

## CHAPTER ONE

# DEFINITIONS OF “CHARITY”

### 1.1 Introduction

Charitable status is relevant for (at least) three distinct purposes:

- (1) The Charities Acts: principally, the regulation of charities and fundraising.
- (2) Charity tax reliefs.
- (3) Trust law: the rules governing charitable trusts differ in minor respects from non-charitable trusts.

### 1.2 English charities

Section 1(1) Charities Act 2006 provides:

#### **Meaning of “charity”**

(1) For the purposes of the law of England and Wales, “charity” means an institution which—

- (a) is established for charitable purposes only, and
- (b) falls to be subject to the control of the High Court in the exercise of its jurisdiction with respect to charities.

We refer to this as an English law charity.

### 1.3 Charitable purposes

Section 2 Charities Act 2006 defines “charitable purpose”:

#### **Meaning of “charitable purpose”**

(1) For the purposes of the law of England and Wales, a charitable purpose is a purpose which—

- (a) falls within subsection (2), and
  - (b) is for the public benefit (see section 3).
- (2) A purpose falls within this subsection if it falls within any of the following descriptions of purposes—
- (a) the prevention or relief of poverty;
  - (b) the advancement of education;
  - (c) the advancement of religion;
  - (d) the advancement of health or the saving of lives;
  - (e) the advancement of citizenship or community development;
  - (f) the advancement of the arts, culture, heritage or science;
  - (g) the advancement of amateur sport;
  - (h) the advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity;
  - (i) the advancement of environmental protection or improvement;
  - (j) the relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantage;
  - (k) the advancement of animal welfare;
  - (l) the promotion of the efficiency of the armed forces of the Crown, or of the efficiency of the police, fire and rescue services or ambulance services;
  - (m) any other purposes within subsection (4).<sup>1</sup>
- ...
- (4) The purposes within this subsection (see subsection (2)(m)) are—
- (a) any purposes not within paragraphs (a) to (l) of subsection (2) but recognised as charitable purposes under existing charity law or by virtue of section 1 of the Recreational Charities Act 1958 (c. 17);
  - (b) any purposes that may reasonably be regarded as analogous to, or within the spirit of, any purposes falling within any of those paragraphs or paragraph (a) above; and
  - (c) any purposes that may reasonably be regarded as analogous to, or within the spirit of, any purposes which have been recognised under charity law as falling within paragraph (b) above or this paragraph.

A discussion of this and “public benefit” requires a book to itself.

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<sup>1</sup> Many of the terms used here are defined in s.2(3) Charities Act 2006.

## 1.4 Scottish charities

Section 7 Charities & Trustee Investment (Scotland) Act 2005 contains a definition of "charity" which is broadly the same as the English law definition but not quite identical.<sup>2</sup>

The English law definition applies for tax purposes even in Scotland. See s.80 Charities Act 2006:

(3) The following provisions extend also to Scotland—

(a) ss. 1 to 3 and 5 ...

(4) But the provisions referred to in subsection (3)(a) and (d) affect the law of Scotland only so far as they affect the construction of references to charities or charitable purposes in enactments which relate to matters falling within Section A1 of Part 2 of Schedule 5 to the Scotland Act 1998 (c. 46) (reserved matters: fiscal policy etc.); and so far as they so affect the law of Scotland—

(a) references in ss. 1(1) and 2(1) to the law of England and Wales are to be read as references to the law of Scotland, and

(b) the reference in section 1(1) to the High Court is to be read as a reference to the Court of Session.

Paragraph 115 of the EN to the Scots Act explains:

Tax relief, other than rates relief, is:

[1] reserved to Westminster and

[2] granted by the Inland Revenue<sup>3</sup> on a UK wide basis.

This Bill will not change this.

Thus a body which has charitable objects within the Scots law definition is not established for charitable purposes only (within the English law definition) and does not qualify for tax relief (unless one takes the view that notwithstanding the differences of language, everything charitable in

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<sup>2</sup> The Joint Committee on the Draft Charities Bill sensibly recommended that the definitions should be made identical (Report para 40 "It would be an issue of some consternation if UK based charities were required to meet different criteria for achieving charitable status in different parts of the UK, or if some organisations were considered charities in one part of the UK but denied charitable status in another.")

<sup>3</sup> Is the statement at [2] just poorly expressed, or is it symptomatic of an attitude? Tax relief is not "granted by the Inland Revenue". It is granted by Parliament and administered by HMRC.

Scotland is also charitable in England).

English charity law is for this purpose regarded as part of Scots domestic law; it is decided in the Scots courts as any other issue of Scots law, it is not regarded as an issue of foreign law to be decided by expert evidence.<sup>4</sup>

A joint statement from Office of the Scottish Charity Regulator (OSCR) and HMRC attempts to deal with the serious problems which arise from this:<sup>5</sup>

**Defining the phrase ‘charitable purpose’ or the word ‘charitable’ in the constitutions of Scottish Charities**

OSCR and HMRC have clarified the requirement for ‘definition clauses’ (defining the meaning of the words ‘charitable’, ‘charitable purpose’ or ‘charity’) in constitutions of bodies on the Scottish Charity Register that also wish to seek tax relief from HMRC.

The agreement reached between OSCR and HMRC was informed by the knowledge that there is very little divergence between the concept of what is ‘charitable’ etc in terms of the Charities and Trustee Investment (Scotland) Act 2005 and what is ‘charitable’ etc for the purposes of the Taxes Acts and the mutual desire to maintain that position going into the future. The objective of the agreement has been to arrive at an operational arrangement that has a minimum impact on Scottish charities.

HMRC and OSCR have therefore agreed as follows:

1. Not all charities on the Scottish Charity Register that have been established under Scottish law need a definition of the terms ‘charitable’ or ‘charitable purpose’ to be included in their constitution in order to be able to meet the requirements of HMRC and qualify for tax reliefs. A definition clause is not needed if:
  - a. The terms ‘charitable’ or ‘charitable purpose’ are not used in the constitution; or
  - b. The constitution does not contain a reference to general ‘charitable purposes’, nor a dissolution clause which allows the distribution of assets for ‘any charitable purpose’.

In practice, constitutions of charities do usually use the word “charitable”.

2. Any charities on the Scottish Charity Register that may have adopted a definition or interpretation clause published by OSCR prior to

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<sup>4</sup> *City of Glasgow Police Athletics Association v IRC* 34 TC 76.

<sup>5</sup> 19 February 2008 [www.hmrc.gov.uk/charities/oscr-hmrc-statement082202.pdf](http://www.hmrc.gov.uk/charities/oscr-hmrc-statement082202.pdf)

February 2008, that was different from those contained in this statement, do **not** need to change this in order to be able to benefit from tax relief

3. Scottish charities **already on the Register** and which are already registered with HMRC which do not have a 'definition clause' in their constitution will **not** be required by HMRC to change their constitutions in order to qualify for tax relief. (However, HMRC stress that it would be good practice to make such a change if the constitution were updated for another reason).

That is, for charities established before February 2008, HMRC will ignore the problem. But not for the future:

4. Scottish charities to be entered **new** on the Register by OSCR (and that use the terms charitable etc in their draft constitutions), will be advised (both by OSCR and HMRC) that, should they at any point wish to claim tax relief, they will probably need to define the terms 'charitable' or 'charitable purpose' (where used) in a way acceptable to HMRC, i.e. by inserting the model definitions clause(s) (see below).

5. HMRC and OSCR wish to maintain the working practice (of HMRC) that entry on the Scottish Charity Register would, in the vast majority of cases, satisfy HMRC for the purposes of granting tax relief (and that separate submission of a constitution to HMRC will not usually be necessary). OSCR will therefore bring to the attention of HMRC any charities that are entered on the Register without a definition clause in the constitution, where exact drafting of the constitution would need this for HMRC purposes. (OSCR will also inform the relevant charity if this is the case). This will allow HMRC to make separate, individual assessments of these cases should these charities request tax relief.

**Example definition clauses:**

These clauses can be amended or adjusted as appropriate and necessary within the context of the exact drafting of the constitution concerned. What is to be achieved is a definition which unambiguously defines the terms 'charitable purpose', 'or 'charitable' in terms of the 2005 Act as well as the Tax legislation. Which one of the example clauses should be used depends on the drafting of the constitution.

To define the term 'charitable purpose':

*'The expression 'charitable purpose' shall mean a charitable purpose under section 7 of the Charities and Trustee Investment (Scotland) Act 2005 which is also regarded as a charitable purpose in relation to the applications of the Taxes Acts .'*

To define the term 'charity' or 'charitable body', 'charitable institution', 'charitable organisation (etc):

*“Charitable body’, ‘charitable institution’, ‘charitable organisation’ [as applicable in the context of the constitution] and charity’ shall mean a body on the Scottish Charity Register which is also regarded as a charity in relation to the application of the Taxes Acts*

Similar problems arise for English law charities which wish to obtain rating relief in Scotland (or if they wish to register as Scots charities for any other reason). Rating relief only applies if a body meets the Scots law definition of charity. Here it seems that there is no transitional relief on offer. The Charity Commission offer the following guidance:

Any E&W [England & Wales] charity that wishes to refer to itself as a charity and occupies any land or premises in Scotland or carries out activities in any office, shop or similar premises in Scotland, needs to apply for registration as a charity with OSCR. If the charity meets the Scottish charity test contained in the 2005 Act, it will be entered on the Scottish Charity Register. More information about the Scottish charity test is available on OSCR’s website [www.oscr.org.uk](http://www.oscr.org.uk). The test requires that the charity’s objects are charitable under section 7 of the 2005 Act and that the charity cannot distribute or apply any of its property for purposes which are not charitable under section 7.

The governing documents of charities established under the law of E&W are interpreted according to that law. However, the terms “charitable” or “charitable purposes” do not have precisely the same meaning under the 2005 Act as it does under E&W law.

The effect of the difference between E&W law and Scots law is that where an E&W charity’s governing document makes reference to “charitable” or “other charitable purposes” in its objects and/or dissolution clause, it is not clear that the organisation can only use its assets for purposes which are exclusively charitable in accordance with the 2005 Act. This means that it will fail the Scottish charity test.

**6. What can we do to enable these charities to register in Scotland?**

E&W charities that have applied for registration with OSCR and have been asked to make an amendment to their governing documents before they can be registered, will generally need to contact the Commission. In most cases, an amendment to a charity’s purposes or objects can only be made with our consent. Often an amendment to a dissolution clause will also need the consent of the Commission and/or a parent body.

The standard wording we have agreed with OSCR is set out below:

(a) Where a charity is established in E & W and undertakes significant activities in Scotland and its objects clause makes reference to “charitable” or “other charitable purposes”, this form of wording will be

suitable for use as an interpretation clause for the governing document: ***Throughout this [insert type of GD e.g. Trust Deed], "charitable" means charitable in accordance with the law of England and Wales provided that it will not include any purpose which is not charitable in accordance with section 7 of the Charities and Trustee Investment (Scotland) Act 2005. For the avoidance of doubt, the system of law governing the constitution of the charity is the law of England and Wales.***

(b) This clause is intended to be used where the **objects** clause is acceptable as charitable both in E & W and in Scotland but the charity does not meet the distribution test (i.e. its dissolution clause makes reference to "charitable" or "other charitable purposes") in section 7 of the 2005 Act:

***Nothing in this [insert type of GD e.g. trust deed] shall authorise an application of the property of the charity for purposes which are not charitable in accordance with section 7 of the Charities and Trustee Investment (Scotland) Act 2005.***<sup>6</sup>

## 1.5 Northern Ireland

Section 1 Charities Act (Northern Ireland) 2008 provides contains a definition of "charity" which is broadly the same as the English and Scottish law definitions but not quite identical to either:

(1) For the purposes of the law of Northern Ireland, "charity" means an institution which—

(a) is established for charitable purposes only, and

(b) falls to be subject to the control of the Court in the exercise of its jurisdiction with respect to charities.

(2) The definition of "charity" in subsection (1) does not apply for the purposes of a statutory provision if a different definition of that term applies for those purposes by virtue of that or any other statutory provision.<sup>7</sup>

The English law definition of "charity" applies for tax purposes even in Northern Ireland. See s.80(5)(6) Charities Act 2006:

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<sup>6</sup> "Guidance for English and Welsh charities that have been asked to amend their governing documents before they can register in Scotland" accessible [www.charity-commission.gov.uk/supportingcharities/oscrguide2.asp](http://www.charity-commission.gov.uk/supportingcharities/oscrguide2.asp).

<sup>7</sup> See Chapter 24 (Charitable trusts), *Drafting Trusts & Will Trusts in Northern Ireland*, 2nd ed., 2007 James Kessler QC and Sheena Grattin (Tottel).

(5) The following provisions extend also to Northern Ireland—

(a) ss. 1 to 3 and 5 ...

(6) But the provisions referred to in subsection (5)(a) and (e) affect the law of Northern Ireland only so far as they affect the construction of references to charities or charitable purposes in enactments which relate to matters falling within paragraph 9 of Schedule 2 to the Northern Ireland Act 1998 (c. 47) (excepted matters: taxes and duties); and so far as they so affect the law of Northern Ireland—

(a) references in ss. 1(1) and 2(1) to the law of England and Wales are to be read as references to the law of Northern Ireland, and

(b) the reference in s.1(1) to the High Court is to be read as a reference to the High Court in Northern Ireland.

In practice no doubt a practice similar to Scotland will be applied in Northern Ireland.

## **1.6 UK tax definitions**

### 1.6.1 “*charity*”

Section 989 ITA defines “charity”:

The following definitions apply for the purposes of the Income Tax Acts—

“charity” means a body of persons or trust established for charitable purposes only.

Similarly, s.1319 CTA provides:

In this Act, except where the context otherwise requires—

“charity” means a body of persons or trust established for charitable purposes only,

Since this is only a CTA-wide definition, it needs to be repeated when the word is used in other corporation tax contexts.

### 1.6.2 “*Charitable trust*”

Section 519 ITA defines “charitable trust”:

### **519 Meaning of “charitable trust”**

In this Part “charitable trust” means a trust established for charitable purposes only.

This definition applies for the purposes of Part 10 of ITA, but the same definition is almost always applied when the term “charitable trust” is used in a tax context, and if it were made a taxes-act-wide definition a good deal of repetition would be avoided.

#### 1.6.3 “Charitable company”

Section 506(1) ICTA defines “charitable company”:

In this section, s.505 and Schedule 20—  
“Charitable company” means any body of persons established for charitable purposes only.

This definition applies for the purposes of s.505, s.506 and Sch 20 ICTA. But once again, the same definition is almost always applied when the term “charitable company” is used in a tax context and if it were made a taxes-act-wide definition a good deal of repetition would be avoided.

In this book, we refer to a charity within any of these definitions (whether a charitable trust or company) as a “**UK tax charity**”.

### **1.7 Subjective intention of settlor irrelevant**

In *George Drexler Ofrex Foundation v IRC* 42 TC 524 a settlor intended to set up what would not have been a tax charity; but (because the drafter infringed the rule against perpetuities) the parts of the trust deed which took effect were wholly charitable! This was (rightly) held to be a tax charity: see p. 536. The subjective intention of the settlor was irrelevant.<sup>8</sup> This is however a currently controversial issue of charity law.

### **1.8 Classification of charities for tax purposes**

A charity will take one of the following forms:

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<sup>8</sup> The same point is made in *Re Crown Forestry Rental Trust* [2004] 4 All ER 588 at [29].

- (1) A body corporate. This includes:
  - (a) A company incorporated under UK Company Acts, by statute or by royal charter.
  - (b) A charitable incorporated organisation.<sup>9</sup>
  - (c) A Scottish charitable incorporated organisation.<sup>10</sup>These are all "companies" in the normal sense of the word.
- (2) An unincorporated association (classified as a company, see below).
- (3) A trust.

Tax law classifies every charity as a company or a trust. The charitable trust or company is treated for tax purposes as any other trust or company, except so far as specific charity exemptions apply.

### *"Company"*

"Company" is widely defined for tax purposes. Section 992(1) ITA provides (subject to irrelevant exceptions):

In the Income Tax Acts "company" means any body corporate or unincorporated association, but does not include a partnership, a local authority or a local authority association.<sup>11</sup>

#### 1.8.1 *Unincorporated associations*

An unincorporated association is an organisation where a number of people join together for a common purpose (not a business purpose), whose relationship is governed by rules arising under a contract made between each member. Clubs and societies will generally have the status of an unincorporated association unless specific steps are taken to set up a company or a trust. An unincorporated association is treated as a company for tax purposes, under the definition set out above, though it is not a company in the normal sense of the word.

An unincorporated association may be a body of persons "established for charitable purposes only" and so qualify as a tax charity. See 1.9.1

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<sup>9</sup> Section 69A(3) Charities Act 1993 provides: "A CIO shall be a body corporate."

<sup>10</sup> Section 49(2) Charities and Trustee Investment (Scotland) Act 2005 provides: "A SCIO is a body corporate..."

<sup>11</sup> For corporation tax, the same definition is at s.832(1) ICTA. For CGT the definition is substantially the same (the differences do not affect charities): see s.288(1) TCGA.

(Temporary unincorporated association).

### 1.8.2 *Charitable trust with incorporated trustees*

This section considers the position where the trustees of a charitable trust have incorporated under s.50 Charities Act 1993. The property law consequences of this are set out in ss.50 and 51 Charities Act 1993:

**50(1)** Where

- (a) the trustees of a charity ... apply to the Commissioners for a certificate of incorporation of the trustees as a body corporate, and
  - (b) the Commissioners consider that the incorporation of the trustees would be in the interests of the charity, the Commissioners may grant such a certificate, subject to such conditions or directions as they think fit to insert in it...
- (3) On the grant of such a certificate
- (a) the trustees of the charity shall become a body corporate by such name as is specified in the certificate; and
  - (b) ... any relevant<sup>12</sup> rights or liabilities of those trustees shall become rights or liabilities of that body.
- (4) After their incorporation the trustees—
- (a) may sue and be sued in their corporate name; and
  - (b) shall have the same powers, and be subject to the same restrictions and limitations, as respects the holding, acquisition and disposal of property for or in connection with the purposes of the charity as they had or were subject to while unincorporated; ...

**51** The certificate of incorporation shall vest in the body corporate all real and personal estate, of whatever nature or tenure, belonging to or held by any person or persons in trust for the charity, and thereupon any person or persons in whose name or names any stocks, funds or securities are standing in trust for the charity, shall transfer them into the name of the body corporate ...

The trustees of the charitable trust become a “body corporate” and are therefore classified as a company for tax purposes: see s.992 ITA or s.832

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<sup>12</sup> Section 50(6) CA 1993 provides:  
“relevant rights or liabilities” means rights or liabilities in connection with any property vesting in the body in question under s.51 below.

ICTA. However, it is reasonably clear from s.50(4) that this body corporate is not regarded as beneficial owner of the charity's assets. The tax classification of a charitable trust which is incorporated under the Charities Act is therefore the same as any other charitable trust with a sole corporate trustee. Thus if a charitable trust with an incorporated trustee becomes subject to tax (e.g. because it receives trading income outside the trading exemption), it pays income tax like a charitable trust, at trust rates; it does not pay corporation tax.

### 1.8.3 *Commentary: let's tax all charities in the same way*

At present we have two tax regimes for charities, one for trusts and another for companies. In due course the 20 pages of legislation in part 10 ITA 2007 will be repeated (more or less word for word) in the proposed Corporation Tax Act 2011. It is suggested that the position should be simplified: charitable companies should simply be subject to income tax (not corporation tax) so only one tax regime applies to all charities. There is no good reason to have two! This would be a painless and worthwhile simplification in the law, with no significant tax cost.

## 1.9 **Temporary charities**

In this section we consider the status of bodies whose purposes are wholly charitable for a period, but which may in the future cease to be charitable. We refer to these as "**temporary charities**". For temporary charitable trusts, see 28.4–28.5 (Temporary charitable trusts).

### 1.9.1 *Temporary unincorporated association*

For an unincorporated association to qualify as a charity:

- (1) The objects of the association must be wholly charitable.
- (2) The present income of the association can only be expended for a charitable purpose even if the association changes its objects.

A difficulty arises from the relatively informal nature of an unincorporated association. An association is governed by rules formed by a contract, and the rules of the association can always be changed by the members. Any charitable unincorporated association is a "temporary charity". Any

association may cease to be a charity. Moreover, an association can always dissolve itself and cease to exist. But this does not affect the charitable status of the association so long as its constitution requires that income arising while the association is a charity must be applied for charitable purposes only. The association's constitution should expressly so provide; but the courts may infer this intention even if it is not expressed.<sup>13</sup>

In *IRC v Glasgow Music Festival Association* 11 TC 154 Lord Blackburn took the view that a body could not be a charity unless it was "endowed with a fund protected by a trust of a permanent character". This view, founded on the word "established", was rejected by the majority of the Court of Session. It is thought that the phrase "established for charitable purposes only" means no more than "formed for charitable purposes only".

Accordingly, a temporary charitable association may be a tax charity.

### 1.9.2 *Temporary charitable company*

Before the reforms of the Companies Act 1989 and the Charities Act 1992 a temporary charitable company was a tax charity. Indeed, nearly all charitable companies were temporary charities, since they had power to alter their objects with only the minor restrictions imposed by (what is now) s.64(1) Charities Act 1993. (This provided that an alteration of articles so as to cease to be a charity was not to affect property acquired for less than full consideration and income therefrom.)

The position now is that a charitable company cannot change its objects clause without the consent of the Charity Commission.<sup>14</sup> The Commission are unlikely to consent to a charitable company acquiring non-charitable objects so most charitable companies are no longer temporary charities. However, temporary charitable companies may still exist. A company may adopt objects which are limited so as to be charitable for a period, and which then cease to be charitable. Since there is no alteration of the memorandum of the company, the law does not prevent this.

The position of such a company is analogous with that of a temporary charitable trust. It is considered that it does qualify as a tax charity.

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<sup>13</sup> See *IRC v Yorkshire Agricultural Society* 13 TC 58 at p.78.

<sup>14</sup> See s.64(2) CA 1993.

## 1.10 Mixed charitable institutions

This section considers the status of a body whose objects at any one time are partly charitable and partly not charitable; We shall refer to these bodies as "mixed charitable institutions". For mixed charitable trusts see 28.4 (Mixed charitable trusts).

An unincorporated association or company whose objects include charitable and non-charitable purposes is not a "charity" and does not qualify for any charity tax relief. The best course for such institutions is to split up into two parts: a charitable arm, restricted to charitable purposes only, which will qualify for tax exemption; and a non-charitable arm, unrestricted in its activities. The latter will not qualify for tax relief, but may obtain relief by giving funds to the charity (by Gift Aid).

If a single unincorporated association or company holds two identifiably separate funds, one of which is to be applied for charitable purposes only, then what is the position? Unless the association or company holds the charitable fund as trustee, one cannot say that there is any body of persons established for charitable purposes only, and it is therefore not a tax charity. The recommended approach is to ensure a complete separation between charitable and non-charitable purposes.

## 1.11 Foreign charitable objects of UK charity

An institution may be a charity even though its objects are outside the UK. For instance, the relief of poverty in India is a charitable object in English law, even though no person in the UK could benefit. Such charities qualify for the same tax relief as charities whose objects relate to the UK.<sup>15</sup>

The IHT Manual provides:

**IHTM11128 - Procedure: beneficiaries outside the UK** [June 2005]

The primary purpose of some large, well-known, UK charities such as Oxfam and Christian Aid is the relief of poverty, etc, abroad. This does not prevent a gift to such a charity (IHTM11112) being exempt, even if the gift is stated to be for the work of the charity in a specific foreign

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<sup>15</sup> Less economically developed countries naturally take a different view on this policy issue. S.88 Inland Revenue Ordinance (Hong Kong) restricts charity relief if the profits are expended substantially outside Hong Kong. Similarly the Indian Income-tax (Amendment) Act 1953 restricts charity exemption in India to purposes which relate to India. For one anti-avoidance provision see 4.7 (Payment to a foreign body).

country.

*Example*

A legacy of £10,000 to Oxford Famine Relief (better known as ‘Oxfam’) absolutely for the charity’s work in Ethiopia.

The legacy is exempt under s.23 (1) IHTA 1984.

If the charity exemption is sought for property held on trust for charitable purposes which include bodies or objects outside the UK, you should refer the case to TG (IHTM01081).

**(This text has been withheld because of exemptions in the Freedom of Information Act 2000)**

Perhaps the omitted material relates to steps to prevent tax evasion involving fraudulent foreign charities.

The IHT Manual also provides:

**IHTM11132 - Procedure: the Charities Aid Foundation**

The Charities Aid Foundation is a conglomerate charity which as well as managing other charities is itself a charity (IHTM11112). A bequest to the Foundation which is not conditioned or was accompanied merely by a wish that it be used in a certain way qualifies for relief. Where, however, the bequest is accompanied by a direction that it be applied for purposes outside the United Kingdom, you should refuse relief.

You should refer any similar case relating to other charities to TG (IHTM01081).

Where a bequest to charity is accompanied by a direction that the funds be used for non-charitable purposes, charity relief does not apply. However, a direction to use funds for “purposes outside the UK” may be a charitable purpose and may qualify for relief. The author of the Manual does not, we think, mean to say otherwise. The point is that these cases are thought to need investigation, and relief should not be granted until that has been done.

## 1.12 Foreign charities

In order to be a UK tax charity, a charity must be established in the UK: see *Camille and Henry Dreyfus Foundation v IRC* 36 TC 126.<sup>16</sup> Bodies

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<sup>16</sup> We mention for completeness *Civil Engineer v IRC* [2002] STC (SCD) 72 which follows *Dreyfus* but adds nothing to it.

established outside the UK do not qualify for UK tax relief even if they are established for purposes which are charitable under English law.<sup>17</sup>

What conditions must a charity satisfy in order to qualify as “established in the UK”? The Court of Appeal gives this guidance:

... a ‘trust established for charitable purposes only’ must here mean a trust taking effect and enforceable under the law of the United Kingdom and creating an obligation enforceable in the courts of the United Kingdom ... [The condition] is only satisfied by a body of persons which is under the law of the United Kingdom, subject to an obligation enforceable in our courts.<sup>18</sup>

This is the same as the test of an English law charity.<sup>19</sup> It raises a further question: when is a body subject to an obligation “enforceable in our courts”?

There are many possible connecting factors and there is a substantial case law. *Gaudiya Mission v Brahmachary* concerned an Indian charitable company administered in India, but which conducted activities and had assets (a temple) in London. The Court of Appeal held it was not within the jurisdiction of the English Court, and so not a charity for the purposes of English charity law:

The Act is neither intended, nor apt, to apply to an institution established for charitable purposes outside England and Wales, i.e. an institution constituted in accordance with the law of a foreign state. ... These cases establish that the power of the court to direct schemes, one of the most distinctive powers of the court with respect to charities, can only be exercised in relation to a charity established in, and in accordance with the law of, England and Wales.<sup>20</sup>

One might think from this that any charitable trust governed by a foreign

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<sup>17</sup> The position is similar in New Zealand: foreign charities are not charities for New Zealand tax purposes but can be for the purposes of New Zealand charities law (Charity Law in Australian and New Zealand, G Dal Pont, pp 26 - 29).

<sup>18</sup> 36 TC at 152.

<sup>19</sup> s.1(1)(b) Charities Act 2006; see 1.2 (English charities).

<sup>20</sup> [1998] Ch 341 at p.350, 352. But in Ireland, an American charitable company running a nursing home in Ireland was held, following the comments in *Dreyfus*, to have sufficient “establishment” in Ireland to give rise to the charity tax exemption: *Revenue Commissioners v Sisters of Charity of the Incarnate Word* [1998] IEHC 24 [1998] 2 IR 553 accessible [www.bailii.org](http://www.bailii.org).

proper law is outside the jurisdiction of the High Court. But other passages approved in the same case suggest that in the case of a charitable *trust*, where the trustees are in England, the Court has jurisdiction. At pages 351 and 352 the Court approved these passages from earlier cases:

*if the trustee is abroad* there is no power in the court to direct a scheme to be settled, and the practice in such a case is to hand over the fund to the trustee to be applied according to the trusts of the will without directing a scheme. ...

The objection, in the ordinary case, to administering a foreign charity under the superintendence of the court, is this: *those who are engaged in the actual execution of it, are beyond the court’s control*, and those who are within the jurisdiction are answerable to the court for the acts of persons as to whom they can derive no aid from the court.

(Our emphasis)

Thus in *IRC v Gull* 21 TC 374, a will trust governed by the law of Ontario with one trustee in the UK and one outside it was held to be a tax charity; this was apparently approved in *Camille & Henry Dreyfus Foundation v IRC* 36 TC 126.

The position is changed, arguably, by the Recognition of Trusts Act 1987. This provides that the duty of trustees to account for their administration is governed by the proper law: see The Hague Convention, Article 8(j). Arguably this excludes the jurisdiction of other courts. Certainly a place of jurisdiction clause may do so.<sup>21</sup>

The Charity Commission practice is to have regard only to the governing law of a trust or place of incorporation of a company:

The Charity Commission can only register an organisation governed by the laws of England and Wales. We cannot register an organisation set up under the laws of any other country including Scotland, Northern Ireland, the Isle of Man or the Channel Islands. ... The position is different for charitable companies. The sole criterion for deciding if they are regulated by the Commission is whether or not they are incorporated in England and Wales.<sup>22</sup>

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<sup>21</sup> See *Drafting Trusts & Will Trusts*, James Kessler and Leon Sartin, 9th ed 2008, para 27.6 (Exclusive jurisdiction clause).

<sup>22</sup> “Charities Working Internationally” para 7, accessible [www.charity-commission.gov.uk](http://www.charity-commission.gov.uk).

In Scotland, a charity is subject to the jurisdiction of the Court of Session if (a) it is established under the law of Scotland; or (b) it is managed or controlled wholly or mainly in or from Scotland.<sup>23</sup>

The safe course is to arrange that the charity is indisputably “established in the UK”. If a trust, the charity should be subject to a UK proper law and have at least one UK trustee. (If necessary this can be achieved without great inconvenience by use of a corporate trustee.) If a company, the charity should be incorporated under the Companies Acts and have at least one director here.

If a foreign charity has UK sources of income and desires to qualify for UK tax relief, the most convenient course may be to set up a sub-charity in the UK. This may also be advantageous for a foreign charity with no UK-source income, if it wishes to take advantage of double tax treaties: see 14.1 (Double taxation treaties). Difficulties arise where a charity needs to satisfy the requirements of UK tax law (to secure UK tax relief) and also the requirements of another country’s tax code. These cases will need to be considered in the light of their particular circumstances.<sup>24</sup>

## 1.13 EU charities

### 1.13.1 *Articles 43, 48 (freedom of establishment), 39 (movement of workers), 12 (discrimination)*

The restriction of tax relief to UK charities seems a sensible rule because there may be scope for abuse if a foreign charity qualified for UK charity tax reliefs without being within the jurisdiction of the UK courts or the Charity Commission. However, this rule is not compatible with EU law. It breaches the freedom of establishment guaranteed by Articles 43 and 48 of the EC Treaty.<sup>25</sup> The rule also infringes the freedom of movement and

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<sup>23</sup> Section 34(4) Charities and Trustee Investment (Scotland) Act 2005.

<sup>24</sup> For a structure which constitutes a charity under UK and foreign law, see 14.6 (Dual qualified charity).

<sup>25</sup> Article 43 provides:

“Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular

freedom from discrimination afforded under Articles 39<sup>26</sup> and 12<sup>27</sup> of the EC Treaty to workers of other Member States working or established in the UK when they wish to make gifts or leave legacies to charities in their country of origin.<sup>28</sup>

### 1.13.2 Article 56 (movement of capital)

In *Centro di Musicologia Walter Stauffer v Finanzamt München für Körperschaften*,<sup>29</sup> an Italian charitable foundation (tax exempt in Italy) received rental income from property in Germany. The German authorities sought to impose German tax on the rental income. Had the charity been established in Germany rather than in Italy it would have been exempt from the tax under German law. The case was brought on the questions of freedom of establishment and of movement of capital under article 56.<sup>30</sup>

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companies or firms within the meaning of the second paragraph of Article 48, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the chapter relating to capital."

Article 48 provides:

"Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States."

"Companies or firms" means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making.

<sup>26</sup> Article 39 provides:

1. Freedom of movement for workers shall be secured within the Community.
2. Such freedom of movement shall entail the abolition of any discrimination based on nationality between workers of the Member States as regards employment, remuneration and other conditions of work and employment..."

<sup>27</sup> Article 12 provides:

"Within the scope of application of this Treaty, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited."

<sup>28</sup> See IP/02/1527.

<sup>29</sup> C-386/04.

<sup>30</sup> Article 56 provides:

1. Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.
2. Within the framework of the provisions set out in this Chapter, all restrictions on payments between Member States and between Member States and third

The ECJ held that freedom of establishment was not relevant because the investment property in Germany was not actively managed by the Italian charity. The issue which remained, therefore, was whether German law constituted an obstacle to the free movement of capital (which it clearly did) and, if so, whether the restriction could be justified under Article 58(1)(a). This article provides:

The provisions of Article 56 shall be without prejudice to the right of Member States  
(a) to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested.<sup>31</sup>

The court held that this derogation must be strictly interpreted. The application of Article 58 “must concern situations which are not objectively comparable or to be justified by overriding reasons in the general interest.” The court then held that in this particular case, derogation from Art 58 was not justified and the free movement of capital was infringed because the objects of the Stauffer foundation would have been recognised as charitable in Germany had it been established there.

Following *Stauffer*, a Member State, whilst determining eligibility for tax relief, must ask whether the charity would have qualified had it been established in that Member State. Whether it would have qualified (once residence is assumed) remains a matter of domestic law.<sup>32</sup>

A Press Release of 10 July 2006 issued by the Commission provides:

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countries shall be prohibited.”

<sup>31</sup> Article 58 continues::

“1. The provisions of Article 56 shall be without prejudice to the right of Member States ...

(b) to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, or to take measures which are justified on grounds of public policy or public security.

2. The provisions of this Chapter shall be without prejudice to the applicability of restrictions on the right of establishment which are compatible with this Treaty.

3. The measures and procedures referred to in paragraphs 1 and 2 shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 56.”

<sup>32</sup> See paragraph 57 of the judgement.

Reference: IP/06/964

*The European Commission has sent the UK a formal request to end discrimination of foreign charities. The UK allows tax relief for gifts to charities, but only if they are established in the UK. Charities in other Member States are excluded from the relief and the Commission considers that this discrimination is contrary to the EC Treaty. The request is in the form of a 'reasoned opinion' under Article 226 of the EC Treaty. If the UK does not reply satisfactorily to the reasoned opinion within two months the Commission may refer the matter to the European Court of Justice.*

“The rules of the Internal Market forbid discrimination of charities in other Member States,” said EU Taxation and Customs Commissioner László Kovács. “Gifts to bona fide charities in other Member States should get the same tax treatment as gifts made to domestic charities.” The UK offers various forms of tax relief for gifts to charities. However, this favourable tax treatment is only granted if the charity is established in the UK.

The difference in treatment between gifts made to charities in the UK and charities in other Member States constitutes an obstacle to the free movement of capital. Cross-border gifts are explicitly mentioned in Council Directive 88/361/EEC, which provides for a Community definition of capital movements.

The discrimination is also contrary to the free movement of persons, as workers and self-employed persons moving to the UK might wish to make gifts to charities established in the Member State where they came from.

Finally, the rules are contrary to the freedom of establishment, as foreign charities are forced to set up branches in the UK in order to benefit from the favourable tax treatment.

If the UK would like to check whether the assets and income of charities in other Member States are only used for charitable purposes, it can ask for assistance of the Member States where the charities are established on the basis of the Mutual Assistance Directive (77/799/EEC).

The Commission's case reference number is 2005/2281.

Similar press releases have been issued in respect of Ireland, Poland and Belgium. At the time of going to print, there have been no referrals to the ECJ, though the two month deadline has long since elapsed.

### 1.13.3 *Persche v Finanzamt*

*Persche v Finanzamt* [2009] STC 586 was referred to the ECJ on three questions. The first was whether gifts come within the compass of the provisions of the EC Treaty relating to the free movement of capital, even if they are made in the form of everyday consumer goods.

Mr. Persche had donated towels, toy cars and zimmer frames to a charitable retirement and children's home in Portugal but was refused a deduction in Germany. In paragraph 25 of the judgment the court states:

Where a taxpayer of a member state seeks the deduction for tax purposes of a sum reflecting the value of gifts to third persons resident in another member state, it does not matter, in order to determine whether the national legislation in question is covered by the Treaty provisions on the movement of capital, whether the underlying gifts were made in money or in kind.

Thus gifts in kind do come within the ambit of Article 56.

The second question was whether Article 56 precluded legislation allowing the benefit of a tax deduction for tax purposes only for gifts made in favour of charitable bodies established in that state. In answering this question the court held (at paragraphs 49 and 50):

The fact remains that where a body recognised as having charitable status in one member state satisfies the requirements imposed for that purpose by the law of another member state and where its object is to promote the very same interests of the general public, so that it would be likely to be recognised as having charitable status in the latter member state, which it is a matter for the national authorities of that same member state, including its courts, to determine, the authorities of that member state cannot deny that body the right to equal treatment solely on the ground that it is not established in its territory ...

...a body which is established in one member state but satisfies the requirements imposed for that purpose by another member state for the grant of tax advantages, is, in respect of the grant by the latter member state of tax advantages intended to encourage the charitable activities concerned, in a situation comparable to that of bodies recognised as having charitable purposes which are established in the latter member state.

*Persche* makes it clear that by denying tax relief available to charities in

other member states which meet the criteria of a charity within the member state granting the relief will breach the EC Treaty provisions on free movement of capital.

The third question related to the principle of proportionality and the application of the provisions of Directive 77/779<sup>33</sup> - was it proportional to require the member state to gather the information it would need to determine whether or not a foreign charity met the criteria for the tax relief in order to decide whether or not to grant the relief. The court held (at paragraphs 51 - 61):

... the exclusion of the deduction for tax purposes for gifts to bodies established and recognised as charitable in a member other than the donor's member state cannot be justified by the difficulty, for the donor's member state, of verifying whether such bodies actually satisfy the statutory objectives for the purposes of its national legislation or by the necessity of monitoring the actual running of those bodies.

... the need to guarantee the effectiveness of fiscal supervision constitutes an overriding reason in the public interest capable of justifying a restriction on the exercise of the freedoms of movement

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<sup>33</sup> Article 1 of the directive provides:

"1. In accordance with the provisions of this Directive the competent authorities of the Member States shall exchange any information that may enable them to effect a correct assessment of taxes on income and on capital, ...

2. There shall be regarded as taxes on income and on capital, irrespective of the manner in which they are levied, all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the disposal of movable or immovable property, taxes on the amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation..."

Article 2 provides:

"1. The competent authority of a Member State may request the competent authority of another Member State to forward the information referred to in Article 1(1) in a particular case. The competent authority of the requested State need not comply with the request if it appears that the competent authority of the State making the request has not exhausted its own usual sources of information, which it could have utilised, according to the circumstances, to obtain the information requested without running the risk of endangering the attainment of the sought after result.

2. For the purpose of forwarding the information referred to in paragraph 1, the competent authority of the requested Member State shall arrange for the conduct of any enquiries necessary to obtain such information.

In order to obtain the information sought, the requested authority or the administrative authority to which it has recourse shall proceed as though acting on its own account or at the request of another authority in its own Member State."

guaranteed by the Treat. ... it must comply with the principle of proportionality, in that it must be appropriate for securing the attainment of the objective it pursues and must not go beyond what is necessary to attain it ...

... the possibility cannot be excluded a priori that the taxpayer is able to provide relevant documentary evidence enabling the tax authorities of the member state of taxation to ascertain, clearly and precisely, the nature and genuineness of the expenditure incurred ...

Nothing would prevent the tax authorities concerned from requiring the taxpayer to provide such proof as they may consider necessary in order to determine whether the conditions for deducting expenses provided for in the legislation at issue have been met and, consequently, whether to allow the deduction requested ...

... a member state is authorised to apply measures enabling it to ascertain in a clear and precise manner whether the body meets the conditions imposed by national law in order to be entitled to the exemption and to monitor its effective management ... Any administrative disadvantages arising from the fact that such bodies may be established in another member state are not sufficient to justify a refusal on the part of the authorities of the state concerned to grant such bodies the same tax exemptions as are granted to national bodies of the same kind.

The same applies in the case of the taxpayer who claims a tax deduction in a member state for a gift to a body established and recognised as charitable in another member state, even if, in such circumstances, and contrary to what was the case in *Centro di Musicologia Walter Stauffer*, the taxpayer from whom the tax authorities have to obtain the necessary information is not the body which received the gift but, indeed, the actual donor.

... declarations by a body which fulfils, in its member state of establishment, the requirements of the law of that member state for the grant of tax advantages, cannot be left out of consideration, particularly if that legislation makes the grant of tax advantages intended to encourage charitable activities subject to identical requirements.

... the tax authorities concerned may, pursuant to Directive 77/799, call upon the authorities of another member state in order to obtain all the information that may be necessary to effect a correct assessment of a taxpayer's liability to tax (*Centro di Musicologia Walter Stauffer* (para 50))...

A change in the UK law is inevitable. In the meantime EU charities should claim UK charity tax reliefs, as they are entitled to them under EU law. (Claims might possibly be delayed pending clarification of the law,

but note the time limits for claims.) However, donations to UK charities (eg “friends of” EU charities) is the most straightforward way to ensure that reliefs will be obtained without difficulty.

#### 1.13.4 *UK charities supporting foreign charities*

UK charities may be set up in order to obtain charity relief not obtainable on a gift to a foreign charity directly. The Charity Commission addresses this from a charity law perspective:

14. If an organisation is set up to raise funds for a specified organisation in another country, it may or may not be charitable.

15. A common example might be where an organisation has been set up to support the work of a particular hospital located overseas. The deciding factor will be the degree of control the trustees have over the use of the funds passed to the hospital.

If they:

- are merely required to pass over any funds collected to the hospital; and
- have no say in how those funds are to be used,

then the organisation is merely acting as a channel for the funds and is not charitable. The organisation could not ensure in these circumstances that the hospital would use the funds only for purposes which were regarded as charitable in accordance with the laws of England and Wales.

16. If such an organisation wishes to be a charity it should clearly demonstrate that:

- it has purely charitable objects;
- its trustees have control over how its funds will be used; and
- the trustees are responsible for the selection of beneficiaries and/or projects to support.

17. Careful consideration should be given to the drafting of objects. For example, an object that states simply that the organisation is established to “..support the charitable work of the .....hospital” would not be ideal. If the hospital ever closed, the supporting body would have no outlet for its funds. In such cases, if the supporting body is a charity, the Commission’s intervention may be required if its work is to carry on. It would be preferable for the objects to be expressed in a broader way, for example “The relief of sickness in [country] in particular by supporting the charitable work of the .....hospital.” This wording would provide a potentially wider outlet for the organisation’s funds.

18. The hospital can suggest the types of support it requires so that funds can be directed where they are most needed, but the final decision about how funds will be used must rest with the trustees of the supporting charity.<sup>34</sup>

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<sup>34</sup> “Charities Working Internationally” accessible [www.charity-commission.gov.uk](http://www.charity-commission.gov.uk).

It is suggested that *Furniss v Dawson* does not apply provided that the UK charity takes reasonable care, as indeed it must: see 4.7 (Payment to a foreign body).

## **1.14 Registration of charities and tax relief**

### *1.14.1 Does non-registration forfeit tax relief?*

A charity may qualify for charity tax relief even if is not on the register. That may happen if the need to register is overlooked or if registration is pending (and of course small charities do not have to register). Trustees of a charity which fails to register may incur a penalty but the body is still a charity<sup>35</sup> and it will not lose its tax relief.

### *1.14.2 Do all registered charities qualify for tax relief?*

An institution on the English charity commission register is conclusively presumed to be a charity law charity "for all purposes": s.4 Charities Act 1993. Thus HMRC will not normally contend that a registered charity is not a charity for tax purposes. That issue is determined in the process of registration.

## **1.15 Dispute over charitable status**

Charitable status is a matter which concerns the Charity Commission and HMRC. HMRC practice is to consult and adopt the view of the Charity Commission. Where the Charity Commission determines that a body is not a charity they inform HMRC.

In the event of a dispute in England a body has two modes of appeal. It may appeal to the Charity Tribunal under s.2A Charities Act 1993, against the decision of the Charity Commissioners that it is not a charity. Alternatively it may appeal to the Tribunal against a tax assessment. The choice between the two forms of appeal will often be decided on tactical considerations.

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<sup>35</sup> No authority is needed as this is self evident; but for an example see *Re Murawski* [1971] 1 WLR 707.

## **1.16 Brief history of charity tax controversies**

The definition of tax charity may be thought to be too narrow in some ways so that bodies which deserve tax relief do not qualify as "charities". This is easily dealt with. Either the term "charity" may be extended to include such bodies or (which amounts to the same) tax relief applicable to charities may be extended to these non-charitable bodies. There have been a few minor reforms of this type. Normally the desire has been to restrict charity tax relief rather than to extend it.

Charity tax relief goes back to the origin of income tax, being found in the 1799, 1803 and 1842 Income Tax Acts, and was controversial from the beginning. An Inland Revenue memorandum prepared for the 1920 Royal Commission on Income Tax explains the 19th century history of the subject:

In 1863 Mr Gladstone proposed to repeal the income tax exemption in favour of charities, on the ground that the exemption amounted to a grant of public money without public control, and a large number of charities, especially the "dole" charities, were not beneficial to the community. ... The proposal was strongly opposed and was eventually dropped, although the matter went so far as the introduction of a repealing clause in the Customs and Inland Revenue bill of the year 1863.

Again in 1871, in relation to the Charity Commission, a resolution was passed in the House of Commons to the effect that "discontinuing the exemption of endowed charities from income tax is a suitable method of carrying out the decision of this House against the payment of the expenses of the Charity Commission out of public funds". No action was, however, taken to put the resolution into effect.<sup>36</sup>

No one more recently has seriously proposed the complete abolition of charity tax relief.<sup>37</sup> The Inland Revenue invited the 1920 Royal Commission to consider some restriction on charity tax exemption:

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<sup>36</sup> Royal Commission on Income Tax, 6th instalment of the Minutes of Evidence, Cmd. 288-6, Appendix 31. For more historical background see *Trusting Leviathan*, Martin Daunton, Cambridge University Press, 2001 p.210-217.

<sup>37</sup> However a minority in the 1955 Royal Commission on the Income Tax proposed that charities should be taxed at a lower rate: Report Cmd. 615 p.352 & 417.

It might perhaps take the form of confining the relief from income tax:-

- (a) to charities concerned primarily to benefit classes of persons with small incomes which, if not below the limit of exemption, are subject to little or no tax after allowance of all reliefs, and
- (b) to other charities not falling under (a), but conforming to the popular conception of the term, i.e., to charities for the relief of physical distress.

Under a restricted exemption of this nature, charities for the relief or education of the poor, hospitals and other charities for the relief of physical distress (such as the National Life-Boat Institution) will continue to enjoy the relief. On the other hand, charities for the education of the well-to-do, religious bodies, and the miscellaneous charities which are not infrequently for the benefit of the well-to-do in part, or are for the dissemination of some particular doctrine, religious or secular, would no longer be entitled to claim relief.

... there is no doubt that there would be strong opposition to the proposal, particularly from the richer charities ...

The 1920 Royal Commission concluded that for the purposes of income tax, "charity" should be redefined,<sup>38</sup> but it did not say what the new definition should be! The 1955 Royal Commission again proposed that the concept of "charity" should be narrowly defined for the purpose of charity tax exemption.<sup>39</sup> It put forward a definition: "the relief of poverty, the prevention of or relief of distress, the advancement of education, learning and research, and the advancement of religion". It would exclude the fourth class of charity (objects beneficial to the community and within the spirit of the Statute of Elizabeth). But the Royal Commission recognised that "exemption would be denied to a number of praiseworthy activities which at present enjoy it" and nothing was done.

The Charities Act 2006 has now provided a statutory definition of charitable purpose. However (apart from the provisions about public benefit, a discussion of which is beyond this book) the definition of charity has not changed in substance. Everything (or virtually everything) which was charitable before the Act took effect is charitable now. Unlike the earlier proposals to reform the definition of charity, the Charities Act 2006 was not a reform much motivated by tax considerations.

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<sup>38</sup> Report of the Royal Commission on the Income Tax Cmd. 615 p.67.

<sup>39</sup> Royal Commission on the Taxation of Profits and Income Final Report, 1955, Cmd. 9497, p.57.

### **1.17 Policy reasons for reliefs for charities and donors to charity**

Almost all western countries (and many underdeveloped countries)<sup>40</sup> recognise the desirability of supporting non-profit organisations by granting some degree of charity tax exemption and donor incentives. The eligibility criteria and the benefits available differ but there is a broad consensus in the international community that such reliefs are in principle justified.

The case for tax reliefs on a charity's income and gains is essentially self-evident, but if one wishes to be more analytic, the arguments include the following:

- (1) charities are a cost-effective means of delivering services the cost of which would otherwise fall on the State;
- (2) charities promote important values, including voluntarism, self-responsibility, and participative democracy; and
- (3) charities represent an important mechanism for encouraging philanthropy.

The case for tax reliefs for donors to charity is similarly self-evident, but if one wishes to be analytic, the arguments include the following:

- (1) a pragmatic argument: donor tax reliefs encourage philanthropy and so benefit charities.
- (2) fairness and other arguments

As to the pragmatic argument, commonsense and anecdotal evidence suggests that donor deductibility increases philanthropy, but the extent to which donor deductibility leads to greater donations is not straightforward to measure. As a starting point, it depends on the price elasticity of charitable giving, marginal tax rates, the level of relief, and the administrative cost and hassle involved. A deduction for charitable donations offers taxpayers at the highest rates the highest level of benefit for their donations. Hence donations ought to rise with increases in the top tax rates. On the other hand, an increase in tax rates reduces taxpayers available income and with it the funds needed to make charitable contributions. In addition, philanthropy depends on unmeasurable donor perceptions of fairness so point (2) interacts with point (1). It seems to us

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<sup>40</sup> See eg the Katz commission report in South Africa [www.polity.org.za/polity/govdocs/commissions/1999/katz9\\_2.htm](http://www.polity.org.za/polity/govdocs/commissions/1999/katz9_2.htm).

unrealistic to expect that the many causative factors can be untangled, though this does not stop economists from trying.<sup>41</sup>

The second and in our view no less important justification for donor based reliefs is fairness or (more precisely expressed) horizontal equity, the view that people who are relevantly equal should be treated equally. Of course this begs the question of whether two taxpayers with the same income are relevantly equal, if one does and the other does not make a gift to charity. In our view, charitable giving is not equivalent to any other personal expenditure. Those who give to charity are making a payment to the public benefit, just as taxes are a payment for the public benefit, so it is just and reasonable to allow some tax relief for charitable donors. Thus the pragmatic argument that donor reliefs increase charitable giving (while valid) is not the only or even the main justification for the reliefs.

A third justification for donor based reliefs is that charitable giving is a good *per se*: an act of civic participation which strengthens the fabric of the community, and so is to be encouraged for its own sake.

Behind these arguments there lie deeper issues on the role of the State. Those who take the view that governments know better than individuals how all resources should be applied will naturally find charity reliefs unpalatable.<sup>42</sup> Those with animosity towards government spending will tend to support the reliefs.

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<sup>41</sup> In the US context, Lester Salamon has commented:

“Whether such tax incentives actually induce taxpayers to make charitable contributions or merely influence the timing and amount of such gifts is open to debate, but there appears to be compelling evidence that they have some effect at least on the timing and amount of gifts.”

<sup>42</sup> The International Guide to Nonprofit Law, Lester Salamon (1997) John Wiley & Sons.  
“Critics charge ... that such incentives are undemocratic since they vest in the hands of private persons, decisions over how to allocate revenues that would otherwise come to the government in the form of taxes.” The International Guide to Nonprofit Law, Lester M. Salamon (1997) John Wiley & Sons.