to 2.10. For companies, the main differences are:
- they always have to account to the Inland Revenue for the basic rate income tax they deduct from their donations (which, of course, the charity can claim back from the Inland Revenue)
 - they get full tax relief by deducting the gross donations in their Corporation Tax return.

For example, if a company wishes to give £1,000 to charity it deducts basic rate income tax of £230 (£1,000 @ 23 per cent), accounts for the £230 to the Inland Revenue, and pays the ‘net’ donation of £770 to the charity. The charity claims the £230 back from the Inland Revenue and the company deducts the gross donation of £1,000 in its Corporation Tax return.

¹ *Dimensions of the Voluntary Sector* (Charities Aid Foundation, 1998)

² *Inland Revenue Statistics* (1998)

- 3.7** Some respondents asked for Gift Aid to be simplified by abolishing the requirement for companies to deduct basic rate income tax from their donations and allowing them to pay their donations 'gross'. Unfortunately, arrangements in the past permitting the payment of 'gross' covenanted donations by companies were used in tax avoidance schemes which resulted in loss to the Exchequer and damaged the public's faith in charities generally. We are therefore not attracted to allowing 'gross' donations in the Deed of Covenant scheme or the Gift Aid scheme. This issue does not arise when the donations can be treated as an allowable expense of the business.
- 3.8** We do, however, want to build on the existing arrangements in the Gift Aid scheme. Chapter 2 looked at some proposals for improving Gift Aid as it applies to individuals. We envisage that most of these improvements would extend equally to the scheme as it applies to companies. We also explore at paragraphs 4.16 to 4.17 the possibility of improving the flexibility of Gift Aid for subsidiary companies of charities.

OPERATING A PAYROLL GIVING SCHEME

- 3.9** Payroll Giving is an easy and effective means of giving. Employers' costs of operating a Payroll Giving scheme are allowable expenses of their business. There is also a specific tax relief for businesses which sponsor the costs of a Payroll Giving agency charity. Employers can simply deduct these costs when computing the profits of their business.
- 3.10** Employers can encourage their employees to give through Payroll Giving by matching the donations that their employees make. This can help to build a partnership between employers, employees and charities – for example, with local charities. Employers and employees alike can see directly the benefits that their donations provide for the community. And by operating the scheme in this way, employers can empower their employees by effectively putting decisions about which charities the business should support in their hands. It is straightforward for employers to get tax relief for these matching donations – they can simply deduct them as an allowable expense of their business or use Gift Aid.

GIFTS IN KIND

- 3.11** We believe that, as well as giving cash, businesses should be encouraged to give their skills, expertise and other resources. The tax system already contains some important tax reliefs designed to do this. For example, there is a special tax relief for businesses which donate trading stock, and equipment like computers, to certain kinds of charitable cause.

Seconding staff to a charity

- 3.12** Many businesses give by seconding employees to a charity and bearing all of the payroll costs of these employees – salaries, pension contributions, etc. This is a valuable way for charities to get access to free private sector expertise and professionalism to support their work. And it is also often valuable for the personal development of the employees and thereby, indirectly, for the employer's business. Businesses can get tax relief for all of the payroll costs of seconded staff as allowable expenses of their business.

Gifts of assets

- 3.13** We want to encourage gifts of assets. These gifts can provide valuable support for charities. As with gifts by individuals, businesses can get full relief from tax on any capital gains arising when they give assets to charity. The difficulty involved in valuing assets, and the potential for tax avoidance, means that businesses cannot get tax relief for the costs of some kinds of asset that they give to charity.

- 3.14** However, businesses can get tax relief for the costs of gifts of trading stock and equipment which they sell or use in the course of their business. This can include items such as computers, photocopiers, minibuses and furniture. The relief does not, however, apply to gifts to all charitable causes. It has long been available for gifts to schools and colleges in the UK. And in last year's Budget it was extended to gifts to charities to be used for medical purposes or by schools and colleges in the world's poorest countries.
- 3.15** We propose to extend the scope of the tax relief to cover any charitable cause, as part of the Chancellor's Budget measures this year.

4

SUPPORTING CHARITY BUSINESSES – DIRECT TAX

- 4.1** This chapter looks at how the tax system can do more to support charities that run a business. It covers direct tax (income tax and corporation tax).
- 4.2** Many charities run a business as part of carrying out their charitable work. Many also run a business to raise funds for their work. In the past, charities relied primarily on donations, legacies, investment income and grants to provide funds. But in recent years profits from running a business have increasingly formed an important part of their income. We want to support charity businesses, and the tax system already contains a number of reliefs for them. However, there are a number of important issues to be borne in mind when considering the direct tax treatment of charity businesses.
- 4.3** Firstly, charity law itself prohibits charities from running a business themselves on a substantial or regular basis for fund-raising purposes. This is because there is an expectation that a charity's income will be used for its charitable purposes or invested prudently, rather than being risked on a business venture. So, many charities separate out their fund-raising businesses into a subsidiary company so that the charity's assets are protected from the risks of the business.
- 4.4** Secondly, some charity fund-raising businesses compete with commercial businesses – particularly small businesses. The most visible example is charity shops. These have become a familiar feature of the high street – there are around 6,300 charity shops in the UK with a combined annual income of £350 million. Some small independent shopkeepers have said they are concerned that their livelihoods may be put at risk by charity shops, especially those that buy in and sell new goods. They complain that further tax reliefs for the profits of charity shops would give charities an unfair competitive advantage.
- 4.5** As far as possible, we want the direct tax treatment of charity businesses to be made simpler and fairer, and to support charities in maximising their opportunities and carrying out their charitable work. At the same time it is important that we respect the requirements of charity law and take account of the need to maintain fairness between charity businesses and other businesses.

THE PRESENT DIRECT TAX SYSTEM FOR CHARITY BUSINESSES

- 4.6** In practice, provided certain conditions are met, all of the profits of a charity's business activities are generally relieved from direct tax. For businesses carried on directly by the charity there is no charge to tax on any profits if:
- the charity is actually carrying out its primary charitable purpose through the business – for example, holding an exhibition in a museum in return for admission fees – the 'primary purpose' exemption
 - the work of the business is mainly carried out by beneficiaries of the charity – for example, a workshop for disabled people making furniture
 - the profits arise from the sale of donated items
 - the profits arise from a fund-raising event falling within the Inland Revenue's concession.

4.7 In determining whether the profits of a business are exempt under the primary purpose exemption, the Inland Revenue will disregard any non-primary purpose element, provided the turnover from this element:

- is small in absolute terms, and
- is less than 10 per cent of the turnover of the whole business.

4.8 The Inland Revenue's concession for fund-raising events relieves from tax the profits of many small-scale events which charities or voluntary organisations arrange in order to raise funds for charity. To qualify for the concession, events must not be carried on regularly or be in competition with other businesses. The public must be aware that the proceeds of the event will go to charity.

4.9 For businesses carried on through a subsidiary company there is also generally effective relief from direct tax. The company is taxable on the profits it makes. But, in the same way as any other company, it can donate those profits to its parent charity under the Deed of Covenant scheme or the Gift Aid scheme and get full tax relief for its donation so that there is no tax to pay. In this way, the charity effectively ends up with the profits of the business without suffering any tax.

Charities told us:

“...The Treasury seems content to allow such income to escape the tax net by allowing the trading subsidiary to pass their income to the parent charity, but has left in place a cumbersome vehicle to achieve this. ”

“.....Besides the professional fees such as audit, legal and taxation, we have two sets of costs for stationery, board meetings and the running costs of maintaining two separate functions.”

IMPROVING THE DIRECT TAX SYSTEM FOR CHARITY BUSINESSES

4.10 Many charities told us that all of the profits from charity businesses should be exempt from tax. They pointed out that most charities with taxable business profits were using the subsidiary company route anyway, so at the end of the day no tax was being paid on those profits. They did not think that charities should have to face the administrative burdens and costs of setting up and operating a subsidiary company and using a Deed of Covenant or Gift Aid.

4.11 We accept that using the subsidiary company route can be a costly administrative burden for charities – especially for small charities carrying on a small business. Some larger charities, however, are often attracted to using a subsidiary company for good commercial reasons. We have thought very carefully about exempting all of the profits of charity businesses from tax, but we do not think we can go as far as this. Charity law, for good reasons, prohibits charities from running a business themselves on a substantial or regular basis for fund-raising purposes, and the tax system for charities has to reflect this. And it has to acknowledge the interests of small businesses, which would have concerns about any special exemptions for charity business profits.

4.12 But we see scope to take a number of important steps to improve the tax reliefs for charity businesses:

- we are considering introducing a new tax relief to exempt the profits of small businesses carried on by charities, without the need for a subsidiary company

- we are considering extending the scope of the concession for charity fund-raising events, so that it applies to a wider range of events, and aligning it with the VAT relief to make the tax system simpler for charities – this is covered at paragraphs 5.16 to 5.18
- for those charities which would still have to use the subsidiary company route, we are considering how we might make the current arrangements more flexible
- we plan to produce clearer guidance for charities on the tax treatment of income from sponsorship and licensing their name.

EXEMPTING THE PROFITS OF SMALL CHARITY BUSINESSES

4.13 We recognise that many charities – especially small ones – wish to do no more than sell Christmas cards or raise funds from occasional small-scale business activities. But they are put off from doing so because they do not want the administrative burden of setting up and operating a subsidiary company – or simply cannot justify the costs. To help these charities we are considering introducing an exemption from tax for a *de minimis* level of direct business activity. This should offer a major improvement in the tax system for these charities.

4.14 We are considering how a *de minimis* exemption might work. We think it should operate by reference to the annual turnover of the business, rather than, say, the level of profits. To satisfy charity law, we think that there should be a modest monetary limit, together with a ‘proportionality test’. This means that the *de minimis* level would be set at £*x* of annual turnover and no more than *y per cent* of the charity’s total income from all sources. We want to receive people’s views on where these limits should be set. It would, of course, be necessary to consider whether the existing practice on ‘mixed’ primary purpose businesses described at paragraph 4.7 might have to be reviewed to take account of any general *de minimis* exemption.

Points for consideration

- (xii) **Would a *de minimis* exemption for charity businesses improve the climate for charities – especially small charities – that carry on small, occasional business activities, while respecting charity law and the interests of other small businesses?**
- (xiii) **How, and at what levels, should this *de minimis* exemption operate? How should the exemption deal with the situation where the turnover of a charity’s business activities fluctuates from year to year around the *de minimis* level?**

MAKING THINGS EASIER FOR CHARITIES WITH SUBSIDIARY COMPANIES

4.15 A number of respondents made suggestions for changing the way in which the tax system operates in relation to subsidiary companies of charities. We found real difficulties with some of these suggestions:

- Allowing subsidiary companies to build up their working capital by retaining tax-free profits. This would amount to a special exemption from tax for the profits of subsidiary companies of charities and, for the reasons stated at paragraph 4.11, we are not attracted to doing this. Companies that are not owned by charities would view this as an unfair competitive advantage.
- Creating a new relief for subsidiary companies of charities so that they do not need to use a Deed of Covenant or Gift Aid to get tax relief when they pass their

profits to their parent charity. The change that we are considering for Gift Aid (see paragraphs 4.16 to 4.17) should make this relief more flexible for subsidiary companies of charities. We do not think there is a significant need for a further tax relief, which would add considerable complexity to the tax system.

- Allowing subsidiary companies to pay covenanted donations and Gift Aid donations ‘gross’ to their parent charity, without the need to deduct and account for basic rate income tax. For the reasons stated at paragraph 3.7 we are not attracted to doing this.
- Allowing loans to, and the purchase of shares in, a subsidiary company by a charity automatically to be qualifying investments for tax purposes, without the need to show that they are made for the benefit of the charity and not for the avoidance of tax. The rules on qualifying investments were introduced in 1986 to counter tax avoidance involving charities and we do not wish to relax them at this time. In any event, these rules reflect the trustees’ duty to take care when considering investing in a business venture carried on by a subsidiary company. We believe it is right for tax law to reflect charity law on this point.

4.16 Some respondents welcomed the increased flexibility that was introduced into the Deed of Covenant scheme for subsidiary companies of charities in 1997 and suggested that this be extended to Gift Aid. The change in 1997 allowed subsidiary companies to carry back covenanted payments they make to their parent charity up to nine months – into an earlier accounting period – and get relief in that accounting period. So a company with an accounting period ending on 31 December 1999 has up to 30 September 2000 in which to compute its profits and make the covenanted donation and still get tax relief in the accounting period ending 31 December 1999.

4.17 We think this is something that we could usefully do. By extending the flexibility of carry-back to Gift Aid, subsidiary companies could wait until after the end of the accounting period before deciding what amount to donate to the parent charity.

Point for consideration

(xiv) Would subsidiary companies of charities welcome the option to carry back Gift Aid donations? We would particularly like to hear from companies which have used the carry back facility for covenanted donations.

SPONSORSHIP AND LICENSING THE CHARITY’S NAME AND LOGO

4.18 Some respondents told us that the rules for the taxation of income from sponsorship and licensing the charity’s name and logo need to be clearer. We recognise that the direct tax rules in this area can be complex and difficult to understand. The treatment of the income for tax purposes depends on the nature of the arrangements in each case. The tax treatment also interacts with the Home Office regulations (The Charitable Institutions (Fund-Raising) Regulations 1994) about charities’ dealings with commercial participators. We therefore plan to produce clearer guidance for charities on the tax treatment of income from sponsorship and licensing their name and logo.

5

SUPPORTING CHARITY BUSINESSES AND ACTIVITIES – VAT AND BUSINESS RATE RELIEF

5.1 The previous chapter looked at how the rules for direct tax can do more to support charity businesses. This chapter looks at how the VAT system can support charity businesses and activities. It also covers charities’ business rate relief. We have looked for opportunities to make the VAT and business rate rules for charities simpler and fairer. At the same time we must take account of the needs of small businesses and respect the requirements of charity law and European Community (EC) VAT law.

5.2 The current EC VAT legal requirements, which prevent the UK from introducing new VAT reliefs, are discussed later in this chapter (see paragraphs 5.11 and 5.12). An aim of this Review was to obtain the views of charities to help inform the Government’s negotiating position in preparation for any future proposals the European Commission may make to change EC VAT law. In particular we do not yet know when any further proposals on a common VAT system might appear from the European Commission, or what shape they might take. But we do want to be well informed should we have to respond quickly. Changes to EC VAT law do however require the unanimous agreement of Member States. Many charities took the opportunity of the first phase of the Review to share their vision of the future of VAT. These views were most welcome and will be borne in mind.

CHARITIES AND VAT

5.3 Charities in the UK currently benefit from some £200 million per year in reliefs from VAT through a variety of zero rates and exemptions. Many of these reliefs are special zero rates for charities, which were introduced by Parliament in recognition of the important part that charities play in our society.

5.4 Charities made clear to us the value to them of the existing VAT reliefs but they also said that VAT reliefs can complicate the tax system and increase their compliance costs.

IRRECOVERABLE VAT

5.5 The VAT rules apply equally to charities and commercial organisations in determining what is a supply in the course of business. In the simplest terms, anything done in return for consideration in money or something else is a business activity. This distinction is important because for their business activities charities can recover the VAT they incur on purchases relating to taxable (standard rate or zero rated) supplies, but not in relation to VAT exempt supplies. Charities are also unable to recover the VAT they incur on the things that they buy in order to carry out their non-business activities.

5.6 Examples of business supplies and non-business activities are:

Business supplies	Non-business activities
<ul style="list-style-type: none">• selling advertising space• running fund-raising events• sale of donated items	<ul style="list-style-type: none">• services supplied free of charge, such as soup kitchens or hospice care• giving grants for which nothing is received in return

Charities told us:

“Charities should be allowed to reclaim 100 per cent of the input VAT incurred on their non-business expenditure on goods and services used in fulfilment of their charitable objectives.”

- 5.7** Some charities argued that they should receive the same treatment as local authorities under Section 33 of the VAT Act 1994. This provision allows local authorities a full refund of their irrecoverable VAT incurred for non-business purposes. It was originally enacted so that VAT did not fall as a burden on local taxpayers. The only bodies added to Section 33 since 1972 have been those undertaking what are, or were formerly, local authority functions, and who have the power in law to precept on local taxes. Charities have no such power and so it is inappropriate in our view to consider extending Section 33 to include them.
- 5.8** We have looked closely at the case for a UK grant scheme from public expenditure to compensate charities for the VAT they incur on goods and services used in their exempt and non-business activities. Having given this very careful consideration we have concluded, for reasons of principle and of cost, that this is not an idea we wish to pursue.
- 5.9** A fundamental principle of VAT is that organisations and individuals can only recover VAT to the extent to which they make taxable supplies. If individuals or organisations are not making taxable supplies, they cannot recover VAT on the things that they buy. This includes charities providing services for no charge and those making exempt supplies. To give charities this tax back would be contrary to this fundamental principle.
- 5.10** Moreover, any such scheme would mean a large rise in public spending on charities. Charities have estimated that their VAT bill relating to their non-business activities and exempt activities is in the region of £460 million per year. The figure would continue to rise in proportion to the size of the sector and its range of activities. We would therefore be faced with a permanent, high and rising demand on annual public expenditure, which would need to be found from elsewhere in the Government’s budget, and would inevitably compete with other public spending priorities. A grant scheme would also increase administrative costs for charities and Government. It would add further complexities to the system, and run counter to our objectives of simplifying the tax system for charities and helping to minimise their compliance costs.

KEEPING VAT RULES AND RELIEFS UP TO DATE

- 5.11** Many VAT reliefs were introduced a number of years ago. Over the years, the scope and application of some of these reliefs have been changed in various ways, often based on individual cases. EC VAT law allows the UK to make marginal adjustments to existing VAT zero rates but does not allow us to introduce new ones, or significantly extend those we already have. Most VAT exemptions are mandatory under EC VAT law, and European Member States have little or no discretion about their application or scope.
- 5.12** This means that even if we were persuaded of the case, we could not agree to the many requests received from charities during the first phase of the Review for new zero rates. However, we do want to explore with charities the scope for modernising our existing reliefs and making them more consistent where this is possible under EC VAT law.

Charities told us:

“Although we accept that the Government cannot expand the zero rate, some conditions for obtaining relief are burdensome and the rules are complex. There have also been technological changes since the reliefs were given....”

“The interpretation of VAT has grown extensively as a result of legislation and court decisions both in the UK and Europe and as a result has become extremely complex for an organisation subject to VAT.”

- 5.13** We think there are a number of useful things that we can do to improve the VAT system for charities, which do not constitute new VAT reliefs. We recognise that some VAT reliefs for charities are outdated and do not reflect developments in technology or changing patterns of care. For example, we have recently extended the relief for welfare services provided by charities to needy people to include routine domestic help, such as cooking and cleaning. This change followed a VAT Tribunal decision and close consultation with charities. It has been widely welcomed by the sector.
- 5.14** We are now considering ways to extend the VAT relief for charity fund-raising events to reflect new approaches being used by charities, alongside extending the Inland Revenue’s concession, and aligning both reliefs. We also want to improve the relief for charity advertising, making it more consistent, logical and up to date. We want to raise the £250 *de minimis* level for accounting for VAT on assets on hand at de-registration. These options are set out in more detail below.
- 5.15** We also intend to change the relief for the provision of a bathroom for use by disabled people. Currently, this is zero rated when provided in a residential care home, but a similar supply to a day centre or other charity premise is standard rated. We intend to change UK VAT law so that zero rating applies in both cases. We want to hear if charities have any other suggestions for changes to VAT rules or reliefs that would bring them up to date, and make them more consistent, but would not amount to the introduction of a new relief or the significant extension of an existing one.

Point for consideration

- (xv) Within the constraints outlined, what suggestions do you have for bringing VAT rules and reliefs up to date?

REFORMING THE VAT AND DIRECT TAX TREATMENT OF FUND-RAISING EVENTS

- 5.16** The direct tax rules for charity fund-raising events are described in Chapter 4. For VAT, goods and services sold in relation to certain events organised by charities – or subsidiary companies of charities – to raise funds for charity are exempt. The event must be a one-off, stand-alone event, as opposed to one of a series of events.

Charities told us:

“The lack of integration between the Inland Revenue’s concession and the VAT exemption makes it difficult to plan fund-raising events in the most straightforward and beneficial way. It would be helpful if these rules were completely co-ordinated instead of having small differences with a potentially significant tax cost.”

5.17 We recognise that complete alignment of the two sets of rules would be very helpful to charities that run fund-raising events. The two sets of rules have the same objective – to support charities that run fund-raising events while protecting the interests of commercial businesses with which the charities may compete. However, over the years, the VAT relief and the Inland Revenue’s concession have developed separately, so that the way they work is different in a number of respects, thus imposing an additional burden on charities. For example, a rock concert run for a charity with thousands of people present might qualify for VAT relief, but would not get relief from direct tax.

5.18 We want to develop a common, integrated approach for both VAT and direct tax. This would mean that charities would no longer have to deal with two sets of rules, and two Government Departments. We want to pick up the best of the existing reliefs. Thus, for VAT we are proposing to extend the exemption to increasingly popular events, such as charity cycle rides, in which people pay to participate. And for direct tax, we propose to extend the Inland Revenue’s concession to all those events which would be exempt for VAT purposes; for example, large-scale events, such as the rock concert mentioned above. The concession would also be extended to the activities of the subsidiary companies of charities.

Points for consideration

- (xvi) Would reforming and aligning the VAT and direct tax schemes in this way reduce the burden on charities and help them to raise more funds?
- (xvii) What kinds of fund-raising event cause charities difficulties because of the differences in the rules for VAT and direct tax? Please give examples.
- (xviii) Do you currently run fund-raising events which do not receive VAT or direct tax reliefs? Please give examples.

MEMBERSHIP BENEFITS

5.19 For VAT purposes, the receipt of membership subscription fees is business income if members receive benefits in return. The benefits will be either taxable (zero or standard rated) or exempt depending on their nature, and the subscription is apportioned accordingly.

5.20 Membership subscriptions received by certain non-profit-making organisations (including some charities) are outside the scope of VAT if the only benefit to members are copies of annual reports and accounts and the right to attend general meetings about the organisation’s activities. However, the 1999 Budget introduces a change to this treatment. Such subscriptions, as well as any that are currently taxed, will become exempt provided they meet certain conditions. This change will take effect from a date to be announced by Customs & Excise and a Technical Note will be issued in early April.

5.21 Notwithstanding this change, when nothing more than an acknowledgement – such as a thank you note, or lapel flag – is given in return for the membership subscription, the subscription will continue to be treated as a VAT-free donation.

Charities told us:

“Our supporters are largely unaware of the VAT payments which membership incurs. Most donors view their membership as support, not as a means of securing benefits. They are dismayed to learn that their ‘gifts’ are being taxed where the benefits are nominal.”

5.22 A number of charities told us that they find the VAT rules about when a subscription can be treated as a VAT-free donation confusing. Charities also told us that there is inconsistency between the VAT and direct tax rules for membership subscription fees which make the rules difficult to understand. While we want to look at the scope for aligning the VAT rules more closely with those for direct tax, EC VAT law determines what is taxable or exempt for VAT purposes.

5.23 However, we recognise that the VAT rules can be confusing and we want to explore the scope to clarify and simplify them. In particular, we want to explore whether the introduction of a *de minimis* limit, below which ‘nominal’ benefits could be disregarded for VAT purposes, would make the rules easier and simpler to apply.

Points for consideration

- (xix) What “nominal” benefits do charities give in return for membership subscriptions?
- (xx) Would the introduction of a *de minimis* limit be the best way of simplifying the VAT rules? How could we value “nominal” benefits?

CHARITY ADVERTISING

5.24 The supply of advertising is zero rated for VAT where:

- the advertisement is for fund-raising purposes, or
- the advertisement shows the charity’s aims and objectives.

The advertisement must be published (for example in a newspaper) or broadcast (for example on television) and any goods or services used to produce a published advertisement also qualify for zero rating.

Examples of what qualifies	Examples of what doesn’t qualify
<ul style="list-style-type: none"> • artwork for a qualifying printed advert • advert published in a newspaper • advert broadcast in a cinema 	<ul style="list-style-type: none"> • making a qualifying broadcast advert • advert distributed with a newspaper • advert placed on the Internet

Charities told us:

“By excluding from charitable zero rating advertising for charity staff, the cost to the charity is increased, depleting the sums available for charitable purposes.”

5.25 Many charities told us that the current VAT relief for charity advertising imposes an unnecessary restriction on the content of qualifying advertisements, and the media through which they can be published and broadcast. Charities have also told us that the relief causes problems for those selling advertising space in deciding whether or not to charge VAT. There was particular concern about recruitment advertisements, which charities wanted to see brought within the scope of the relief.

5.26 We recognise the importance of charity advertising in raising awareness of charities and the work that they do. We also recognise that the existing relief has failed to keep pace with changes in patterns of charity advertising, and that this has created a number of anomalies that we want to address. We therefore want to extend the VAT relief for charity advertising.

- 5.27** We want to consult charities to ensure the scope of the relief is clear and unambiguous, and that it meets the needs of today’s charities. In particular, what forms of advertising should be included in the scope of the VAT relief (for example, advertising on the Internet); and how should “advertisement” be defined?

Points for consideration

- (xxi) What forms of advertising do charities consider should be included in the VAT relief for charity advertising?
- (xxii) How can “advertising” be clearly defined?
- (xxiii) How much do charities spend on advertising in a typical year, and how much of this is not relieved of VAT?
- (xxiv) Do you advertise on the Internet? What other forms of new media are you considering using?

VAT AND DE-REGISTRATION

- 5.28** When VAT-registered traders cancel their registration, perhaps because they cease trading, they will normally:

- hold goods on which they have already claimed input tax, and
- be required to account for VAT on the value of these goods when the VAT due exceeds £250.

The £250 limit means that organisations, including charities, do not have to account for VAT at de-registration if the value of the assets on hand on which input tax has been claimed is £1,428 or less.

Charities told us:

“There are specific problems for charities which have a separate trading entity which has to register for VAT. The difficulties relate to the question of de-registration, with its ensuing clawback VAT trap. We hope that these difficulties can be resolved as part of the review.”

- 5.29** Charities said that the de-registration requirement causes problems for them when they transfer a subsidiary trading company back to the parent charity. They felt that as the subsidiaries are often set up to satisfy the requirements of charity law, the VAT provisions add an unfair and unreasonable administrative burden.

- 5.30** We want to increase the £250 *de minimis* limit for de-registration, which would benefit small businesses as well as charities. However, a high limit would distort competition with VAT-registered businesses, and increase the scope for tax avoidance. We are therefore considering raising the *de minimis* limit to between £500 and £1000.

Point for consideration

- (xxv) What would be the benefits to charities of raising the £250 *de minimis* limit for de-registration, to £500, £750 or £1000?

VAT INCURRED ON NATIONAL LOTTERY-FUNDED PROJECTS

- 5.31** National Lottery grants are intended to take account of the full cost of projects, including any VAT. Charities making bids for lottery funding should therefore take account of VAT when putting together their business case.

Charities told us:

“It is suggested that.....those organisations involved in [lottery-funded] projects be allowed to recover the VAT from the Government by way of a “one-off” grant.”

- 5.32** Some charities receiving grants from the National Lottery Charities Board have asked for additional Government grants to meet the VAT they pay on their lottery-funded projects. Because lottery grants are intended to take account of the full cost of projects, including any VAT, this should not be necessary. However, from what charities told us, it appears that VAT is sometimes overlooked from their bids for lottery grants. Customs & Excise will therefore talk to the National Lottery Charities Board to see whether any further guidance is needed to ensure VAT is not overlooked by charities seeking lottery grants.

CHARITY BUSINESSES AND BUSINESS RATE RELIEF

- 5.33** Charity premises are automatically entitled to 80 per cent business rate relief. The remaining 20 per cent may be waived at the discretion of the local authority. To qualify for the relief a property must be occupied by a charity and must be used ‘wholly or mainly’ for charitable purposes. As well as property used directly by the charity, this is deemed to include property which is ‘wholly or mainly’ used for the sale of goods donated to a charity, provided the net proceeds are applied for the purpose of the charity.

Charities told us:

“For each shop that is closed the loss of income to charity will be a disaster as they will not be able to replace this steady source of funds.”

Independent shopkeepers told us:

“Charity shops used to sell donated second hand goods. Now they are selling new goods cheaper than I can, because their overheads are less than mine. I appreciate they do a good job, but at an unfair advantage.”

- 5.34** None of the responses criticised business rate relief for general charity premises, such as a Head Office, but views about relief for charity shops were more mixed.

- 5.35** We recognise the value to charities of the business rate relief for their general premises. We also recognise the important part that charity shops play in raising funds and the contribution of business rate relief to making these shops viable. So, we have no plans to withdraw these reliefs. However, we also acknowledge the real concerns of small independent shopkeepers that business rate relief gives charity shops that sell new, bought-in goods a competitive advantage. It was never the intention that charities should have relief on business premises that are predominantly used to sell new, bought-in goods and we do not want to extend the relief in this way.

5.36 Many local authorities, charities and others told us that the rules about what constitutes ‘wholly or mainly’ are not clear, so that there is inconsistent treatment up and down the country. This lack of clarity makes it difficult for charities to comply with the rules and causes problems for local authorities seeking to apply them. We are considering whether local authorities and charities should have clearer guidance about the meaning of ‘wholly or mainly’ and whether there should be more assurance checking of compliance with the rules.

5.37 In deciding whether a charity shop ‘wholly or mainly’ sells donated goods, local authorities currently take all the following relevant factors into account:

- the percentage of sales space occupied by donated goods
- the percentage of turnover and profit represented by the sale of donated goods
- the percentage of individual items sold which are donated goods.

Points for consideration

(xxvi) Would local authorities and charities welcome clearer guidance on the meaning of ‘wholly or mainly’? What are the factors that need to be taken into account?

(xxvii) Are the current assurance checks adequate? If not, how might they be improved?

OTHER TAXES

5.38 As well as direct tax, VAT and business rates, charities are affected by a number of other indirect taxes, such as Insurance Premium Tax, Air Passenger Duty and Excise Duty on road fuel. There are no general reliefs from these taxes for charities. Many charities affected by these taxes asked for specific reliefs or exemptions from these taxes. However, having given these ideas careful consideration, we have concluded that they would further complicate the tax system and, in some cases, could be unfair to businesses with whom charities may compete.

6

SIMPLIFYING THE TAX SYSTEM FOR CHARITIES

- 6.1** Apart from tax reliefs, another important way that the tax system can support charities is by being as simple as possible for them to operate. This way the administrative burden on charities, and their compliance costs, can be kept to a minimum and they can focus on their core activities.

Charities told us:

“...it now requires a lot of our Finance Department’s time to determine the correct tax position. Thus, our hard-earned income is often spent on tax administration.”

- 6.2** Many charities told us that they find the tax system complex, inconsistent and confusing. It contains two separate sets of rules – for direct tax and VAT – and it is administered by two separate Departments – the Inland Revenue and Customs & Excise. We recognise that the tax system can impose more burdens on charities than is necessary, diverting their resources and efforts away from their charitable activities.
- 6.3** We want to make the tax system as simple as possible for donors and charities to operate and this consultation document contains a number of proposals designed to achieve this. For example, the option to allow Gift Aid certification by telephone should cut down on paperwork for donors and charities and enable them to deal with each other by phone in line with modern ways of doing business. We also want to harmonise the direct tax and VAT rules wherever possible. The two types of tax operate in very different ways, but we see scope to bring the rules for direct tax and VAT together in some areas. For example, the proposal at paragraphs 5.16 to 5.18 to extend and revise the Inland Revenue’s concession and the VAT relief for charity fund-raising events should make things easier for charities when they organise events.
- 6.4** We want to find new ways for the Inland Revenue and Customs & Excise to improve the service they offer charities – by working together to provide an integrated service so that charities can get the help they need from one place, and by providing clearer guidance. This chapter contains suggestions for improving that service.
- 6.5** We also recognise the important role that charity workers play in helping charities to carry out their activities, whether they be paid employees of the charity, employees on secondment from business or volunteers. They all carry out essential work in our local communities. This chapter contains suggestions for improving the guidance for charities on the tax treatment of payments to charity workers.

IMPROVING THE SERVICE

- 6.6** The Inland Revenue, Customs & Excise and other Departments have a strategy for working together to provide a better service for taxpayers. This Closer Working is part of our key strategy for modernising Government. The two Departments have already developed some integrated services – such as the employers’ help-line – which offers advice covering VAT registration and employers’ responsibilities for Pay As You Earn and National Insurance Contributions. Many employers, including charities, have found this service helpful.
- 6.7** We think charities could also benefit from having a single point of contact on tax issues. Therefore, building on their experience with the existing telephone help-lines, the Inland Revenue and Customs & Excise plan to set up a new help-line which charities can ring if they have any enquiries on either direct tax or VAT. This will mean that charities will only have to

ring one number (at local rates) in order to get all the help they need. The help-line will be staffed by specialist advisers and will offer charities advice covering a full range of tax issues. We think that charities will find this facility very helpful.

- 6.8** The Inland Revenue and Customs & Excise also plan to produce a directory for charities, covering both direct tax and VAT, listing and summarising all leaflets and publications for charities, useful addresses and phone numbers where charities can get more help, and other useful information. They also plan to produce packs of guidance, covering both direct tax and VAT, tailored to the needs of charities. Alongside all of this, they will be reviewing all of their existing leaflets and publications to ensure that they are up to date and cover all of the areas where charities need guidance. In addition, the two Departments are considering how they can make better use of the Internet for passing information to charities.

Points for consideration

- (xxviii) In which areas relating to direct tax or VAT do charities feel they most need further advice? And in which areas would joint Inland Revenue/Customs & Excise packs be helpful?
- (xxix) In what other ways could the two Departments provide better co-ordinated advice to charities – for example, the Internet?

CHARITY WORKERS

Charities told us:

“...volunteer expenses... an area fraught with difficulty for charities....”

- 6.9** Some respondents suggested that charity employees should not have to pay any income tax or National Insurance Contributions on their earnings from the charity. Others suggested that those charity employees who have student loans should not have to repay them while working for a charity. We are not attracted to these ideas as they would be seen as unfair to other groups of workers.

- 6.10** Some respondents expressed concern about the difficulties that charities face in understanding their Pay As You Earn obligations, particularly in relation to payments they make to volunteer workers. People who give their time to charity may regard themselves as volunteers, but where they receive payment from the charity they may, in certain circumstances, have to be treated as an employee of the charity for tax purposes. This in turn affects the tax treatment of the payments that the charity makes to them. Where the arrangement between the charity and the charity worker amounts to an employer/employee relationship, the charity has to operate Pay As You Earn on payments that it makes. But there is no requirement to operate Pay As You Earn if the payments do not include any element of profit.

Example 1

Mrs X helps two afternoons a week in a charity shop. She is not paid for her time but is reimbursed the cost of her bus fares to and from the shop – £2 per day. Mrs X makes no profit from the arrangement, so the charity does not have to operate Pay As You Earn on the payments for her bus fares or report details of the payments to the Inland Revenue.

Example 2

Mrs Y works five days a week in the same charity shop. She is paid £4 an hour for her time and £2 per day for her bus fares. Unlike Mrs X, Mrs Y profits from the arrangement and, therefore, the charity must operate Pay As You Earn on all the payments it makes to her, including the payment for her bus fares. (Like any other employee, Mrs Y is fully taxable on all the payments she receives towards the cost of travel between her home and her permanent workplace.) And the charity must report details of the payments to the Inland Revenue.

6.11

We recognise that charities can find these rules complex and difficult to apply. To help charities understand when they have to operate Pay As You Earn and what they have to report to the Inland Revenue, the Revenue plan to produce a new leaflet containing practical advice and worked examples. We want to hear from charities what sort of day-to-day issues they face on which they need guidance. We also plan to improve existing guidance, such as in leaflet IR 122, *Volunteer Drivers*, and again we want to hear from charities how the guidance might usefully be improved.

Point for consideration

(xxx) What issues need to be covered in an explanatory leaflet to help charities understand when they have to operate Pay As You Earn in respect of their employees and what to report to their tax office?

