

UK National Report for the EATLP Rotterdam

Congress on the Taxation of Charities

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Part I: General Considerations¹

1.01 In the UK, there are no general tax rules that grant special or preferential status to ‘not-for-profit activities’ as such. However, there are preferential tax rules for the taxation of charities and some other not-for-profit organisations in the UK.² These rules are not to be found in any one place. Rather, they are to be found interspersed throughout the various tax statutes that go to make up the UK tax system. Each relevant tax statute has its own rules. However, one feature that is common to all of these tax statutes is their use of and reliance upon the ‘charity’ concept.³

1.02 As a result of Schedule 6 of the Finance Act 2010, charity has a new, generic meaning for the purposes of income tax, capital gains tax, corporation tax, value added tax,⁴ inheritance tax, stamp duty, stamp duty land tax, and stamp duty reserve tax. This new definition of charity is designed primarily to ensure that UK tax law in this area is compliant with EU law.⁵ However, apart from the rules concerning Gift Aid, many of the relevant provisions still refer to the old definition of charity,⁶

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¹ My deepest thanks go to James Kessler QC and Harriet Brown, whose book *Taxation of Charities and Non-Profit Organisations*, 8th edn. (Key Haven Publications, 2011) was heavily relied upon in writing this report.

² Registered Community Amateur Sports Clubs and Scientific Research Associations are not charities yet they enjoy some of the same tax benefits as charities. For Scientific Research Associations, see fn.39 below.

³ Another concept used in more than one tax, although with differing meanings, is that of ‘eligible bodies’. For the purposes of corporation tax, see the Corporation Tax Act 2010 c.4 (hereinafter “CTA10”), ss.468 and 469. For the purposes of VAT, see Value Added Tax Act 1994 c.23 (hereinafter “VATA”), Sch. 8, Group 15, Note 4 and VATA, Sch. 9, Group 6, Note 1 (two examples are given for VATA because the meaning is context dependent).

⁴ The word ‘charity’ does not appear in the VAT Directive (for reference see below at fn.68) but it is used in VATA. On the relevance of this and other terms, in relation to domestic and EU VAT legislation, see Sigrid Hemels, “Effectiveness of the Current VAT Treatment of Charities: Are the Objects of the VAT Exemptions in the Public Interest Being Achieved and If Not, How Can This Be Improved within the Restrictions Imposed by EU Legislation?” *International VAT Monitor* (2011) No.5 [4.1].

⁵ In 2006, the European Commission sent the UK a reasoned opinion concerning putting an end to its discrimination against non-UK EU charities. See Press Release, *Commission requests the United Kingdom to end discrimination of foreign charities* (Brussels, 10 July 2006; IP/06/964).

⁶ For instances of the old definition, see CTA10, ss.202 and 1119. For the proposition that although there were numerous ‘old definitions’, they mainly amounted to the same thing, see Kessler and Brown, fn.1 above, at [2.1].

despite the fact that the legislative amendments are in place to bring the various statutes into line with this new ‘one size fits all’ definition “in due course”.⁷

1.03 The Finance Act 2010 definition of ‘charity’ is a body of persons or trust that is established only for charitable purposes and meets certain jurisdiction, registration and management conditions.⁸ Central to this definition is the meaning of ‘charitable purposes’, which takes its meaning from non-tax legislation. To be a charitable purpose a purpose must be both for the public benefit and a prescribed activity.⁹ However, the legislation mitigates the prescriptive criteria somewhat by providing that it is enough that the purpose of the activity in question is either analogous to or comes within the spirit of any of the prescribed activities listed.¹⁰

1.04 The prescribed activities listed include activities that can arguably be separated into market and non-market activities. Those prescribed activities that might be viewed as market activities are: the advancement of education, health, the arts, culture, heritage and science; and the promotion of the efficiency of the armed forces, the police, fire and rescue services and ambulance services. Those prescribed activities that might be viewed as non-market activities are: the saving of lives; the prevention or relief of poverty; the advancement of religion, citizenship, community development, amateur sport, human rights, conflict resolution or reconciliation, environmental protection or improvement, and animal welfare; the promotion of religious or racial harmony and, equality and diversity; and the relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantage.

1.05 Charities for the purposes of UK tax law must be either a trust or a body of persons. The precepts of UK trust law dictate that only express public trusts can be charitable trusts.¹¹ With regards ‘a body of persons’, it is defined by tax statute as “any body politic, corporate or collegiate and any company, fraternity, fellowship and society of persons whether corporate or not corporate”.¹² Thus, a

⁷ See <http://www.hmrc.gov.uk/charities/guidance-notes/chapter2/fp-persons-test.htm>.

⁸ Finance Act 2010 c.13 (hereinafter “FA10”), Sch.6(1)(1). The main difference between the new and the old definition of charity is the broadening of the jurisdiction condition and the introduction of the registration and management conditions.

⁹ Charities Act 2006 c.50, s.2.

¹⁰ Charities Act 2006 c.50, s.2(4). For an application of this ‘development by analogy’ doctrine, see *Scottish Burial Reform and Cremation Society v Glasgow City Corporation* [1968] AC 138 (HL), where a trust to promote cremation was held to be charitable by analogy with earlier cases concerning trusts for the maintenance of graveyards. See also Lord Simonds in *National Anti-Vivisection Society v IRC* [1948] AC 31 at 74 (a “purpose regarded in one age as charitable may in another be regarded differently”).

¹¹ J.G. Riddall, *The Law of Trusts*, 3rd edn. (Butterworths: London, 1987) at 15.

¹² Income Tax Act 2007 c.3 (hereinafter “ITA”), s.989 and CTA10, s.1119.

body of persons includes unincorporated associations,¹³ companies limited by shares or guarantee, partnerships,¹⁴ Chartered bodies¹⁵ and statutory corporations.¹⁶

1.06 It must also be remembered that part of the new definition of a charity is that it meets certain jurisdiction, registration and management conditions. Thus, in order to qualify for preferential tax treatment, a body of persons or trust must be:

- subject to the jurisdictional control of a court of a Member State or other territory as specified in a statutory instrument;¹⁷
- a registered charity under section 3 of the Charities Act 1993 or a similar law of another territory;¹⁸ and
- managed by persons that are fit and proper persons to be managers.¹⁹

1.07 The question whether there are any special rules for non-resident and international charities (hereinafter “non-UK charities”) can be answered at a general level by analysing the new definition of charity. For the purposes of UK tax law, the new definition applies as much to non-UK charities as to UK-based charities. Presumably, this means that non-UK charities will have to pass all of the five tests for eligibility:

- The legal persons test – is it a trust or a body of persons?
- The charitable purposes test – (i) is the purpose of the underlying activity for the public benefit and (ii) is the underlying activity a prescribed activity or is it analogous to or does it come within the spirit of one of those activities?
- The jurisdiction test – is it subject to the jurisdictional control of a court of either an EU Member State or other specified territory?
- The registration test – is it registered as a charity under a law sufficiently similar to the Charities Act 1993?
- The management test – is it managed by fit and proper persons?

Each of these tests as they might be applied to non-UK charities is now considered in turn.

¹³ An ‘unincorporated association’ is two or more persons bound by a contractual relationship for one or more common (non-business) purposes: *Conservative and Unionist Central Office v Burrell* [1982] STC 317.

¹⁴ See ITA, s.681DL(7) and CTA10, s.882(7).

¹⁵ The Privy Council controls significant aspects of the internal affairs of bodies incorporated by Royal Charter, of which there are currently over 900 in the UK.

¹⁶ On statutory corporations generally, see Dennis Morris, “Establishing Statutory Corporations: Mere Scissors and Paste?” *Statute Law Rev* (1998) 19(1) at 41.

¹⁷ FA10, Sch.6(2). In the UK, the court must be the High Court (England and Wales), the Court of Session (Scotland) or the High Court in Northern Ireland.

¹⁸ FA10, Sch.6(3).

¹⁹ FA10, Sch.6(4). Managers are defined as those persons that have the general control and management of the administration.

The Legal Persons Test

1.08 In order to be a charity under the old definition, a charity must have been established in the UK.²⁰ Clearly, this is not the case under the new definition. Arguably, the question for the UK courts for non-UK charities as a result of the new definition is either (i) whether the charity is equivalent to a UK trust or body of persons (i.e. were it established in the UK, would it have been considered a trust or body of persons?) or (ii) whether it is considered as such by its domestic jurisdiction.²¹ If one accepts the proposition that what counts as a trust or body of persons is a question of domestic law,²² it is arguable that the correct test for the courts is whether the charity is equivalent to a UK trust or body of persons. Thus, designation as a trust or a body of persons for a non-UK charity is arguably subject to substantively the same test as a UK charity (see paragraph 1.04 above).²³ It is submitted that applying the same test would be consistent with the four EU Treaty freedoms, in that it would result in the same treatment afforded to both UK and non-UK charities.

The Charitable Purposes Test

1.09 Given that the meaning of charitable purposes “applies regardless of where the body of persons or trust in question is established”,²⁴ the issue becomes one of how these tests are to be applied to non-UK charities. While it has been suggested that the objects of a non-UK charity is a question of foreign law,²⁵ which is a question of fact for the UK courts, it is perhaps the better view that the UK courts should ignore the foreign law designation and apply the two tests – public benefit and prescribed activity – in accordance with English law. The basis for this argument is the recognition under EU law that a charity recognised as such in one EU Member State must also be recognised as a charity in accordance with the law of the EU Member State where the exemption is sought.²⁶ Accordingly, it is submitted that applying the test in this way would be consistent with the four EU Treaty freedoms, in that it would result in the same treatment afforded to both UK and non-UK charities.

²⁰ See Kessler and Brown, fn.1 above, at [2.9.2].

²¹ Foreign law is a question of fact for the UK courts.

²² It was recognised in both *Hein Persche v Finanzamt Lüdenscheid* (C-318/07) 27 January 2009 (“*Persche*”) and *Centro di Musicologia Walter Stauffer v Finanzamt München für Körperschaften* (Case C-386/04) [2006] ECR I-8203 (“*Stauffer*”) that what counts as charitable is a question of domestic law. See *Stauffer* at [39]. By extension, therefore, one might also argue that the same is also true with regards legal form.

²³ For the application of domestic criteria to a foreign enterprise for the purposes of determining its legal status for UK tax purposes, see *Memec Plc v IRC* [1998] STC 754; 71 TC 77 (Court of Appeal).

²⁴ FA10, Sch.6 at [1(4)].

²⁵ See Kessler and Brown, fn.1 above, at [2.8.2].

²⁶ See *Stauffer*, fn.22 above, at [40].

The Jurisdiction Test

1.10 The legislation provides that the organisation in question must be subject to the control of “any other court in the exercise of a corresponding jurisdiction under the law of a relevant territory”, which is either an EU Member State or a territory specified in regulations made under a statutory instrument by the HMRC Commissioners.²⁷

1.11 Before the ECJ decision in *Persche* (C-318/07),²⁸ the view of the UK government was that UK tax reliefs for donors and charities applied only in relation to UK charities. However, from 27 January 2009, the date of the *Persche* decision, UK tax reliefs for charities became available to eligible organisations in:

- the EU, by virtue of paragraph 2(3)(a) of FA10; and
- Iceland and Norway, by virtue of regulations enacted under paragraph 2(3)(b) of FA10.

Presumably, Lichtenstein, the remaining EEA member country, will join Iceland and Norway when HMRC are satisfied that sufficient information exchange and collection of tax arrangements are in place to ensure the reliefs can be administered properly.²⁹

1.12 It should be noted that the jurisdiction condition is phrased such that it is not restricted to EU, EEA or EFTA Member States. Rather, it leaves sufficient scope for organisations in non-European countries to become eligible were the territory to be included in the regulations under paragraph 2(3)(b) of FA10.

The Registration Test

1.13 The starting point is the registration requirement under the law of England and Wales. The legislation provides that any organisation that does not come under the law of England and Wales must have complied with a corresponding registration requirement under the law of its home jurisdiction.³⁰ Presumably, if there is no registration requirement in a particular territory, it is unlikely that a non-UK charity based in that territory would pass the registration test, even if that territory were an EU Member State.

1.14 The registration requirement for England and Wales is that there shall be a register of charities, kept by the Charity Commission for England and Wales in such manner as it thinks fit but

²⁷ The Taxes (Definition of Charity) (Relevant Territories) Regulations 2010 SI No. 1904 is the only statutory instrument in force to-date. It provides that the Republic of Iceland and the Kingdom of Norway are relevant territories.

²⁸ See *Persche*, fn.22 above.

²⁹ See Explanatory Memorandum to The Taxes (Definition of Charity) (Relevant Territories) Regulations 2010 SI No. 1904 at [7.2] and [7.5].

³⁰ FA10, Sch.6, at [3] referring to the Charities Act 1993 c.10, s.3.

legible and open to public inspection at all reasonable times. It must contain, at least, the name of every charity registered and there is a duty to remove organisations that cease to be charities or simply cease to be or operate.³¹ Presumably, therefore, these elements would make up the *de minimis* conditions for a corresponding registration requirement to fulfil the registration condition for the purposes of UK tax law. Accordingly, the registration requirement is unlikely to raise problems under the application of the basic EU treaty freedoms.

The Management Test

1.15 With regards the application of the fit and proper test, neither the legislation nor the HMRC guidance notes distinguish between the management of a UK and a non-UK charities.³² Presumably, the test will be applied in the same way for the managers of non-UK charities as it is for UK charities. Accordingly, the management condition is unlikely to raise problems under the application of the basic EU treaty freedoms.

Part II: Income Tax

2.01 Charities and similar entities are taxed on their income. While some gifts are not treated as income for tax purposes because they do not fall within any of the charging provisions,³³ other gifts to charities and similar entities are deemed by legislation to constitute income for tax purposes. There are four kinds of gift that are deemed to be income for tax purposes:

- gift aid donations;³⁴
- gifts under a payroll deduction scheme;³⁵
- gifts of money from companies that are not charities;³⁶ and
- gifts of money from other charities provided, *inter alia*, it is not made for full consideration in money or money's worth.³⁷

³¹ Charities Act 1993 c.10, s.3.

³² Given that “fit and proper” is not defined in the legislation, the explanatory notes for FA10 state that it takes its natural meaning. For HMRC’s guidance notes on the application of this test, see <http://www.hmrc.gov.uk/charities/guidance-notes/chapter2/fp-persons-test.htm>.

³³ It is difficult to see how grants to charities could be considered taxable receipts given the need to bring the payment within one of the income tax schedules. While some grants are specifically dealt with by statute, these are not obviously relevant to charities. For example, Industrial Development Grants are taxable receipts unless they are spent in relation to capital assets or corporation tax (CTA10, ss.102 and 1252 and Income Tax (Trading and Other Income) Act 2005 c.5 (hereinafter “ITTOIA”), s.102), whereas some types of employment training and housing grant are specifically excluded (ITTOIA, ss.781 and 769).

³⁴ ITA, s.521 and CTA10, ss.472 and 475.

³⁵ ITA, s.521A and CTA10, s.472A.

³⁶ ITA, s.522 and CTA10, ss.473 and 476.

³⁷ ITA, s.523 and CTA10, s.474.

2.02 Gift aid donation and gifts under a payroll deduction scheme only apply to individuals. The legislation provides that both types of gift are grossed up by the basic rate of income tax, which means the charity can claim, according to current rates, an extra 25 per cent of the sum donated. The same rule applies, but at the equivalent trust rate, to money gifted by non-charitable trusts to a charity.³⁸

2.03 Just because a gift or payment is treated as income for tax purposes does not mean that it will be charged to tax. If the amounts are applied to charitable purposes and a claim is made, they are exempted.³⁹ Generally, charities can make a claim for an exemption either by way of a free-standing claim to an officer of Revenue and Customs or by including it in a self-assessment return.⁴⁰

2.04 The main categories of income to which the abovementioned exemption applies are:

- the four categories of deemed income outlined above;
- profits (or post-cessation receipts) of a charitable trade;⁴¹
- profits of a small-scale trade;⁴²
- profits from fundraising events;⁴³
- profits from holding lotteries;⁴⁴
- rents or receipts from an estate, interest or right in or over land;⁴⁵
- savings and investment income;⁴⁶
- non-trading profits from loan relationships (corporation tax only);⁴⁷
- annual payments charged to tax as miscellaneous income;⁴⁸
- some types of income and gains from intangible fixed assets (corporation tax only);⁴⁹

³⁸ ITA, s.494.

³⁹ For Scientific Research Associations, undertaking R&D that may lead to (or facilitate an extension of) a trade, is a deemed charitable purpose. See CTA10, s.469(2).

⁴⁰ See ITA, ss.538 and 538A, and CTA10, s.477A. HMRC may limit the number of free-standing gift aid relief claims made by a person in a tax year or require a smaller claim to be made in a tax return.

⁴¹ A charitable trade is defined as a trade carrying out a primary purpose (i.e. a charitable purpose) of the charity or where the work in connection with the trade is mainly carried out by beneficiaries of the charity. See CTA10, s.479 and ITA, s.525.

⁴² CTA10, s.480 and ITA, s.526. Currently, the threshold is turnover of £5,000 or, in circumstances where the turnover from the non-primary-purpose trade exceeds that amount, 25% of the charity's incoming resources subject to a maximum of £50,000. This limit applies to all non-primary-purpose trading activities in any one year. 'Incoming resources' means the total receipts of the charity as shown in its statement of financial activities including grants and donations, legacies, investment income and income from trading activities. This category is not exempt for similar bodies.

⁴³ CTA10, s.483 and ITA, s.529.

⁴⁴ CTA10, s.484 and ITA, s.530.

⁴⁵ CTA10, s.485 and ITA, s.531. The property income exemption applies to businesses located in the UK and overseas. For corporation tax purposes, the estate, interest or right in or over land must be "vested in any person for charitable purposes". For income tax purposes, it must be "vested in a person in trust for a charitable trust or for charitable purposes".

⁴⁶ CTA10, s.486 and ITA, ss.532 and 534. This covers interest payments and distributions (such as dividends).

⁴⁷ CTA10, s.486.

⁴⁸ CTA10, s.488 and ITA, s.536.

⁴⁹ CTA10, s.488.

- royalties and other income from intellectual property (income tax only);⁵⁰
- income derived from a relevant telecommunication right (income tax only);⁵¹
- distributions of a non-UK resident company that would be chargeable if the company were UK resident (income tax only);⁵² and
- income from estates in administration.⁵³

Deductible Business Expense

2.05 The general rule is that no deduction is allowed in calculating trading profits for expenses incurred in providing entertainment or gifts.⁵⁴ However there is an exception for gifts to charity.⁵⁵ An extra-statutory concession extends this relief to other benevolent organisations.⁵⁶ A gift is only deductible if it satisfies the usual business expenditure rules, i.e. it must be on revenue account and be made wholly and exclusively for the purposes of the trade. Thus, a gift must serve the business purposes of the trade rather than the personal preferences of the trader. So long as the object is to serve those business purposes, it should not matter if there is some private advantage to the trader.⁵⁷

2.06 A gift is also deductible if a donor states that they will give a percentage of their receipts from a certain item to a charity, if their purpose is to increase sales.⁵⁸

Accumulated Income

2.07 The issue with regards accumulated income is whether or not it can be said to be *applied for charitable purposes*.⁵⁹ Despite one view that it cannot,⁶⁰ the Court of Appeal has expressed the view that:

“Charitable trustees who simply leave surplus income uninvested cannot, I think, be said to have ‘applied’ it at all ... But if the income is reinvested by them and held, as invested, as part of the funds of the charity, I would be disposed to say that it is no less

⁵⁰ ITA, s.536.

⁵¹ ITA, s.536.

⁵² ITA, s.536.

⁵³ CTA10, s.489 and ITA, s.537.

⁵⁴ ITTOIA, s.45(1) and CTA09, s.1298(1).

⁵⁵ ITTOIA, s.47 and CTA09, s.1300.

⁵⁶ HMRC’s Extra Statutory Concession (ESC) B7.

⁵⁷ See *Mallalieu v Drummond* [1983] STC 665 at 668 per Lord Brightman and *Vodafone Cellular Ltd. v Shaw* [1997] STC 734 at 742.

⁵⁸ See Kessler and Brown, fn.1 above, at [18.2.2].

⁵⁹ See *IRC v Helen Slater Charitable Trust Ltd* 53 TC 230 (“applied for charitable purposes” has in general the same meaning as “applied to charitable purposes only”, notwithstanding the slight difference in language).

⁶⁰ See *General Nursing Council for Scotland v IRC* 14 TC 645 per Lord Blackburn, though Lord Sands disagreed and the other two judges expressed no view.

being applied for charitable purposes than it is if it is paid out in wages to the secretary.”⁶¹

2.08 Where charitable trustees have a power to accumulate income and allow income to accumulate without good reason, this amounts to a breach of trust. Income retained in this way is probably not “applied for charitable purposes” and the tax relief may be lost.⁶²

Capital Gains

2.09 Charities are, in principle, taxable on gains from the disposal of assets.⁶³ However, so long as a gain⁶⁴ is applicable and applied for charitable purposes, charities are exempt persons.⁶⁵

2.10 **Liquidation.** A distribution of assets to members of a company on its winding up are not income for tax purposes.⁶⁶ Thus such distributions are on capital account for tax purposes. The capital gains exemption will mean that the liquidation of a company and the return of its accumulated ‘wealth’ to the shareholding charity should result in no charge to tax for the charity.

Part III: VAT

3.01 The first issue to address is whether a charity is a business for the purposes of the Value Added Tax Act 1994 (hereinafter “VATA”). Section 4(1) of VATA provides that:

“VAT shall be charged on any supply of goods or services made in the United Kingdom, where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him.”⁶⁷

3.02 The VAT Directive does not use the word ‘business’.⁶⁸ Rather it uses the term ‘economic activity’, which must be considered to have the same meaning.⁶⁹ Due to the fact that an exhaustive

⁶¹ *IRC v Helen Slater Charitable Trust Ltd* 53 TC 230 at 250. See also *Nightingale v Price* [1996] STC (SCD) 116 and *Sheppard v IRC (No 2)* 65 TC 724 at 731.

⁶² See Kessler and Brown, fn.1 above, at [3.19.1].

⁶³ In respect of these gains, trusts will be subject to capital gains tax and companies will be subject to corporation tax.

⁶⁴ On the face of it would appear that this includes ‘deemed gains’. However, there is an argument to the contrary. See Kessler and Brown, fn.1 above, at [4.5].

⁶⁵ Taxation of Chargeable Gains Act 1992 c.12 (hereinafter “TCGA”), s.256.

⁶⁶ CTA10, s.1030 and *Re Dominion Tax and Chemical Co Ltd* [1929] 2 Ch 387.

⁶⁷ Thus, there are four elements to the charge to UK VAT: (i) there must be a supply of goods or services (ii) that takes place in the UK (iii) made by a taxable person and (iv) made by way of business.

⁶⁸ See Article 9(1) of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p.1).

⁶⁹ See Kessler and Brown, fn.1 above, at [32.6.2].

definition of either business or economic activity is not attempted in the legislation,⁷⁰ nor is it considered desirable or possible so to do,⁷¹ reference to UK case law for guidance on the meaning of the term in various contexts becomes necessary. Relevant to charities, it is not necessary for there to be either a profit motive or any “commercial element” for there to be a business.⁷² Moreover, six business indicators were identified in *C&E Commissioners v Lord Fisher*,⁷³ which concern whether:

- the activity is a serious undertaking either earnestly pursued or not necessarily confined to commercial or profit-making undertakings;
- the activity is an occupation or function actively pursued with reasonable or recognisable continuity;
- the activity has a certain measure of substance as measured by the quarterly or annual value of taxable supplies made;
- the activity was conducted in a regular manner and on sound and recognised business principles;⁷⁴
- the activity is predominantly concerned with the making of taxable supplies to consumers for a consideration;⁷⁵ and
- the taxable supplies are of a kind which, subject to differences of detail, are commonly made by those who seek to profit by them.

Accordingly, whether or not a charity is a taxable person for UK VAT purposes is to be determined on a case-by-case basis.⁷⁶

Reliefs

3.03 There are two specific UK VAT reliefs: a reduced rate of 5 per cent and zero-rating.⁷⁷ While the reduced rate is only occasionally relevant to charities,⁷⁸ “charities etc.” forms one of the 16 groups

⁷⁰ See VATA, s.94, which states that business *includes* (i) any trade, profession or vocation, (ii) provision by a club, association or organisation (for a subscription or other consideration) of facilities or advantages to members, and (iii) the admission, for a consideration, of persons to any premises.

⁷¹ *C&E Commissioners v Morrison's Academy Boarding Houses Association* [1978] STC 1 at 6 per Lord Emslie.

⁷² *Ibid.*

⁷³ [1981] STC 238 at 245. See also Kessler and Brown, fn.1 above, at [32.6.6].

⁷⁴ See ECJ Case C-16/93, *RJ Tolsma v Inspecteur der Omzetbelasting Leeuwarden* (1994) (there has to be a legal relationship between the service provider and recipient, as well as reciprocal performance).

⁷⁵ See ECJ Case 89/81, *Staatssecretaris van Financiën v Hong-Kong Trade Development Council* (1982) (providing all services free of charge means no taxable person).

⁷⁶ For examples of cases where it was held that charities were not carrying on a business, see *C&E Commrs v Yarburgh Children's Trust* [2002] STC 207, *C&E Commrs v St Paul's Community Project* [2005] STC 95, *C&E Commrs v The Apple and Pear Development Council* [1986] STC 192, *Institute of Chartered Accountants in England and Wales v C&E Commrs* [1999] STC 398 and *Wellcome Trust v C&E Commrs* [1996] STC 945. For an instance where a charity was held to be carrying out a business, see *Riverside Housing Association v HMRC* [2006] STC 2072.

⁷⁷ The standard rate is currently 20 per cent, see VATA, s.2(1).

⁷⁸ See Kessler and Brown, fn.1 above, at [33.8.2].

specified in Schedule 8 of VATA to which zero-rating applies. Section 30 of VATA provides that zero-rating means that no VAT is to be charged on a supply but, in all other respects, it is treated as a taxable supply. There are no provisions relating to zero-rating in the VAT Directive.

3.04 Group 15 of Schedule 8 of VATA provides broadly that the following activities are zero-rated: the sale or letting of donated goods; the donation of goods for any one of a number of specified purposes; exports to non-EU Member States; the donation or sale of goods to eligible bodies with certain funding restrictions;⁷⁹ the repair and maintenance of certain goods owned by an eligible body and the supply of such goods; supplying a charity various goods and services in relation to advertising;⁸⁰ and supplies to charities involved in the medical treatment of or research into medicines for human beings and animals. Detailed notes accompany these items that, in the main, define the terms used.

Exempt Supplies

3.05 Section 31(1) of VATA provides that exempt supplies are specified in Schedule 9 of VATA and that acquiring goods from another EU Member State is an exempt acquisition if the goods are acquired in pursuance of an exempt supply. Of the 15 groups specified in Schedule 9, education (Group 6), health and welfare (Group 7), subscriptions (Group 9), sports (Group 10), fundraising events (Group 12) and cultural services (Group 13) are of particular relevance to charities. It should be noted that VATA expands upon the relevant provisions of the VAT Directive by prescribing in some considerable detail what kinds of activities fall to be treated as exempt supplies for UK VAT purposes.

3.06 **Education.** Article 132(1)(i) and (j) of the VAT Directive provides that, subject to the exceptions set out in Articles 133 and 134, EU Member States shall exempt:

“the provision of children's or young people's education, school or university education, vocational training or retraining, including the supply of services and of goods closely related thereto, by bodies governed by public law having such as their aim or by other organisations recognised by the Member State concerned as having similar objects; [and] ... tuition given privately by teachers and covering school or university education”.

3.07 Group 6 of Schedule 9 of VATA provides broadly that the following activities are exempt supplies: the provision by an eligible body of education, research (where supplied to an eligible body) and vocational training; private tuition in a subject ordinarily taught in a school or university by an individual teacher acting independently of an employer; the provision of examination services by or to an eligible body or to a person receiving education or vocational training, which is itself either exempt

⁷⁹ See further Kessler and Brown, fn.1 above, at [33.29].

⁸⁰ Relief on supplies of advertising services to charities under VATA, Sch.8, Group 15, Item 8 has a long history and is now given broadly. See further Kessler and Brown, fn.1 above, at [33.27].

or provided otherwise than in the course or furtherance of a business; the supply of goods or services (but not examination services) that are closely related to the first supply listed provided they are for the pupil, student or trainee; vocational training and the supply of any goods or services essential thereto; education or vocational training and the supply by the same person of any goods or services essential thereto provided the funds are provided by a number or prescribed bodies; the provision of facilities by a youth club or clubs to their members.

3.08 Given the use of the term eligible bodies in relation to education, it should be noted that most eligible bodies will be charities.⁸¹

3.09 Although many of the terms used in Group 6 of Schedule 9 of VATA are defined therein, the word 'education' is a notable exception. However, VAT Notice 701/30 suggests that it means "a course, class or lesson of instruction or study in any subject: whether or not that subject is normally taught in schools, colleges or universities; and regardless of when and where it takes place." Furthermore, it suggests that education includes registration, lectures, educational seminars, conferences, symposia, recreational courses, and assessed distance teaching (and associated materials), but that it excludes admission to events such as plays, concerts, sports meetings and exhibitions.⁸²

3.10 **Health and Welfare.** Article 132(1)(b),(g) and (p) of the VAT Directive provides that, subject to the exceptions set out in Articles 133 and 134, EU Member States shall exempt:

"hospital and medical care and closely related activities undertaken by bodies governed by public law or, under social conditions comparable with those applicable to bodies governed by public law, by hospitals, centres for medical treatment or diagnosis and other duly recognised establishments of a similar nature; ... the supply of services and of goods closely linked to welfare and social security work, including those supplied by old people's homes, by bodies governed by public law or by other bodies recognised by the Member State concerned as being devoted to social wellbeing; [and]... the supply of transport services for sick or injured persons in vehicles specially designed for the purpose, by duly authorised bodies".

3.11 Group 7 of Schedule 9 of VATA provides that the following activities are exempt supplies:

- medical care by a person registered or enrolled in the medical practitioners register, the Opticians Act 1989 register, either of the ophthalmic opticians registers, either of the section 9 Opticians Act 1989 lists, the Health Professions Order 2001 register, the Osteopaths Act 1993

⁸¹ See Kessler and Brown, fn.1 above, at [33.10.2].

⁸² See Kessler and Brown, fn.1 above, at [33.10.4].

register, the Chiropractors Act 1994 register, and the article 5 Nursing and Midwifery Order 2001 register;

- medical care or the supply of dental prostheses, by a person in the dentists' register or the section 36B Dentists Act 1984 register;
- any services or dental prostheses by a dental technician;
- medical care a person in the article 19 Pharmacy Order 2010 register or the Pharmacy (Northern Ireland) Order 1976 register;
- care or medical or surgical treatment and, in connection with it, the supply of any goods, in any hospital or state-regulated institution;
- the provision of a deputy for a person registered in the medical practitioners register;
- human blood and products for therapeutic purposes, derived from human blood;
- human (including foetal) organs or tissue for diagnostic or therapeutic purposes or medical research;
- the supply by a charity, a state-regulated private welfare institution or agency, or a public body, of welfare services and of goods supplied in connection with those welfare services;
- the not for profit supply of goods and services incidental to the provision of spiritual welfare by a religious community to a resident member of that community in return for a subscription or other consideration paid as a condition of membership; and
- transport services for sick or injured persons in vehicles specially designed for that purposes.

3.12 Welfare services are defined by VATA as those services which are directly connected with: the provision of care, treatment or instruction designed to promote the physical or mental welfare of elderly, sick, distressed or disabled persons; the care or protection of children and young persons; and the provision of spiritual welfare by a religious institution as part of a course of instruction or a retreat, not being a course or a retreat designed primarily to provide recreation or a holiday. Furthermore, regulated services supplied by a state-regulated private welfare institution are included.⁸³

3.13 **Subscriptions.** Article 132(1)(l) of the VAT Directive provides that, subject to the exceptions set out in Articles 133 and 134, EU Member States shall exempt

“the supply of services, and the supply of goods closely linked thereto, to their members in their common interest in return for a subscription fixed in accordance with their rules by non-profit-making organisations with aims of a political, trade-union, religious, patriotic, philosophical, philanthropic or civic nature, provided that this exemption is not likely to cause distortion of competition”.

⁸³ VATA, Sch.9, Group 7, Note 6.

3.14 Group 9 of Schedule 9 of VATA exempts the supply to members of services (and goods connected with those services) that are made available without payment (other than through a membership subscription) and refer only to the aims of the following non-profit-making organizations:

- a trade union or other organisation of persons having as its main object the negotiation on behalf of its members of the terms and conditions of their employment;
- a professional association, membership of which is wholly or mainly restricted to individuals who have or are seeking a qualification appropriate to the practice of the profession concerned;
- an association, the primary purpose of which is the advancement of a particular branch of knowledge, or the fostering of professional expertise, connected with the past or present professions or employments of its members; and
- an association, the primary purpose of which is to make representations to the Government on legislation and other public matters that affect the business or professional interests of its members.
- a body which has objects which are in the public domain and are of a political, religious, patriotic, philosophical, philanthropic or civic nature.

3.15 The “not likely to cause distortion of competition” element of Article 132(1)(l) is arguably reflected in Note 1 of Group 9 when it provides that “Item 1 does not include any right of admission to any premises, event or performance, to which non-members are admitted for a consideration”.

3.16 **Sports.** Article 132(1)(m) of the VAT Directive provides that, subject to the exceptions set out in Articles 133 and 134, EU Member States shall exempt “the supply of certain services closely linked to sport or physical education by non-profit-making organisations to persons taking part in sport or physical education”.

3.17 Group 10 of Schedule 9 of VATA provides that the following activities are exempt supplies: (i) the grant of a right to enter a competition in sport or physical recreation where the consideration for the grant consists in money which is to be allocated wholly towards the provision of a prize or prizes awarded in that competition; (ii) the grant, by an eligible body (i.e. a non-profit making body not subject to commercial influence) established for the purposes of sport or physical recreation, of a right to enter a competition in such an activity; (iii) and the supply by an eligible body to an individual, except, where the body operates a membership scheme, an individual who is not a member, of services closely linked with and essential to sport or physical education in which the individual is taking part.

3.18 A recent First-Tier Tax Tribunal decision relates specifically to the third exempt supply item listed in paragraph 3.14 above. Bridport and West Dorset Golf Club was a non-profit making members’ golf club. Judge Colin Bishopp decided that the green fees that they charged to visiting non-

members were VAT exempt because restricting the exemption to supplies made to members was contrary to the purpose of the exemption in the VAT Directive (i.e. to encourage widespread participation in sport). Thus, it was held that domestic law has not correctly implemented the terms of the VAT Directive.⁸⁴

3.19 **Fundraising Events.** Article 132(1)(o) of the VAT Directive provides that, subject to the exceptions set out in Articles 133 and 134, EU Member States shall exempt

“the supply of services and goods, by organisations whose activities are exempt pursuant to points (b), (g), (h), (i), (l), (m) and (n), in connection with fund-raising events organised exclusively for their own benefit, provided that exemption is not likely to cause distortion of competition”.

3.20 Group 12 of Schedule 9 of VATA exempts the supply of goods and services by:

- a charity in connection with an event that is organised for charitable purposes by a charity or jointly by more than one charity, whose primary purpose is the raising of money, and that is promoted as being primarily for the raising of money;
- a qualifying body in connection with an event that is organised exclusively for the body’s own benefit, whose primary purpose is the raising of money, and that is promoted as being primarily for the raising of money
- a charity or a qualifying body in connection with an event (i) that is organised jointly by any number of charities and the qualifying body, (ii) that is organised exclusively for charitable purposes or exclusively for the body's own benefit or exclusively for a combination of those purposes and that benefit, (iii) whose primary purpose is the raising of money, and (iv) that is promoted as being primarily for the raising of money.

3.20 Group 12 of Schedule 9 of VATA exempts the supply of goods and services (in connection with an event that is promoted as being primarily for, and whose primary purpose is, the raising of money) by:

- a charity where the event is organised for charitable purposes by a charity or jointly by more than one charity;⁸⁵
- a qualifying body⁸⁶ where the event is organised exclusively for the body’s own benefit;

⁸⁴ *Bridport and West Dorset Golf Club Ltd v Revenue and Customs Commissioners* [2011] UKFTT 354 (TC) at [38], [44] and [45].

⁸⁵ Charity is extended, subject to limitations, to include companies wholly owned by a charity: VATA, Sch.9, Group 12, Note 2.

⁸⁶ “Qualifying body” includes trades unions and certain professional and business associations, sporting and cultural organisations. See Kessler and Brown, fn.1 above, at [33.15].

- a charity or a qualifying body where the event is organised jointly by any number of charities and the qualifying body, and the event is organised exclusively for (i) charitable purposes, (ii) the body's own benefit, or (iii) a combination of those purposes and that benefit.

3.21 Event here includes an event accessed electronically.⁸⁷ HMRC defines an event as

“an incident with an outcome or a result. This means that activities of a semi-regular or continuous nature, such as the frequent operation of a shop or bar, cannot therefore be an event. The relief is not intended to exempt normal trading activities from VAT.”⁸⁸

3.22 The “not likely to cause distortion of competition” element of Article 132(1)(o) is arguably reflected in Note 11 of Group 12 when it provides that “Items 1 to 3 do not include any supply the exemption of which would be likely to create distortions of competition such as to place a commercial enterprise carried on by a taxable person at a disadvantage.” It is also arguable that Note 4 similarly helps to level the playing field between the ‘not-for-profits’ and the ‘for-profits’ sector. It provides that

“Where in a financial year of a charity or qualifying body there are held at the same location more than 15 events involving the charity or body that are of the same kind, items 1 to 3 do not apply (or shall be treated as having not applied) to a supply in connection with any event involving the charity or body that is of that kind and is held in that financial year at that location.”

3.23 It would appear that goods that are eligible for zero rate relief might still be zero-rated when supplied at an exempt fund-raising event. This means that a VAT registered charity or other qualifying body will be able to recover any input tax directly attributable to the taxable supply of those goods.⁸⁹

3.24 In relation to donations making up part of the admission fee for a non-exempt fundraising event, the case of *Glasgow's Miles Better Mid Summer 5th Anniversary Ball v Customs and Excise Commissioners* decided that any reference to donations on tickets, advertising material or programmes must make it clear that it is entirely up to patrons to decide whether to make a voluntary donation over and above the basic admission charge.⁹⁰

3.25 **Cultural Services.** Article 132(1)(n) of the VAT Directive provides that, subject to the exceptions set out in Articles 133 and 134, EU Member States shall exempt

⁸⁷ VATA, Sch.9, Group 12, Note 1.

⁸⁸ See Kessler and Brown, fn.1 above, at [33.15] who cast some doubt over the veracity of the first of these quoted sentences, as well as setting out a list of what are qualifying events.

⁸⁹ See Kessler and Brown, fn.1 above, at [33.23].

⁹⁰ Decision number 4460, case reference number EDN/89/95, 8 December 1989. In relation to donations making up the whole of the admission fee for a non-exempt fundraising event, see Kessler and Brown, fn.1 above, at [33.25].

“the supply of certain cultural services, and the supply of goods closely linked thereto, by bodies governed by public law or by other cultural bodies recognised by the Member State concerned”.

3.26 Group 13 of Schedule 9 of VATA exempts the supply by both public bodies and eligible bodies of a right of admission to (i) a museum, gallery, art exhibition or zoo, or (ii) a theatrical, musical or choreographic performance of a cultural nature. Where public bodies are local authorities, government departments and non-departmental public bodies listed in the 1995 edition of the “Public Bodies” publication. Eligible bodies are non-public bodies that are precluded from and do not distribute any profit it makes; (b) applies any profits made from supplies of a description falling within item 2 to the continuance or improvement of the facilities made available by means of the supplies; and (c) is managed and administered on a voluntary basis by persons who have no direct or indirect financial interest in its activities.

3.27 In keeping with Article 133(d), Note 3 of Group 13 of Schedule 9 of VATA restricts the exemption such that public bodies are disallowed an exemption where it would be likely to create distortions of competition “such as to place a commercial enterprise carried on by a taxable person at a disadvantage”. It is noteworthy that the same restriction is not in place for eligible bodies, which is arguably consistent with the rationale of the decision in *Bridport and West Dorset Golf Club Ltd v Revenue and Customs Commissioners* discussed in paragraph 3.18 above.

*Cross-Border Supplies*⁹¹

3.28 Specific administrative and substantive VAT rules apply to any charity that provides or receives cross-border supplies of goods or services. In relation to the administrative rules, VAT-registered charities that sell goods to customers registered for VAT in another EU Member State must report those sales on periodic sales lists. This requirement is waived if the value of such sales is less than £11,000 in a twelve-month period. Since 1 January 2010, the requirement with regards to periodic sales lists has applied to services, as well as to goods.

3.29 VAT-registered businesses that trade in goods with other EU Member States are required to provide details of these transactions for statistical purposes. Intrastat is the system used to collect these statistics. Under this system, the movements of goods between EU Member States are referred to as ‘arrivals’ (acquisitions, purchases or imports) and ‘dispatches’ (removals, sales or exports). All VAT-registered businesses, regardless of their intra-EU turnover, must show the total value of arrivals and dispatches in their VAT return. In addition, those who trade in the EU above either or both of the

⁹¹ This section draws both its structure and inspiration from Charity Tax Group and Nuffield Foundation, *Charity Tax Map* (February 2011) at [6].

Intrastat exemption thresholds must also complete monthly Supplementary Declarations. The 2011 and 2012 annual thresholds are £600,000 for arrivals and £250,000 for dispatches.⁹²

3.30 **Goods.** Identifying the place of supply is one of the four elements of the charge to UK VAT.⁹³ Section 7 of VATA contains the basic rules concerning the determination of the place of supply of goods.

3.31 Goods supplied by a charity to a place outside the EU Member States are deemed to be made both in the UK and in the course or furtherance of the business of the charity.⁹⁴ This means that the supply can be zero-rated under Schedule 8 of VATA.⁹⁵ A charity not registered for VAT may register for VAT on the basis of this provision.⁹⁶

3.32 Goods supplied to charities in another EU Member State are supplied in the UK if they are business customers. However, such supplies are not subject to UK VAT. The customer is required to account for tax in the destination EU Member State, which means they charge themselves VAT on the goods and recover as input tax (subject to local rules). Conversely, business customers (including VAT-registered charities) that receive goods free from VAT from a supplier in another EU Member State are required to account for tax in the UK.⁹⁷

3.33 If goods are supplied and delivered by a UK entity to a customer who belongs in another EU Member State but is not VAT-registered there,⁹⁸ the UK is the place of supply and UK VAT is due until the threshold of the relevant EU Member State is exceeded.⁹⁹ Once the threshold is exceeded, the supplier will be required to register for VAT in that EU Member State.¹⁰⁰

3.34 VAT on imports of goods imported from outside the EU Customs Union is normally charged at the same rate as if it had been a UK supply. However, certain donated goods can be imported free of VAT from outside this area by charities and other not-for-profit organisations. The goods have to be any one of the following: basic necessities for the needy and vulnerable; goods to be used or sold at charity events for the benefit of the needy and vulnerable; or equipment and office materials to help

⁹² Larger businesses that trade above the Intrastat delivery terms threshold of £16 million must also specify delivery terms information on their Supplementary Declarations.

⁹³ See fn.67 above.

⁹⁴ VATA, s.30(5).

⁹⁵ See [3.04] above.

⁹⁶ HMRC, VAT Manual V1-9: Charities at [8.1].

⁹⁷ Charity Tax Group and Nuffield Foundation, *Charity Tax Map* (February 2011) at [6.4.2].

⁹⁸ The recipients of these 'distance sales' will mainly be private individuals, but they can also include small unregistered businesses, businesses making only exempt supplies, charities and public bodies.

⁹⁹ The UK threshold is currently set at £70,000 per calendar year. If the supply involves goods that are subject to excise duty, the threshold does not apply.

¹⁰⁰ For the relevant distance selling provisions in the VAT Directive, see Arts. 33(1),(2) and 34(1)-(4).

run an organisation for the benefit of the needy and vulnerable. There are also special procedures for relief from VAT on the import of goods to help deal with disasters in the Customs Union.¹⁰¹

3.35 A VAT-registered charity acquiring, purchasing or importing goods from other EU Member States does not normally have to pay VAT when bringing the goods into the UK. Instead, it accounts for any VAT due on the next VAT return, at the domestic supply rate.

3.36 **Services.** The rules for the place of supply of services changed on 1 January 2010 along with other changes to the VAT rules for international transactions. Section 7A(2) of VATA provides that

A supply of services is to be treated as made (a) in a case in which the person to whom the services are supplied is a relevant business person, in the country in which the recipient belongs, and (b) otherwise, in the country in which the supplier belongs.

3.37 Section 7A(2) of VATA provides that ‘a relevant business person’ here means (if the services are received by the person otherwise than wholly for private purposes) any one of the following: (a) a taxable person under Article 9 of the VAT Directive; (b) a person registered under this Act; (c) a person identified for the purposes of VAT in accordance with the law of another EU Member State; or (d) a person registered under a similar Act of Tynwald.¹⁰²

3.38 Where the place of supply is determined by where the customer belongs, the customer is required to account for VAT under a reverse charge procedure, whereby the supplier treats the supply as if it were zero-rated and the customers charge themselves VAT on the invoice value.¹⁰³

3.39 Charities that are VAT-registered in the UK are required to account for VAT on certain services received from non-UK suppliers. From 1 January 2010, this requirement covers all services (other than VAT-exempt services) where the place of supply is determined by where the customer belongs.

3.40 The changes effective from 1 January 2010 build on the decision in the case of *Skatteverket*.¹⁰⁴ Whereas the UK previously only required the reverse charge to apply when a service was received for a business purpose, VAT-registered charities are now required to apply the reverse charge irrespective of whether or not the service has been provided for a business or non-business purpose. This means that, in order to raise the necessary self-supply invoice and pay the output tax to HMRC, charities need to have a system in place for identifying those invoices from overseas suppliers that do not show VAT

¹⁰¹ For more, see HMRC Guidelines, *How charities can import goods VAT-free* (available at www.hmrc.gov.uk/charities/vat/import.htm and last accessed on 12 December 2011).

¹⁰² An Act of Tynwald is a statute passed by Tynwald, the parliament of the Isle of Man.

¹⁰³ See VATA, s.8. The value of the supplies to which the reverse charge applies is taken into account when determining registration liability.

¹⁰⁴ ECJ Case C-291/07 *Kollektivavtalsstiftelsen TRR Trygghetsrådet v Skatteverket* (2008).

and where the supply falls under the rules above. Recovery of all or part the VAT as input tax will depend on the use of the services.¹⁰⁵

*Shared Services*¹⁰⁶

3.41 Article 132(1)(f) of the VAT Directive provides that

“Member States shall exempt the following transactions ... the supply of services by independent groups of persons, who are carrying on an activity which is exempt from VAT or in relation to which they are not taxable persons, for the purpose of rendering their members the services directly necessary for the exercise of that activity, where those groups merely claim from their members exact reimbursement of their share of the joint expenses, provided that such exemption is not likely to cause distortion of competition”.

3.42 Although this is a mandatory provision, it has not as yet been implemented in UK VAT law. In the March 2010 Budget, the UK government stated that it

“recognises the efficiencies that can be achieved by organisations such as charities sharing services and the potential VAT barrier that exists. The Government will work with charities and other affected sectors to consider options for implementing the EU cost sharing exemption”.

3.43 The result is a proposal for a new group of exempt supplies for the purposes of Schedule 9 of VATA.¹⁰⁷ The new Group 16 will be entitled “Supplies of services by groups involving cost sharing”. It will allow groups to exempt from VAT those supplies made to their members, provided certain conditions are met. The draft provision is as follows:

“Item No.1 - The supply of services by an independent group of persons where each of the following conditions is satisfied —

(a) each of those persons is a person who is carrying on an activity (“the relevant activity”) which is exempt from VAT or in relation to which the person is not a taxable person within the meaning of Article 9 of Council Directive 2006/ 112/EC,

(b) the supply of services is made for the purpose of rendering the members of the group the services directly necessary for the exercise of the relevant activity,

(c) the group merely claims from its members exact reimbursement of their share of the joint expenses, and

¹⁰⁵ Charity Tax Group and Nuffield Foundation, *Charity Tax Map* (February 2011) at [6.5.2].

¹⁰⁶ This section draws its inspiration from the work of the Charity Tax Group.

¹⁰⁷ See [3.05] above.

(d) the exemption of the supply is not likely to cause distortion of competition.”

3.44 Whereas the rules were such that UK VAT was a potential obstacle to charities working together to create economies of scale, the question now must be raised whether facilitating this kind of horizontal integration gives charities an unfair advantage over other small businesses who seek profit for the purposes of distribution (to their members) rather than for purposes of redistribution.

Part IV: Inheritance Tax

Introduction

4.01 Inheritance Tax (IHT) is a direct cumulative tax on capital transfers of value made by individuals.¹⁰⁸ IHT is relevant for: lifetime transfers, including gifts with a reservation of benefit; death; and, settled property with either a right to income or a beneficial interest under a discretionary trust. There is no liability up to a certain threshold.¹⁰⁹ Some lifetime transfers, such as gifts to charities if they fail to qualify for an exemption, are charged at the time of the transfer,¹¹⁰ but most transfers are only chargeable at the time of death if they are transferred within 7 years of death.

4.02 Individuals domiciled in the UK are liable to IHT on property worldwide. Non-UK domiciled individuals are also liable to IHT, but only on chargeable UK property.

4.03 IHT is charged on the value transferred, which is calculated in different ways for lifetime and death transfers: the loss to the transferor’s estate and the value of the estate immediately before death, respectively. The following are exempt from IHT: transfers between spouses; amounts below a certain annual threshold; small gifts to the same person; normal expenditure out of income;¹¹¹ gifts in consideration of marriage/civil partnership; gifts to political parties and housing associations; gifts for national purposes; maintenance funds for historic buildings; employee trusts; and, of course, gifts to charities. It should be noted that other than the main charity exemption, gifts to charity could also fall under a number of the other exemption listed.

¹⁰⁸ All references in this Part to section numbers, schedules or parts are references to the Inheritance Act 1984, c.51 (hereinafter “IHTA”), unless otherwise specified.

¹⁰⁹ Currently, the threshold is £325,000.

¹¹⁰ At half the death rate, which is currently 40%.

¹¹¹ IHTA, s.21. A series of cash donations to charity will usually qualify under this exemption. See Kessler and Brown, fn.1 above, at [23.4].

4.04 A disposition is not a transfer of value if it is, or would be, allowable in computing profits or gains for the purposes of income tax or corporation tax.¹¹² This would apply to gifts by traders that qualify for a deduction (see above, paragraphs 2.05-2.06).

The Main Charity Exemption

4.05 Section 23 provides that transfers of value are exempt to the extent the values transferred are attributable to property given to charities. A transfer of value is fully exempt even if the value transferred exceeds the value of the property received by the charity.¹¹³ However, it is not exempt if the interest in the property received by the charity is a shared interest or an interest limited by time.¹¹⁴

4.06 Property, including assets sold at an undervalue, is ‘given’ to charities if it becomes the property of charities or is held on trust for charitable purposes only.¹¹⁵ Thus, if any part of the property given to charities is applicable for non-charitable purposes then the exemption will not be applied.¹¹⁶

4.07 There must be an acquisition of the property by the charity. Releasing a debt and surrendering a lease may not count because identifying the asset ‘acquired’ is problematic.¹¹⁷

4.08 It is possible that HMRC will automatically apply the exemption if the gift does not exceed £10,000 and it is paid to a registered UK Charity.¹¹⁸

4.09 Section 272 provides that, unless the context otherwise requires, charity and charitable have the same meanings as in the Income Tax Acts. Thus, when the legislation refers to “the property of charities”,¹¹⁹ the old tax definition currently applies. However, a relevant “context” here is that EU law overrides the notion that the charity must be within the jurisdiction of UK courts, so EU and some EEA charities will arguably qualify for relief.¹²⁰

4.10 When the legislation refers to “held on trust for charitable purposes”,¹²¹ it is arguable that there is no jurisdiction requirement. Thus, the possible anomaly that a gift to a foreign charitable trust is exempt but a gift to a foreign charitable company is chargeable. Kessler and Brown advise that for

¹¹² IHTA, s.12(1).

¹¹³ See Kessler and Brown, fn.1 above, at [23.6].

¹¹⁴ IHTA, s.23(3).

¹¹⁵ IHTA, s.23(6).

¹¹⁶ IHTA, s.23(5).

¹¹⁷ See Kessler and Brown, fn.1 above, at [23.7].

¹¹⁸ See Kessler and Brown, fn.1 above, at [23.9.2].

¹¹⁹ IHTA, s.23(6)(a).

¹²⁰ See Kessler and Brown, fn.1 above, at [23.8].

¹²¹ IHTA, s.23(6)(b).

“practical purposes it would be safer to plan on the cautious basis that IHT charity relief applies only gifts to trusts within the jurisdiction of the Courts of the EU, Norway and Iceland.”¹²²

4.11 A trust or bequest directing the trustees to appoint or distribute to bodies described as 'charities' or 'charitable' qualify for exemption without identifying the recipients where the implementing instrument has effect under UK law.¹²³ However, the exemption will not apply if the gift to charity is postponed until after an interest in the property lapses or a period of time passes.¹²⁴ Nor will it apply if the gift depends on a condition that is not satisfied within twelve months of the transfer,¹²⁵ or the property is an interest in land or a building reserved for the benefit of the donor or a connected person.¹²⁶

4.12 Section 52 provides that the termination of a recognised interest in possession is a transfer of value, which may qualify for the exemption, despite constituting a deemed transfer of value.¹²⁷

4.13 Sections 55 and 56 contain a number of anti-avoidance provisions that relate specifically to trusts.¹²⁸

4.14 Ordinarily, neither a loan repayable on demand nor a licence revocable without notice (even if rent free) would constitute a transfer of value because they breach the charitable purposes rule and the limited period rule, respectively. However, a loan or licence to a charity not terminable on demand would be a transfer of value.¹²⁹

4.15 The ‘gift with reservation of benefit’ rules (i.e. when a donor reserves an interest in the gifted property) do not apply to exempt charitable transfers,¹³⁰ but they would where a gift fails the exemption.

Inheritance Tax on Charities

4.16 **Permanently Charitable Trusts.** A permanently charitable trust is not subject to IHT and is exempt from the IHT regime. Section 58(1)(a) provides that property for these purposes means settled property in which no qualifying interest in possession subsists, other than property held only for charitable purposes (whether for a limited time or otherwise).

¹²² See Kessler and Brown, fn.1 above, at [23.8] (online edition only).

¹²³ See Kessler and Brown, fn.1 above, at [23.9.1].

¹²⁴ IHTA, s.23(2)(a).

¹²⁵ IHTA, s.23(2)(b).

¹²⁶ IHTA, s.23(4).

¹²⁷ HMRC accept this conclusion. The legislation often distinguishes between an actual transfer of value and a deemed transfer of value. However, the reference to transfer of value in s.23 includes a transfer of value deemed to be made under s.52. Kessler and Brown, fn.1 above, at [23.23.1].

¹²⁸ See Kessler and Brown, fn.1 above, at [23.24] - [23.27].

¹²⁹ IHTA, s.29(1),(5). See Kessler and Brown, fn.1 above, at [23.28].

¹³⁰ Finance Act 1986, s.102(5)(d).

4.17 Because there is no express jurisdiction requirement, Kessler and Brown consider that this relief for permanently charitable trusts applies to settled property “not governed by UK law (though the purposes must be charitable according to English law)”. Section 43 defines “settlement” for the purposes of the IHTA. It provides, *inter alia*, that it is any disposition of property:

- (a) held in trust in succession or subject to a contingency; or
- (b) held on trust to accumulate income or to make payments out of that income; or
- (c) charged or burdened (otherwise than for full consideration) with the payment of any annuity or other periodical payment; or
- (d) would be so held, charged or burdened, if the disposition were regulated by UK law; or
- (e) whereby property is administered under another country’s law according to equivalent provisions, if the property were so held, charged or burdened.

Thus, section 43 makes it quite clear that foreign law ‘settlements’ can be settlements for UK inheritance tax purposes. Accordingly, it falls to be determined whether the trusts themselves are charities for the purposes of UK law, when considering whether permanent charitable trust status is to be conferred.

4.18 **Temporary Charitable Trusts.** A gift to a temporary charitable trust will not qualify for the charity exemption. No periodic charge is levied on the settled property as long as it is held for the time being for charitable purposes only, but if it ceases to be held for charitable purposes only (otherwise than by being applied for such purposes or being transferred to a charity) a special exit charge is levied at a penal rate.¹³¹

4.19 **Members of Charitable Company.** The rights of a member of a charitable company will usually have no market value. This means that no inheritance tax charge can arise on the death of a member, irrespective of the definition applicable. This remains the case even in the very exceptional case where the charitable company has equity share capital.¹³²

4.20 The rights of a member of a temporary charity may have some value.

Gifts to National Institutions

4.21 Section 25 provides an exemption for property transferred which becomes the property of a body within Schedule 3. For example, museums, libraries, art galleries, local authorities, government departments, universities and health service bodies are included. Some institutions are listed by name. For example, the National Gallery, the British Museum, the Historic Buildings and Monuments Commission for England, the Marine Management Organisation, and Natural England.

¹³¹ IHTA, ss.58(1)(a) and 70. See Kessler and Brown, fn.1 above, at [29.3].

¹³² See Kessler and Brown, fn.1 above, at [23.35].

4.23 Schedule 3 is often referred to as containing ‘national institutions’. Most of these entities will be charities and will not need this relief.

A New Incentive for Charitable Giving

4.24 For deaths on or after 6 April 2012, estates that make charitable legacies of 10 per cent or more of the net estate will face a reduced rate of inheritance tax (36 per cent rather than 40 per cent). There are no plans to apply any taper or other mechanism to mitigate the ‘cliff edge’ of the 10 per cent threshold.¹³³

Part V: Stamp Duty

Stamp Duty Land Tax

5.01 Stamp duty land tax (hereinafter “SDLT”) is a tax on land transactions. Schedule 8 of Finance Act 2003 (hereinafter “FA03”) contains a relief for charities that use land for genuine charitable purposes.¹³⁴ This also probably applies to non-charities if they acquire land as a nominee for a charity.¹³⁵

5.02 HMRC’s view is that the legislation does not provide for partial relief where some of the joint purchasers are charities and some are not. This is currently being challenged.

5.03 While the standard tax definition of ‘charity’ applies, this relief has its own definition of ‘charitable trust’, which is a trust or unit trust where all of the beneficiaries or unit holders are charities.¹³⁶ This means that although the trust or unit trust itself need not be a charity, it is necessary to look to the charitable purposes of the purchaser (i.e. the underlying ‘charities’) to determine whether the transaction qualifies for the relief.

5.04 The purchaser must intend to hold the land either for use in furtherance of the charitable purposes of the purchaser or another charity, or as an investment from which the profits are applied to the charitable purposes of the purchaser.¹³⁷ This condition excludes relief if the purchase was part of a trading transaction. As long as the purchaser intends to hold the greater part of the land purchased, this

¹³³ HMRC Consultation Document, *A new incentive for charitable legacies: A lower rate of inheritance tax when leaving 10% of an estate to charity* (10 June 2011) at [1.18]. For commentary on this proposed relief, see Kessler and Brown, fn.1 above, at [23.37.1].

¹³⁴ An example might be providing accommodation for the clergy.

¹³⁵ Relief must be claimed in a land transaction return or an amendment of such a return: FA03, s.68(2).

¹³⁶ FA03, Sch.8 at [4].

¹³⁷ FA03, Sch.8 at [1(2)].

condition will still apply to the whole transaction.¹³⁸ HMRC regard “the greater part” as a reference to the monetary value of the land.

5.05 The transaction must not have been entered into for the purpose of avoiding tax (whether by the purchaser or any other person).¹³⁹ Kessler and Brown suggest that this condition will rarely prevent a charity from claiming the relief.¹⁴⁰

5.06 Where both of the two conditions identified in paragraphs 5.04 and 5.05 above are fully met, the relief is nonetheless subject to withdrawal within three years of the transaction if (i) the purchaser ceases to be established for charitable purposes only or (ii) the land (or any interest or right derived from it) ceases to be used or held by the purchaser in accordance with either of the two conditions set out in paragraph 5.04 above.¹⁴¹ The withdrawal may be of the whole or only part of the relief.

5.07 Where the purchaser intends to hold the greater part of the land (see paragraph 5.04 above) the conditions upon which the relief will be withdrawn (within three years of the transaction) are more extensive.¹⁴² This makes it possible for charities to claim partial relief on certain acquisitions. The operation of a claw-back mechanism in relation to the full relief initially granted, ensures that there is relief in proportion to the share of the land acquired that the charity continues to hold in furtherance of its charitable aims.

Stamp Duty Reserve Tax

5.10 Section 87 of the Finance Act 1986 imposes the charge to Stamp Duty Reserve Tax (hereinafter “SDRT”). Section 90(7) of the Finance Act 1986 provides relief from SDRT by disapplying section 87 when there is an agreement to transfer securities to a charitable company, a charitable trust, the Trustees of the National Heritage Memorial Fund, the Historic Buildings and Monuments Commission for England or the National Endowment for Science, Technology and the Arts.

5.11 Non-charitable subsidiaries owned by a charity do not qualify for SDLT or SDRT relief. Therefore, land and securities should be purchased by the charity, not the subsidiary. A transfer from the charity to the subsidiary may qualify for group relief if the charity is a company, but not if it is a charitable trust.

¹³⁸ FA03, Sch.8 at [3].

¹³⁹ FA03, Sch.8 at [1(3)].

¹⁴⁰ See Kessler and Brown, fn.1 above, at [34.4.2].

¹⁴¹ FA03, Sch.8 at [2].

¹⁴² See FA03, Sch.8 at [3].

Part VI: Rating Relief

6.01 For England and Wales, the Local Government Finance Act 1988, c.41 (hereinafter “LGFA”) deals with rates, which are a form of property taxation.¹⁴³ Non-domestic rates (or ‘business rates’ as they are more commonly known) are a property tax on businesses and other non-domestic properties. They are imposed by central government but they are nonetheless an important source of revenue for local authorities (known as ‘billing authorities’ in the LGFA).¹⁴⁴

6.02 The charge to tax is on persons for each and every day that they occupy all or part of a “hereditament” (i.e. land, broadly defined) that is shown in a local non-domestic rating list.¹⁴⁵ The charge is levied on an annual basis in relation to chargeable financial years. A local non-domestic rating list must be in force for each and every day the person is brought within the charge to tax. The list must show, *inter alia*,¹⁴⁶ the rateable value of the hereditament, which is, in principle, the open market rental value of the land with due allowance for the cost of maintenance and repairs.

6.03 A hereditament is property that is or would fall to be shown as a separate item in a valuation list.¹⁴⁷ In addition, it is a right to use land for the purpose of exhibiting advertisements and either (i) the right is let out or reserved to any person other than the occupier or (ii) where the land is not occupied for any other purpose, the right is let out or reserved to any person other than the owner of the land.¹⁴⁸ In practice, most land will come within the definition of hereditament.

6.04 A hereditament can be either domestic or non-domestic.¹⁴⁹ Once a hereditament is on a local non-domestic rating list, it is *prima facie* chargeable and entitled to the charitable relief.

6.05 The new definition of charity does not apply for rating purposes. This means, *inter alia*, that there is no jurisdiction requirement for the purposes of rating relief. As long as it is established for charitable purposes only, section 67(10) of the LGFA provides that a charity is an institution, other organisation or any persons administering a trust. ‘Charitable purposes’ has the meaning given by section 2 of the Charities Act 2006.¹⁵⁰

¹⁴³ The rules for Scotland and Northern Ireland will not be covered in this report.

¹⁴⁴ The revenue is collected by local authorities, pooled by central government and redistributed to local authorities.

¹⁴⁵ There is also a charge for some types of unoccupied hereditaments. See LGFA, s.45.

¹⁴⁶ For the other contents of the list, see LGFA, s.42.

¹⁴⁷ See LGFA, s.64(1), and General Rate Act 1967, s.115(1).

¹⁴⁸ LGFA, s.64(2).

¹⁴⁹ For the meaning of both domestic and non-domestic, see LGFA, ss.64 and 66.

¹⁵⁰ See [1.03] *et seq.* above.

6.06 Section 43(6) of the LGFA provides that relief is available where the hereditament is wholly or mainly (i.e. more than half)¹⁵¹ used for charitable purposes.¹⁵² Property occupied (i.e. controlled) but rented out by a charity is not used for charitable purposes,¹⁵³ unless it is rented out in order to fulfill the charitable purposes of the charity.¹⁵⁴ Housing occupied by charity employees may be used for charitable purposes.¹⁵⁵ Premises occupied partly by a trading subsidiary, will qualify for relief in respect of the part occupied by the charity for charitable purposes. However, billing authorities do have discretion to grant rate relief to non-charities (e.g. trading subsidiaries).

6.07 Use for charitable purposes means use for “purposes directly related to the achievement of the objects of the charity” and not use for “the purposes of getting in, raising or earning money for the charity”.¹⁵⁶ Section 64(10) of the LGFA provides that a hereditament shall be treated as wholly or mainly used for charitable purposes at any time if at that time it is wholly or mainly used for the sale of goods donated to a charity and the proceeds of the sale of goods (after any deduction of expenses) are applied for the purposes of a charity.¹⁵⁷

Mandatory Relief

6.08 Mandatory relief is available to charities (and trustees for a charity) under section 43(6) of the LGFA if, on the day concerned, the hereditament is wholly or mainly used for either charitable purposes or the purposes of a registered community amateur sports club.¹⁵⁸ The mandatory relief differs dependent on whether it relates to an occupied or unoccupied hereditament.

6.09 The majority of property subject to the unoccupied hereditament rates under section 45 of the LGFA would be eligible for 100 per cent relief, if the ratepayer qualifies under section 45A.

Discretionary Relief

¹⁵¹ *Fawcett Properties Ltd v Buckingham County Council* [1961] AC 636 at 669.

¹⁵² See also LGFA, ss.45A and 47.

¹⁵³ *Polish Historical Institution v Hove Corporation* (1963) 61 LGR 438.

¹⁵⁴ *Soldiers, Sailors and Airmens Families Association v Merton Corporation* [1967] 1 WLR 127 (restricted lease) and *Forces Help Society v Canterbury City Council* (1978) 77 LGR 541 (licence).

¹⁵⁵ *Royal Society for the Protection of Birds v Hornsea Urban Council* 18 RRC 57 (warden living on a nature reserve was better able to perform his duties) and *Glasgow Corporation v Johnstone* [1965] AC 609 (the use directly facilitated the carrying out of the main charitable purposes).

¹⁵⁶ *Oxfam v Birmingham City Council* [1976] AC 126 at 146 per Lord Cross (charity shops selling mainly donated goods were not entitled to the relief because the shops were not used directly for the objects of the charity but merely for fundraising).

¹⁵⁷ This overrules the decision in *Oxfam v Birmingham City Council* [1976] AC 126 with regards the facts of the case but not the general proposition.

¹⁵⁸ See CTA10, Pt.13, Ch.9.

6.10 The discretion to grant discretionary relief is conferred on billing authorities by section 47 of the LGFA. There are two conditions. First, the ratepayer is either a charity or fulfils one of the two not-for-profit conditions.¹⁵⁹ The second is the need for a decision of the billing authority concerned.¹⁶⁰

6.11 The granting of discretionary relief is at the discretion of the billing authority and an application must be made for relief. The manner of the application is not formal and may vary between billing authorities. There is no centralised control of the application of discretionary relief, and therefore it is necessary to contact the local billing authority.

¹⁵⁹ See LGFA, s.47(2)(b) and (c).

¹⁶⁰ LGFA, s.47(3).

Places of Public Religious Worship

6.12 In addition to charitable relief there is also 100 per cent relief for places of public religious worship. It applies automatically for the Church of England and Church of Wales and other hereditaments certified under the Places of Worship Registration Act 1855 as places of religious worship.¹⁶¹ Certification is subject to challenge by local authorities.¹⁶²

6.13 A place of religious worship must have as its principal use people coming together to do reverence to God. Lord Denning has stated that it must be reverence to a deity, subject to some rare exceptions (e.g. Buddhist temples).¹⁶³ In the same case, it was stated that ‘worship’ means:

“something which must have some at least of the following characteristics: submission to the object worshipped, veneration of that object, praise thanksgiving, prayer or intercession ... when you find an act which contains none of these elements it cannot, in my judgment, answer to the description of an act of worship”¹⁶⁴

6.14 The hereditament must also be open to the public. In *Church of Jesus Christ of Latter-Day Saints v Henning*, a Mormon temple was open only to Mormons ‘of good standing’, which was not sufficiently public.¹⁶⁵ This would also appear to apply to enclosed orders.¹⁶⁶

6.15 The exemption is extended to “a church hall, chapel hall or similar building used in connection with” a place of public religious worship.¹⁶⁷ The test revolves around usage.¹⁶⁸

Part VII: Conclusion

7.01 Given the recent decision to amend VATA with regards horizontal integration¹⁶⁹ and the design of a new definition of charity for the purposes of all but one of the taxes considered in this

¹⁶¹ LGFA, Sch.5 at [11].

¹⁶² *Church of Jesus Christ of Latter Day Saints v Henning* [1964] AC 420.

¹⁶³ *R v Registrar General, ex p Segerdal* [1970] 2 QB 697 at 707 (the Church of Scientology was not entitled to registration of a chapel under the Places of Worship Registration Act 1855).

¹⁶⁴ *R v Registrar General, ex p Segerdal* [1970] 2 QB 697 at 709 per Buckley LJ.

¹⁶⁵ [1964] AC 420. See also *Gallagher v Church of Jesus Christ of Latter-day Saints* [2008] UKHL 56.

¹⁶⁶ See the Australian case of *Association of the Franciscan Order of Friars Minor v City of Kew* [1944] VLR 199 (an order of Carmelite nuns did not qualify for a statutory exemption because they were an enclosed order).

¹⁶⁷ LGFA, Sch.5 at [11(1)(b)].

¹⁶⁸ See *West London Methodist Mission Trustees v Holborn Borough Council* (1958) 3 RRC 86 (a building adjoining a Methodist chapel qualified because it was used for a variety of activities including: youth club, church socials, Sunday school and mission office).

¹⁶⁹ See [3.41] *et seq.* above.

report,¹⁷⁰ it is evident that the UK government is serious about bringing the taxation of charities into line with EU tax law.

7.02 It should also be evident that charities and some other not-for-profit organisations enjoy considerable tax advantages over the ‘for-profit’ sector in the UK. One possible explanation for this state of affairs is that the tax system is simply prioritising the redistribution objective of taxation at the expense of its revenue-raising objective.¹⁷¹ However, the manner in which this prioritisation takes effect means that the government has ceded to the private sector part of its responsibility for choosing where (and, in some cases, when) redistribution is needed. The only possible justification for devolving responsibility must be that charitable institutions are considered to be better at redistributing wealth than government in some areas. This certainly chimes with the ideological underpinnings of the current UK government’s vision of a ‘Big Society’.¹⁷²

¹⁷⁰ See [1.03] *et seq.* above.

¹⁷¹ A provisional figure for the cost of UK tax relief in relation to charities and charitable giving for 2010/11 is £3.34 billion. See <http://www.hmrc.gov.uk/stats/charities/table10-2.pdf>, last accessed 14 December 2011.

¹⁷² The Big Society is about creating a climate that empowers local people and communities by taking power away from politicians and encourages people to take an active role in their communities. See <http://www.number10.gov.uk/news/big-society>, last accessed 14 December 2011.