

*This file contains the Table of Contents, Introduction and Chapter 1 of
Taxation of Charities and Nonprofit Organisations 13th Edition
2022/23 by James Kessler QC, Etienne Wong and Jon-Selous Borlace*

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INTRODUCTION AND WHAT'S NEW

Scope of this book

The subject of this book is the taxation of:

- (1) charities
- (2) other nonprofit organisations¹
- (3) their donors and supporters

The importance of tax, and the tax cost of ignoring tax law, will be obvious to all our readers. It is the duty of charity trustees – and their professional advisers – to ensure that a charity's tax affairs are properly managed.

The years 2020-2022 in review

HMRC have reversed their longstanding view and now accept that waiver of a debt qualifies for Gift Aid relief; an unexpected consequence of the Covid pandemic. In *Eynsham Cricket Club v HMRC*, the Court of Appeal confirmed that a registered club cannot be a charity. *Re Webster* illustrated the importance of inserting the correct figures in a tax return when claiming Gift Aid carry-back relief.

The years 2020-2022 in review

On VAT, the last couple of years saw the Court of Justice of the European Union deliver its ruling in *University of Cambridge* (on VAT recovery) and the Supreme Court hand down its judgment in *SAE Education Limited* (on the education exemption). They also saw new HMRC guidance on the VAT treatment of digital advertising, and the culmination of the dispute between local authorities across the UK and HMRC regarding the VAT liability of charges for access to sports and leisure

¹ A note on terminology: The term “not for profit entity” is sometimes used. “Public benefit entity” has the same meaning; though it is more formally defined in FRS 100 as “an entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any equity is provided with a view to supporting the entity's primary objectives rather than with a view to providing a financial return to equity providers, shareholders or members.”

facilities (in Chelmsford City Council, Midlothian Council and Mid Ulster District Council).

There have been many revisions to the HMRC Guidance Note, as usual, and new guidance from the Charity Commission. Many other parts of the book have been rewritten in an attempt to analyse the problems more deeply and more clearly.

Thanks...

We are very grateful to Robert Venables QC, joint author of the first two editions of this book, for enjoyable discussions on many aspects of tax, and to Setu Kamal, Harriet Brown, Mary Ashley and Ross Birkbeck, co-authors of previous editions. Yanpei Zhang as research assistant resolved many puzzles. We owe a great debt to Jane Hunt and Ruth Shaw who work diligently on this challenging text throughout the year.

... and request for help

Comments from readers would be of the greatest value and interest to the authors. The pleasure in writing this book consists in the interest of the questions which it raises and the success which it may have achieved in answering them. On the basis of what is known at 1 April 2022, it seeks to state the law for 2022/23.

James Kessler QC
Etienne Wong
Jon-Selous Borlace

15 Old Square
Lincoln's Inn
London WC2A 3UE

kessler@kessler.co.uk
Ewong@15oldsquare.co.uk
jon-selousborlace@15oldsquare.co.uk

OBTAINING FURTHER ADVICE - AND DISCLAIMER

Further advice

If you want advice on which you are legally entitled to rely you can obtain it - but not from this work.

In particular you may instruct any of the authors to advise. We enjoy writing, but spend most of our time giving independent specialist professional advice, including, in particular, advice on the taxation of charities. For further details see <https://www.taxationofcharities.co.uk>.

In cases where a charity which we wish to support cannot be expected to pay a commercial fee, we will consider acting for less than a commercial fee or pro bono. If a matter is not suitable, for reasons of cost or any other reasons, we will give recommendations.

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The views contained in this book are put forward for consideration and are not to be relied upon. Neither the authors nor the publisher accept any responsibility for any loss to any person arising as a result of any action taken or refrained from in reliance on this work.

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CHAPTER ONE

POLICY ISSUES IN CHARITY TAXATION

- 1.1 Introduction
- 1.2 Brief history of charity tax
- 1.3 Reform of tax definition of charity
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- 1.5 Matched funding incentives
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 - 1.7.2 Charitable Remainder Trusts

1.1 Introduction

This chapter considers the history of charity tax relief and its policy and human rights issues. It concludes with a look into the future.

1.2 Brief history of charity tax

Tax relief for income of charities 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.¹ 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

1 This chapter only considers the UK position, but the issues are international: see Chia “Charitable Treatment?—a Short History of the Taxation of Charities in Australia” https://law.unimelb.edu.au/__data/assets/word_doc/0006/1977270/2.-TaxingCharitiesFINAL2.doc

For more historical background see Daunton, *Trusting Leviathan* (2001) p.210-217.

dropped, although the matter went so far as the introduction of a repealing clause in the Customs and Inland Revenue bill of the year 1863.²

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”.³ No action was, however, taken to put the resolution into effect.⁴

No-one more recently has seriously proposed the complete abolition of charity tax relief.⁵

This chapter focuses on IT relief; see too:

For the history of specific types of charity tax relief, see:

Topic	See para
Gift Aid	15.2
Corporate Gift Aid	17.2.1
IHT charity relief	24.5
Charity rating relief	40.1

1.3 Reform of tax definition of charity

1.3.1 Single definition: problems

At present (more or less) the same definition of charity is used for different purposes:

- (1) Tax reliefs
- (2) Charity law, which provides special rules governing registration, administration and duration of charities.

Lord Cross pointed out the problems which arise from using the same definition for both purposes:

-
- 2 See Hansard, [Bill 91] Committee (4 May 1863)
http://hansard.millbanksystems.com/commons/1863/may/04/bill-91-committee#S3V0170P0_18630504_HOC_45
 - 3 HC Deb 21 April 1871 vol 205 cc1505-14
<http://hansard.millbanksystems.com/commons/1871/apr/21/the-charity-commission-exemption-of>
 - 4 Royal Commission on Income Tax, 6th instalment of the Minutes of Evidence, Cmd. 288-6, Appendix 31.
 - 5 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 is, of course, unfortunate that the recognition of any trust as a valid charitable trust should automatically attract fiscal privileges, for the question whether a trust to further some purpose is so little likely to benefit the public that it ought to be declared invalid and the question whether it is likely to confer such great benefits on the public that it should enjoy fiscal immunity are really two quite different questions. The logical solution would be to separate them and to say - as the Radcliffe Commission proposed⁶ - that only some charities should enjoy fiscal privileges.

It would be better to have two distinct definitions.⁷

1.3.2 *Reform proposals*

Proposals for reform generally involve leaving the charity law definition alone, and providing a separate (usually narrower) definition for tax purposes. But that cannot be done unless one can come up with a better definition of what should be a charity for tax purposes. While the current definition of charity is not ideally suited to identify the causes for which tax relief is appropriate, it is difficult to come up with a better one.

The Inland Revenue invited the 1920 Royal Commission to narrow the definition of charity for tax purposes:

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, ie, 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

6 See 1.2 (Brief history of charity tax).

7 The trust law problems raised by non-charitable purpose trusts would best be resolved not by a wider definition of "charity" but by a regime which allows such trusts, subject to safeguards, as exists in many trust law jurisdictions. But in practice this problem may not be very important.

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

...

The 1920 Royal Commission concluded that “charity” should be redefined for tax purposes⁸ but it did not say what the new definition should be!

The 1955 Royal Commission (the Radcliffe Commission) again proposed that “charity” should be narrowly defined for tax purposes.⁹ 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”. This would exclude the fourth class of charity (other objects beneficial to the community). The Commission recognised that under its proposal “exemption would be denied to a number of praiseworthy activities which at present enjoy it” and nothing was done.

The Charities Act 2006 (now the CA 2011) provided a statutory definition of charitable purpose. However the definition of charity has not materially changed. Everything (or virtually everything) which was charitable before 2006 is charitable now. Unlike earlier proposals to reform the definition of charity, the 2006 Act was not a reform much motivated by tax considerations.

1.3.3 *Single definition: consequences*

The present situation of a single definition has some impact on the way the courts approach the question of what is charitable. Lord Cross continues:

But, as things are, validity and fiscal immunity march hand in hand and the decisions in the *Re Compton* [1945] Ch 123 and *Oppenheim* [1951] AC 297 cases were pretty obviously influenced by the consideration that if such trusts as were there in question were held valid they would enjoy an undeserved fiscal immunity.¹⁰

Although other judges expressed the view that tax advantages should not be a relevant consideration in determining whether an object is charitable, that must inevitably play a role in judicial thinking. This issue was reviewed in *Independent Schools Council v Charity Commission* which

8 Report of the Royal Commission on the Income Tax Cmd. 615 p.67.

9 Royal Commission on the Taxation of Profits and Income Final Report, 1955, Cmd. 9497, p.57.

10 *Dingle v Turner* [1972] AC 601 at p.625.

reached the same conclusion:

... the fact that fiscal privileges are given underlines the need for genuine public benefit.¹¹

1.4 Charity reliefs: Policy

Almost all western countries (and many underdeveloped countries)¹² recognise the desirability of supporting nonprofit organisations by granting tax exemptions to charities and to donors. The details differ but there is a broad international consensus that some reliefs are in principle justified.

For a discussion of the policy issues the starting point should be Melbourne Law School (2011) “Taxing Not-for-profits: a Literature Review”.¹³

1.4.1 Reliefs of charity

The case for tax reliefs on a charity’s income and gains is that it facilitates the work of charities. The benefit to the public from (most) charitable activity is perhaps self-evident, but if one wishes to be more analytic, the arguments include the following:

- (1) Charities offer a means of delivering services:
 - (a) which may not be provided by private businesses
 - (b) which may be more effectively or cheaply provided than by the state (given a charity’s special relationship with the community)
 - (c) the cost of which may otherwise fall on the State.Hence some traditionally government activities are being outsourced to charities.
- (2) Charities promote important values, including voluntarism, self-responsibility, and participative democracy.

11 [2012] Ch 214 at [176].

12 See eg the Katz Commission report in South Africa
http://www.polity.org.za/polity/govdocs/commissions/1999/katz9_2.htm.

13 Melbourne Law School (2011)
https://law.unimelb.edu.au/__data/assets/word_doc/0006/1977270/2.-TaxingCharitiesFINAL2.doc See too:
Fleisher, “How is the opera like a soup kitchen?” in Bhandari, ed, *Philosophical Foundations of Tax Law* (2017).
Koele *International Taxation of Philanthropy* para 2.3 (Political philosophy of preferential tax status)
<https://dspace.library.uu.nl/handle/1874/23627>

- (3) Charities constitute an important mechanism for encouraging philanthropy.

HMRC publish data on the tax cost of charity reliefs,¹⁴ but raw statistics require interpretation. For instance, local authorities are exempt from taxation; if they spin off activities into charities there is no net tax cost, (unless you count in the cost of local authorities tax relief too) but additional figures enter into the HMRC data. Similarly for national government. The amount involved here may be substantial and may not be easy to measure. The charts are highly misleading as they do not adjust for inflation.

1.4.2 *Reliefs of donor*

Donor tax reliefs raise slightly different issues.

Some donor reliefs prevent a charge which would otherwise arise on a gift to charity (such as CGT and IHT relief on lifetime gifts). It is self-evident that these reliefs encourage philanthropy, and that few donors would make voluntary gifts to charity if the making of the gift gave rise to a tax charge.

Other donor reliefs (corporate Gift Aid, QIDR and higher rate relief for individual Gift Aid) confer an income tax deduction on the donor. We refer to these as “**donor-deduction reliefs**”. The case for donor-deduction reliefs is similarly self-evident, but if one wishes to be analytic, the arguments include the following:

- (1) A pragmatic argument: donor-deduction reliefs encourage philanthropy and so benefit charities and the public generally
- (2) Fairness arguments

As to the pragmatic argument, it is relevant to ask whether donor deductibility does increase philanthropy? and if so by how much: are the reliefs value for money, ie, does the additional amount received by charity exceed the tax foregone? Commonsense and anecdotal evidence suggest that the answer to the first question must be yes; but that will not answer the second question: the extent to which donor deductibility leads to greater donations is not easy to measure. As a starting point, it depends

14 HMRC, “UK Charity Tax Relief Statistics 1990-91 to 2016/17” (2017)
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/532722/UKCharityTaxReliefStatisticsCommentary.pdf

on:

- (1) The price elasticity of charitable giving (what donations would be made if there were fewer or no tax reliefs?)¹⁵
- (2) The value of the tax relief (which in turn depends on the marginal tax rates).
- (3) The administrative cost and hassle involved.
- (4) Donor's perceptions: incentive effects of reliefs may be diminished if donors underestimate the value of relief, or it may be increased if donors overestimate it.¹⁶

A full deduction for charitable donations offers the highest level of benefit to top rate taxpayers. If tax rates increase, the value of the incentive rises so if the incentive is effective, charity giving by top rate taxpayers ought to increase. That seems to offer scope for measurement. But 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: pragmatic and fairness considerations interact. It seems to us unrealistic to expect that the many causative factors can be untangled: most of what can be said on the effect of donor relief on the motivation of donors remains in the realm of conjecture in psychology and must remain there. But this does not stop economists from trying. *Taxing Not-For-Profits*¹⁷ summarises the American economic literature:

... early accusations that the charitable contribution deduction was

15 There is also the question of to what extent donors could continue to find ways to obtain relief for charitable support if the current reliefs such as Gift Aid were abolished.

16 This factor is hard to measure: for discussion in a US context, see Listokin, "Tax Expenditure Saliency" [2014] *American Law and Economics Review* p.144.

17 Melbourne Law School (2011) p.30

https://law.unimelb.edu.au/_data/assets/word_doc/0006/1977270/2.-TaxingCharitiesFINAL2.doc in reviewing the US material it is of course necessary to consider to what extent the position in the UK is the same as in America. For a UK study, see Smith, "Increasing Charitable Giving: What Can We Learn from Economics?" (2012), *Fiscal Studies*, 33: 449-466.

See too See Feldstein (1975) "Income tax and charitable contributions: Aggregate and distributional effects", *National Tax Journal* 28(1) 81-100; Brown(1987) "Tax incentives and charitable giving – evidence from new survey data", *Public Finance Quarterly* 15(4) 386-396.

inefficient as it did not induce more giving than it ‘lost’ in revenue¹⁸ stimulated the growth of a voluminous econometric literature on the relationship between tax incentives and charitable giving... The research focuses on whether tax incentives are economically efficient ways of driving charitable giving,¹⁹ based on their ‘**price elasticity**’. Price elasticity measures the increase in aggregate giving in response to a decrease in after-tax cost, and a price elasticity figure greater than 1 indicates that is a ‘**treasury efficient**’ measure.

Such literature has demonstrated strong independent links between levels of giving and changes in the “price of giving”, being the net, out of pocket cost of giving a dollar to charity.²⁰ A major review by Clotfelter in 1985 found a notable consistency in the findings, with the consensus being that the price elasticity for the population of taxpayers was probably greater than 1, with a range of -0.9 to -1.4, and taxes also influence giving through changing the income. As well, it was observed that the price elasticity appeared to rise with income; there are substantial lags in giving behaviour; and there is little effect of ‘crowding out’ individual contributions through government contributions.²¹ While there were tax effects on corporate giving, this

18 Footnote original: See, eg, Taussig, ‘Economic Aspects of the Personal Income Tax Treatment of Charitable Contributions,’ (1967) 20 *National Tax Journal* 1; Schwartz, ‘Personal Philanthropic Contributions,’ (1970) 78 *The Journal of Political Economy* 1264.

19 Footnote original: For summaries, see Charles T Clotfelter, *Federal Tax Policy and Charitable Giving* (University of Chicago Press, 1985); J Johnson, ‘The Determinants of Charitable Giving with Special Emphasis on the Income Deduction Under the Income Tax—A Survey of the Empirical Literature’ (1981) 3 *Canadian Taxation* 258; Scharf, Hogg, and Cherniavsky, *Tax Incentives for Charities in Canada*, (Working Paper No CPRN, No 03, Canadian Policy Research Networks, 1997).

20 Footnote original: See the overviews in John Peloza and Piers Steel, ‘The Price Elasticities of Charitable Contributions: A Meta-Analysis’ (2005) 24 *Journal of Public Policy and Marketing* 260; Scharf, Hogg, and Cherniavsky, *Tax Incentives for Charities in Canada*, above. See also Clotfelter, *Federal Tax Policy and Charitable Giving*, (University of Chicago Press, 1985); Gerald E Auten, Holger Sieg and Charles T Clotfelter, ‘Charitable Giving, Income, and Taxes: An Analysis of Panel Data’ (2002) 92 *American Economic Review* 371. The basic economic model used is explained in Charles T Clotfelter and Lester M Salamon, ‘The Impact of the 1981 Tax Act on Individual Charitable Giving’ in Susan Rose-Ackerman (ed), *The Economics of Nonprofit Institutions: Studies in Structure and Policy* (Oxford University Press, 1986) 207, 211–212.

21 Footnote original: Clotfelter, *Federal Tax Policy and Charitable Giving*, (University of Chicago Press, 1985), 274–275.

appeared to be less than for individual contributions, and there was also evidence that corporations time-shift their donations.²²

The literature has examined both the ‘price effects’ (including tax rates), which influence the cost of giving, and the ‘income effects’, such as inflation or economic growth, that affect the income available for charitable giving.²³ Newer methodologies used in more recent studies have reported much lower price elasticities.²⁴ Nevertheless, a recent meta-analysis of the 40 years of research in this field concluded that tax deductions were treasury efficient, and (surprisingly) that the price elasticity was not significantly higher for high-income earners.²⁵

Similarly, in the US context, Lester Salamon has concluded:

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.²⁶

A second and in our view no less important justification for donor-deduction reliefs is fairness or (more precisely expressed) horizontal equity, the view that people who are relevantly equal should pay the same amount of tax. This turns on 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 different to any other personal expenditure. Those who give to charity are making a payment for 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-deduction reliefs increase charitable giving (while valid) is not the only or even the main justification for the reliefs.

22 Footnote original: Ibid 275.

23 Footnote original: Clotfelter and Salamon, ‘The Impact of the 1981 Tax Act,’ in Susan Rose-Ackerman (ed), *The Economics of Nonprofit Institutions: Studies in Structure and Policy* (Oxford University Press, 1986) 210.

24 Footnote original: See, eg, Richard Steinberg, ‘Taxes and Giving: New Findings’ (1990) 1 *Voluntas: International Journal of Voluntary and Nonprofit Organizations* 61; William C Randolph, ‘Dynamic Income, Progressive Taxes, and the Timing of Charitable Contributions’ (1995) 103 *Journal of Political Economy* 709.

25 Footnote original: Peloza and Steel, ‘The Price Elasticities of Charitable Contributions: A Meta-Analysis’ (2005) 24 *Journal of Public Policy and Marketing* 267–268.

26 Salamon, *The International Guide to Nonprofit Law* (1997).

A third justification for donor-deduction 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.

If one accepts that charity reliefs encourage charitable activity, there is still the question of whether charities make better use of funds than the State. (One might similarly ask whether some bodies not within the current definition of charity may make better use of funds than the State, if they qualified for exemption.) This raises deep issues on the role of the State. Those who take the view that governments know better than individuals how resources should be applied will naturally find charity reliefs unpalatable.²⁷ Those with animosity towards government spending will tend to support the reliefs.²⁸

Smith summarises the issue this way:

In providing tax relief, the government forgoes its own spending to subsidise privately-funded public goods and this has implications for the mix of public good provided. The type of good that individuals choose to allocate money to may be different in terms of efficiency of provision and the types of goods provided. In some of the media, this was summarised fairly crudely as a choice between funding the National Health Service or the Royal Opera House. The White Paper is relatively silent on the issue of whether causes matter, focussing only on the overall level of giving, yet it is potentially an important issue.

There is relatively little evidence on the types of charities supported by different donors that would be particularly relevant to the debate on the cap on tax relief...

Smith refers to data from the Individual Giving Survey.²⁹ The relevant figures are those specifying the total amounts given, not the total

27 “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.” Salamon, *The International Guide to Nonprofit Law* (1997).

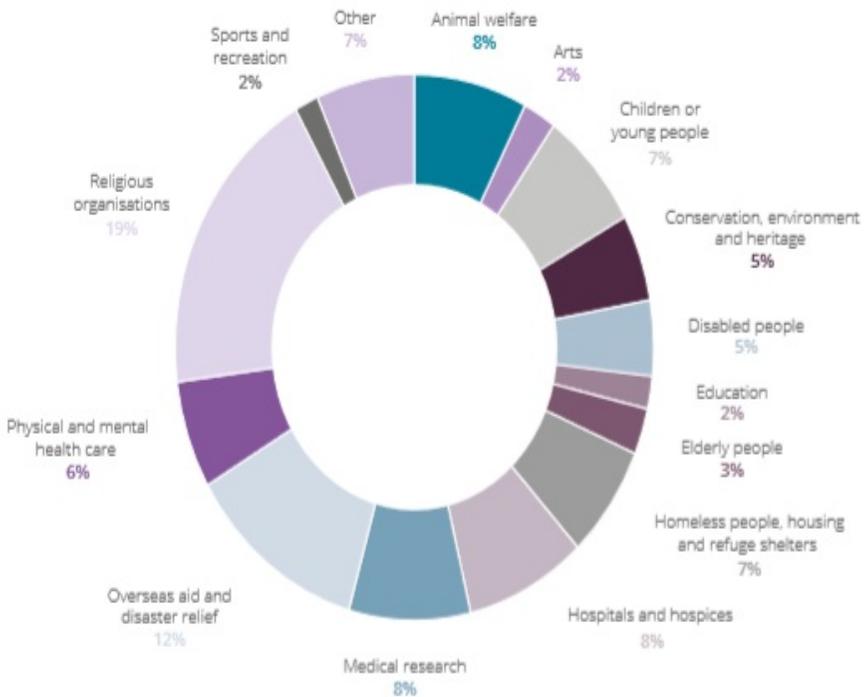
28 A careful discussion of these issues also needs to scrutinise the distinction between government and the charitable sector, which can become blurred; see Galbraith, *The Economics of Innocent Fraud*, (2004) chapter 7 (The Myth of the Two Sectors).

29 An overview of charitable giving in the UK (2018)

<https://www.cafonline.org/docs/default-source/about-us-publications/caf-uk-giving-2018-report.pdf>

number of donors. I here set out the most recent graph.³⁰

Figure 5: Proportion of total donation amount received by each cause in 2017



Base: All adults 16+ who have donated directly to a charity in the last four weeks (n=4,028)

In this graph, religious organisations receive the largest share of donations in terms of total monetary value (19%). If the process of secularisation in the UK continues at its current rate,³¹ the case for tax relief for religious charities may come under scrutiny (though conversely, the sums given for religious charities would decline).³² But medical charities are by far the most popular cause and receive almost one-quarter of all donations, if one regards medical and hospitals (including hospices) as a single item. It is clear that “choice between funding the National

30 The proportion of donors do not add up to 100% due to the fact that a donor can choose more than one cause. The category of ‘other’ has been excluded from the table and for this reason neither does the proportion of total amount donated sum to 100%.
 31 For the sociological background, see Bruce *Secularization* (2011).
 32 The case against tax relief is set out by Edge, “Charitable Status for the Advancement of Religion: An Abolitionist’s View” (1995) 3 CLPR 29.

Health Service or the Royal Opera House” is a tendentious way of summarising the issue, though if one did put it that way, donors greatly favour health over the arts.

Smith concludes:

Looking at this allocation raises some fairly important questions about whether it is optimal in any sense - for example, whether the money is going to the most effective charities, or to the areas of greatest need, or indeed to match donors’ preferences over the allocation of total giving.³³

Once again the raw data needs interpretation. The issues are more complicated than this table suggests in (at least) three ways:

- (1) The statistics do not easily cater for gifts to grant making charities (including the CAF) or the grants made by them.
- (2) Governments may (and no doubt to some extent do) mitigate what they regard as an imbalance by reducing their own allocation to causes which are considered sufficiently well funded by charitable giving.
- (3) This table measures charitable giving: some of that giving would not qualify for charity tax relief.

The statistical problems may be insoluble but at the least it should be noted that raw data gives an impression of accuracy which is entirely spurious.

Although the public debate has focussed on donor-deduction reliefs (primarily, Gift Aid) similar issues would arise if there were a debate on the merits of reliefs enjoyed by charities themselves. Here too the debate should consider not just the total cost of the relief, but the way in which the relief is distributed round different parts of the charitable sector: which sectors have the most investment income and so benefit most from the reliefs? We are not aware of data relating to this issue.

For the question of whether charity tax relief constitutes unfair competition for non-charities, see 8.19.1 (Fair competition argument).

1.4.3 *Proposed cap on donor reliefs*

Gift Aid originally had a (somewhat theoretical) limit of £5m, and at one time deeds of covenant had a much lower limit for higher rate relief.³⁴

33 Smith, “Increasing Charitable Giving: What Can We Learn from Economics?” (2012), *Fiscal Studies*, 33: 449–466.

34 See 15.2 (Gift Aid: History).

Some other countries impose a limit of some kind.³⁵ In the 2011/12 edition of this work, we dealt with this issue quite briefly, saying:

If it is accepted that gifts to charity are in principle to be encouraged, it is difficult to see why more substantial gifts should be discouraged by a cap on the tax relief, so the UK system is to be preferred.

However, the “omnishambles” budget of 2012 provided:

2.40 Cap on unlimited reliefs – The Government will, from 6 April 2013, introduce a new cap on income tax reliefs to ensure that those on higher incomes cannot use income tax reliefs excessively. For anyone seeking to claim more than £50,000 of relief, a cap will be set at 25% of income (or £50,000, whichever is greater).

The statement added somewhat lamely:

The Government will explore with philanthropists ways to ensure this new limit of uncapped reliefs will not impact significantly on charities that depend on large donations.

The impact of the cap on large donations was self-evident: donations would not be made in excess of the cap; donors would instead spread gifts to ensure that the donation of each year did not exceed the cap for tax relief.³⁶

At first sight it seems unlikely that significant charity donations come from individuals giving more than 25% of their income to charity.³⁷ However one must take into account capital gains and inheritances. In the year that an individual sells their business, they may realise a large gain and may well feel it appropriate to give the entire income of the year to

35 Ireland has a compromise limit of 10% of an individual’s total income applicable to gifts to connected charities. This may be designed to stop members of religious charities giving all their earnings back to their order which supports them. Hong Kong restricts relief to 25% of a person’s income: s.16D Inland Revenue Ordinance. In the US there is a general limit of 50% of adjusted gross income.

36 Evidence is also available: Smith, “Increasing Charitable Giving: What Can We Learn from Economics?” (2012), *Fiscal Studies*, 33: 449–466: “Changes in tax relief are likely to trigger sizeable adjustments in contributions and the charitable sector would stand to lose more from the proposed cap on tax relief than the government would gain in tax revenue. On this evidence, the government’s proposal to cap tax reliefs on donations was considering cutting incentives for precisely the group for whom such incentives are likely to matter most for giving...”

37 If that were true it cuts both ways on the policy issues. If there were no limit, it would not make much difference to the tax take.

charity.

The editor of *Taxation* summarised the debate which followed:

There was no worthwhile detail provided in the Budget documentation, which suggests that it was a policy cooked up before the now obligatory deliberate leaking of all the Chancellor's proposals to the *Sunday Times* on Friday night and the actual delivery of the speech on Wednesday lunchtime. The pressures of working in a coalition meant that there had to be a payback for the reduction of the highest rate of tax from 50% to 45%.

The government was not sure whether it was an attack on tax avoiders or the introduction of something like a minimum tax rate. Initially the narrative focused on the former. There were off-the-record briefings about donations into Romanian charitable trusts which would end up back with the donor. If that had been the target, the phrase 'sledgehammer to crack a nut' would never have been more appropriate. It appears that at least one such scheme does exist, but it equally does not appear to be a widespread problem, and could have been stopped by the existing rules if only HMRC had put some manpower into investigating those running such "charities". Conscious that the argument was getting away from it, the government tried to regain some ground, explaining that the Chancellor had seen anonymised tax returns of high-earning individuals who had significantly reduced their tax bills by offsetting ... charitable donations. ... there could have been no way of knowing whether .. any charitable donations were genuinely made for truly charitable purposes, so what the Chancellor saw was meaningless. Only recently has a more realistic line of argument surfaced, which was (ironically) best put in that bastion of Conservative journalism, the *Guardian*:

'There is an entirely reasonable principle behind limiting the relief on donations: namely that people should pay their taxes... No one would openly suggest that the rich should be given special power to divert some large chunk of scarce public funds towards their pet priorities. But that is what happens where donations can be deducted from taxable income without any limit.'³⁸

If this was the real motivation, it would have been possible to deliver it in a way which was consistent with the new approach to making tax policy.³⁹ ... Instead, ... we are back to the 'rabbit out of a hat' approach. If so, the government has only itself to blame for the firestorm it has

38 See 1.4 (Policy reasons for reliefs for charities and donors to charity).

39 HMRC, "Tax policy making: a new approach" (2010).

created.⁴⁰

It has become standard practice that the government proposing a reform offers every possible reason, good bad and indifferent, in its support. So in the absence of a proper policy paper, it is impossible to ascertain what were the actual policy reasons behind the proposed reform, if indeed there were any. But whatever the reasons, the charity lobby had the better of the argument, and public support; and after floating a compromise of increasing the cap to 50%, the government abandoned the proposal.⁴¹

In all the public debate there was no mention of the history of income tax reliefs; though this issue has arisen many times before.⁴² For those who support a principles-based approach to tax reform, the story is a depressing one, though not unfamiliar. But at the end of the day, the right result was reached, and the issue is probably settled for the medium term.

1.5 Matched funding incentives

An alternative to tax reliefs for charity donations is an arrangement under which if an individual gives, the state also makes a payment to same charity. We refer to this as “**matched funding**”. This has not traditionally been a significant feature of UK legislation, but it has occasionally been used. The transitional relief on the reduction of the basic rate of income tax⁴³ is not a valid example as its purpose was to avoid a sudden drop in charity income, not to encourage charitable giving. An example is the 10% matched funding supplement to encourage the payroll giving scheme, which was in effect from 2000/01 to 2003/04. We are not aware of any serious study, and the raw data published by HMRC needs to be treated with considerable care, but it is possible that this was effective in its aim of increasing payroll giving. Certainly the withdrawal of the matched payment lead to a significant drop in giving; perhaps

40 Mike Truman, *Taxation Magazine*, 3 May 2012.

41 HMRC, “Delivering a cap on income tax relief: a technical consultation” (2012) para 2.13.

42 The consultation paper which followed misrecords the debate with a chutzpah which deserves to be recorded: “At the Budget, the Government was clear that it does not want donations to charity to be affected by the relief cap. Therefore, following extensive engagement with the charity sector, the Government has excluded the following from the cap: Gift Aid; Relief for gifts of land and shares; Payroll Giving; and Community Investment Tax Relief.”

See 15.2 (Gift Aid: History).

43 See the 7th edition (2009/10) of this work para 15.40.

donors brought their giving forward to take advantage of the last year of the relief, and then reduced their giving in the following year.

GASDS is a long term matched funding scheme introduced in 2012.

For basic rate taxpayers⁴⁴ (who are no doubt the large majority of donors by number) there is no practical difference between the Gift Aid system (a rebate of basic rate relief to the charity) and GASDS matched funding (payment to the charity regardless of tax status of the donor).

The difference does however cross a recognised line. The 1995 European System of Accounts provides:

4.28. The total value of the taxes which should be recorded ... is reduced by the amount of any tax rebates made by general government as a matter of economic policy and any tax refunds made as a result of over-payments.⁴⁵

This may be paraphrased by saying that a payment would be classified as negative taxation in national accounts if:

- (1) the benefit to the individual taxpayer did not exceed the amount of tax paid by them,
- (2) it was made as a matter of economic policy; and
- (3) the allowance was an integral part of the tax system.

The repayment of basic rate tax under Gift Aid rebate is classified as negative taxation; the GASDS top-up payment is classified as a government grant. GASDS is not part of the tax system, since there is no requirement that the donor should be a taxpayer.

1.6 Human rights

*Association Les Temoins de Jehovah v France*⁴⁶ concerned French gift tax on gifts to the French association of Jehovah's Witnesses. The rate of tax was 60%. French law provides relief for gifts to associations for worship but the association had not obtained the necessary authorisation to benefit from the exemption. The association relied on the gifts for its survival.

Article 9 of the European Convention on Human Rights provides:

44 Including higher rate taxpayers who do not bother to claim higher rate Gift Aid relief, which is common for smaller donations.

45 Council Regulation (EC) No 2223/96 of 25 June 1996 on the European system of national and regional accounts in the Community.

46 Application number 8916/05

<https://jwleaks.files.wordpress.com/2012/07/association-les-tmoins-de-jhov.pdf>

Everyone has the right to freedom of thought, conscience and religion; this right includes freedom to ... manifest his religion or belief, in worship, teaching, practice and observance.

Freedom to manifest one's religion or beliefs shall be subject only to such limitations as are prescribed by law and are necessary in a democratic society in the interests of public safety, for the protection of public order, health or morals, or the protection of the rights and freedoms of others.

The ECHR held that the application of gift tax to the association was a limitation on freedom of religion, because the association faced closure as a result of the tax demand. The court noted a comment by the French Minister of the Budget that tax audits of the sort carried out on the Jehovah's Witnesses "can be the first step in a process that profoundly disrupts a sect or leads to its dissolution". The power to tax includes the power to destroy.⁴⁷

It is well established that for a limitation to be "prescribed by law", a degree of clarity is necessary in that law. In this case, it was insufficiently clear that French gift tax applied to associations at all; the association could not have been expected to know that it was caught. The court therefore concluded that the limitation on freedom of religion was not "prescribed by law". It did not need to go on to consider whether the "necessity" test was met.

Although taxation of religious charities is capable of giving rise to a breach of Article 9,⁴⁸ UK tax rules should usually meet the requirement of being "prescribed by law".

In the context of a less destructive tax demand, a charity's human rights argument based on freedom of expression was summarily dismissed in Canada:

With respect to the Charter argument based on alleged infringement of freedom of expression, the basic premise of the appellant is untenable. Essentially its argument is that a denial of tax exemption to those wishing to advocate certain opinions is a denial of freedom of expression on this basis. ... The appellant is in no way restricted by the Income Tax Act from disseminating any views or opinions whatever. The guarantee of freedom of expression in paragraph 2(b) of the Charter is not a

47 This aphorism derives from Marshall J in *McCulloch v Maryland* 17 U.S. 327 (1819).

48 And, in some circumstances, article 14: see *Religionsgemeinschaft der Zeugen Jehovas v Austria* 40825/98, [2008] ECHR 762 .

guarantee of public funding through tax exemptions for the propagation of opinions no matter how good or sincerely held.⁴⁹

In *Gallagher v Church of Jesus Christ of Latter-day Saints* a local authority argued that a Mormon temple was not entitled to rating relief because it was not a place of “public” religious worship. The right of entry was reserved to Mormons who have acquired a “recommend” from the bishop after demonstrating belief in Mormon doctrine, an appropriate way of life and payment of the required contribution to church funds. Such members are called Patrons and the rituals which take place in the temple are exclusive to them. The church argued that the exclusion of all but Patrons is a manifestation of their religion. Therefore, to deny them exemption on that ground would be to discriminate against them on grounds of religion, contrary to articles 9 and 14 of the Convention.

Lord Hoffmann said:

[13] In order to constitute discrimination on grounds of religion, however, the alleged discrimination must fall “within the ambit” of a right protected by article 9, in this case, the right to manifest one’s religion. In the present case, the liability of the Temple to a non-domestic rate (reduced by 80% on account of the charitable nature of its use) would not prevent the Mormons from manifesting their religion. But I would not regard that as conclusive. If the legislation imposed rates only upon Mormons, I would regard that as being within the ambit of article 9 even if the Mormons could easily afford to pay them. But the present case is not one in which the Mormons are taxed on account of their religion. It is only that their religion prevents them from providing the public benefit necessary to secure a tax advantage. That seems to me an altogether different matter ...

[15] ... I think that even if this can be regarded as a case of indirect discrimination, it was justified. Parliament must have a wide discretion in deciding what should be regarded as a sufficient public benefit to justify exemption from taxation and in my opinion it was entitled to take the view that public access to religious services was such a benefit.⁵⁰

In our view human rights law is unlikely to be a factor in most aspects of UK charity tax, and HR issues will only occasionally arise.⁵¹

49 *Human Life International in Canada v MNR* [1998] 3 FC 202; 52 DTC 6196.

50 [2008] 1 WLR 1852. See 40.10.2 (“Public” worship) for other aspects of this case.

51 Eg in the fit and proper persons test: see 3.10.8 (Human rights); see too 16.22 (Human rights).

1.7 Future developments

1.7.1 Rewrite of HMRC guidance

In 2011 HMRC said:

Improving HMRC guidance - next steps

HMRC recognises that some published guidance is targeted at certain groups within the charity community and can be difficult for people who are not tax professionals to use. HMRC are determined to make guidance accessible to the whole of the charities community, from volunteers to professionals.

To achieve this HMRC will review all charities guidance. This will be a significant undertaking and HMRC will contact many groups and individuals to understand their issues and concerns. HMRC will also consider how to help charities reduce their administrative burdens by, for example, reducing common errors which would save charities time and resources.

Over the course of the next few months HMRC will be:

- exploring how better to engage and interact with customers
- assessing and prioritising all existing charities guidance
- scoping, developing, designing and piloting some different ways of presenting guidance to see if customers find them more helpful
- developing a more detailed timetable for this work
- setting up arrangements to discuss specific topics and issues with customers

This will be a large undertaking, in the interim HMRC will produce a number of short guides on specific topics to support charities.⁵²

There was presumably some high level lobbying here. We would not ourselves have identified existing HMRC guidance as a significant problem in charity tax, but it is easier to review guidance than address harder problems embedded in flawed legislation.

In the 2011/12 edition of this work we said:

It is hard to predict what will come out of this; most probably nothing more important than a few more HMRC “toolkits”.

In practice nothing much seems to have happened. Charity tax guidance continues to be rewritten from time to time, but no more so than on any other topic. Perhaps the idea has been quietly dropped.

⁵² <http://webarchive.nationalarchives.gov.uk/20140109143644/http://www.hmrc.gov.uk/charities/improving.htm>

Those pressing for more guidance should bear in mind that HMRC guidance cannot be relied on:

Taxpayers who used HMRC's previous guidance

HMRC does not accept that its published guidance alone can necessarily create a 'legitimate expectation' for a taxpayer. ... Chargeable gains and allowable losses included in returns or claims should be calculated on the correct statutory basis, which HMRC now understand to be as described in HMRC Brief 30/09. HMRC's primary responsibility is to apply the law correctly and collect underpaid or under-declared tax. However, in some limited circumstances, to apply the statute may be so unfair as to amount to an abuse of power by HMRC and in these circumstances HMRC may [!] be bound by its previous guidance. ... it is not sufficient to have merely suffered disappointment or upset.⁵³

And again:

ADML1605 [Apr 2012]

...Only in exceptional circumstances will HMRC be bound by incorrect advice.

CIOT warn their members:

Whilst it is reasonable *in most circumstances* to rely on HMRC published guidance, a member should be aware that the Tribunal and the courts will apply the law even if this conflicts with HMRC guidance.⁵⁴

The promise of guidance re-emerged in 2016:

5.6 ... the government is committed to updating and improving the guidance on the donor benefit rules that is available online from HMRC. Given the feedback received from respondents, the government intends to broaden this work. The government will form a working group comprised of HMRC, HM Treasury and charity sector representatives, to consider both guidance and also HMRC's interpretation and application of legislation relating to donor benefits, including with reference to relevant tribunal decisions. The aim of this work will be to provide consistency of understanding across the charity sector and

53 HMRC Brief 60/09. Similarly Enterprise Investment Scheme Technical Note (2009): "HMRC has revised its view... where, by the date of this notice, shares have not been issued then, *irrespective of whether the company has had an advance assurance*, we will apply our understanding of the law as set out in this Note."

54 CIOT and others, *Professional Conduct in Relation to Taxation* (2016), para 3.21 <https://www.tax.org.uk/professional-standards/professional-rules/professional-conduct-relation-taxation>

HMRC.⁵⁵

1.7.2 *Charitable Remainder Trusts*

McGregor calls for tax relief for Charitable Remainder Trusts:

It is estimated that 40% of the value of the endowments of academic, medical and cultural institutions in the US are made by Lifetime Legacies. They form an essential plank of American planned-giving endowment campaigns. The attraction from an endowment perspective is that the gift is irrevocable and yet donors can benefit from the income or asset for the rest of their lives; this addresses concerns over personal financial security. It also allows donors to be thanked and recognised during their life. As with tax relief for gifts of objects this mechanism encourages donors to engage with the museum over the long-term, helping to build a philanthropic culture.⁵⁶

The challenges in introducing an effective CRT relief into the UK tax system are considerable but not impossible;⁵⁷ given the scope for fundraising and the US precedent, we think it likely to happen sooner or later.

55 <https://www.gov.uk/government/consultations/simplifying-the-gift-aid-donor-benefits-rules-further-consultation> (Nov 2016)

56 Report on the Role Endowments Could Play in DCMS Funded Museums and Galleries. Dec 2010

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/77725/Endowments_paper_20101208.pdf

57 See Kessler, “Charitable Remainder Trusts: A Proposal”, *Charity Law & Practice Review* Vol 8, Issue 2, p.1 (2005).

