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## The Charity Law & Practice Review

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# TAXATION NOTES AND NEWS<sup>1</sup>

## FINANCE BILL 1998 CHANGES

Robert Venables QC

### Income Tax and Corporation Tax

The Finance Bill contains two clauses giving a limited measure of tax relief to donors to charity where gifts in cash or in kind are made for use by an educational establishment in a designated poor country.<sup>2</sup> The reliefs apply only to gifts made before 2001. The first relief is important in that gift aid does not apply to gifts in kind. The second relief is important in that the threshold for cash gifts to qualify is £100, rather than £250 under the gift aid rules.

#### *Gifts in Kind to Charities*

The first relief, which must be claimed, applies to articles donated by a person carrying on a trade, profession or vocation. The gifted articles must be:

- (a) articles manufactured by the donor
- (b) articles of a class or description sold by the donor in the course of his trade or
- (c) an article used by the donor in the course of his trade, profession or vocation which constitutes "machinery or plant"<sup>3</sup> used by him wholly or partly in the course of that trade, profession or vocation.

Subject to certain exceptions, if the donor disposes of trading stock at a deliberate undervalue, e.g. by way of gift, he would normally be required to bring into his accounts the market value of that stock. The relief operates by suspending that

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<sup>2</sup> The Treasury will make the designation in a statutory instrument.

<sup>3</sup> Within the meaning of Part II of the Capital Allowances Act 1990.

rule, so that the donor is in general taxed only on what he receives, i.e. in the case of a pure gift, on nothing. The donor will still be able to deduct the costs of acquiring or producing the gifted articles.

Similarly, if the donor incurs capital expenditure on the provision of "machinery or plant" for the purposes of his trade etc. he is normally entitled to capital allowances, calculated by reference to the expenditure, which reduce his taxable income. The allowances are given to compensate for the fact that depreciation is not taken into account in computing trading profits for tax purposes. Where an asset which has qualified for allowances is disposed of, the trader is normally in effect taxed on the market value of the asset at the time of disposal. Where the trader disposes of such an asset by way of pure gift, the relief operates by taxing the donor only on what he actually receives for it, i.e. nothing. The capital allowances previously allowed to the donor will not be clawed back.

If relief is given in respect of the gift of an article and any benefit is received by the donor or any person connected with him which is in any way attributable to the making of that gift, then the donor is charged to tax on an amount equal to the value of that benefit. This is fairer than, say, the Gift Aid rules, as relief is not denied altogether because of some relatively minor benefit reserved by the donor.

#### *Gifts of money for relief in poor countries*

The second relief applies to a gift of money of at least £100 made by an individual to a (UK) charity. The charity must have given the required notification to the Revenue, i.e. announced that it proposes to operate the scheme.

The circumstances of the gift must give rise to a reasonable expectation that the sum given will be applied for, or in connection with, either

- (a) the relief of poverty, or
- (b) the advancement of education

in any one or more designated countries or territories.

The sole advantage conferred by the new provision is that the minimum payment which will qualify for Gift Aid treatment is £100, instead of £250. There are also complex rules which allow two or more smaller payments made in a year to be aggregated in order to reach the £100 limit.

## **Inheritance Tax**

### *Gifts of Heritage Property to Non-Charities*

Gifts to not-for-profit bodies of land of outstanding scenic or historic or scientific interest, of a building of outstanding historic or architectural or aesthetic interest, or of a picture, print, book, manuscript, work of art or scientific collection of national, scientific, historic or artistic interest formerly enjoyed exemption from inheritance tax, as did contributions to related maintenance funds.<sup>4</sup> That exemption is removed. The exemption for gifts to charity will still remain. It will therefore now be important to ensure that the donee body is itself a charity.

### *Maintenance Funds*

A gift into a maintenance fund for a historic building can qualify for exemption from inheritance tax under Inheritance Tax Act 1984 section 27. It will now be necessary for a claim for exemption to be made within two years of the gift.

### *Property accepted in lieu of Tax*

New public accounting requirements are being brought in regarding property accepted in satisfaction of tax. The basic rules remain unchanged.

### *Conditional Exemption*

Condition exemption from inheritance tax is available in respect of certain heritage property, subject to conditions as to public access being complied with. The assets can remain in private ownership. An inheritance tax charge is usually triggered if the assets are sold or if the conditions are not complied with. The rules are being tightened up. There may therefore be more cases in future where a donor is prepared to gift his assets outright to a charity, the gift benefiting from the charitable exemption, rather than attempting to go through the hoops of conditional exemption.

## **VALUE ADDED TAX**

### *VAT on Fuel and Power*

VAT on fuel and power for domestic use or for charity non-business use is reduced to 5% from 1st September 1997.<sup>5</sup>

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<sup>4</sup> Inheritance Tax Act 1984 section 26.

<sup>5</sup> Finance (No 2) Act 1996 section 6(1).

*Two Concessions for Charities*

The Commissioners of Customs & Excise have announced two new concessions for charities in Business Brief 13/97 16th June 1997. They relate to Finance Act 1997 ss. 33 and 34 and concern zero-rating for charities. The concessions enable sales of donated goods by charities to other businesses, which are unsuitable for sale to the general public by reason of their poor quality, to be zero-rated. In addition, charities which exclusively serve the needs of the handicapped or which provide transport services predominantly to the handicapped may make purchases of adapted minibuses and other "relevant goods" at the zero-rate. Both concessions apply to supplies made on or after 26th November 1996.

"Agreement on concession for charities

"Customs & Excise have now finalised the details of the two concessions which were announced in Customs & Excise News Release 9/97 of 6 March 1997.

"These concessions relate to FA 1997 ss 33, 34. Both concessions will be back dated to 26 November 1996 [the day of the Budget Speech]."

*Goods Donated to Charity for Sale*

"The concession on section 33 retains zero-rating for sales of goods donated to a charity where they cannot be sold to the general public because of their poor quality."

The supply by a charity of any goods which have been donated for sale is normally zero-rated. Section 33 denies zero-rating unless the sale takes place as a result of the goods having been made available to the general public for purchase (whether in a shop or elsewhere).<sup>6</sup>

"This concession will benefit many charities, particularly those who sell scrap clothing to rag merchants or those who are prevented under safety legislation from selling certain goods (for example, second hand electrical goods or toys) to the public."

*Charities for the Handicapped and Transport Charities*

"The concession on section 34 allows charities which exclusively serve the needs of the handicapped, and transport charities which provide their services predominantly to handicapped persons, to purchase adapted minibuses and other relevant goods at the zero rate. Whether a transport charity qualifies will be judged by looking at its normal commercial documentation, such as its aims and objects

<sup>6</sup>

This paragraph is RV's comment and not part of the text of the Briefing.

or publicity material, and Customs & Excise will not expect charities to keep records of individuals to prove their claim for zero-rating. Customs & Excise will soon be providing guidance for charities and their suppliers which will explain how to make these decisions and what documents must be retained and produced."

The supply is zero-rated of any "relevant goods" to (a) an "eligible body" which pays for them with funds provided by a charity or from voluntary contributions or to (b) an eligible body which is a charitable institution providing care or medical or surgical treatment for handicapped persons. The effect of section 34 is that a charitable institution is not regarded as providing care or medical or surgical treatment for handicapped persons unless it provides care or medical or surgical treatment in a "relevant establishment" and the majority of the persons who receive care or medical or surgical, treatment in that establishment are handicapped persons.<sup>7</sup>

### **Zero-Rating: Sale at Charity Auction**

*David and Janet Foster (t/a David Foster Associates) v C & E Comrs*

The appellants carried on a business as commercial artists which included the design of prints depicting sporting events and personalities. The prints were auctioned at fundraising events arranged by an agency on behalf of sports charities. The sale proceeds were shared between the charity (50%), the celebrity (25%) and the appellants (25%). The agency was entitled to retain commission out of the shares of the celebrity and the appellants. Each print was about 18" by 12" and comprised a portrait of the celebrity surrounded by drawings of the subject in action, team trophies and written inserts. For sale by auction the print was presented in a glass frame. The appellants appealed to a VAT Tribunal against an assessment of output tax in respect of their share of the sale proceeds on the ground that the sales of the prints were zero-rated as books, booklets, brochures, pamphlets or leaflets (VATA 1994 Sch 8 Group 3 item 1).

The Tribunal dismissed their appeal on the grounds that although the inclusion of information on written inserts gave the prints some of the characteristics of a leaflet, their size and intended use were not shared with leaflets and the prints were clearly not brochures or pamphlets, which normally consisted of more than one sheet.

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<sup>7</sup> This paragraph is RV's comment and not part of the text of the Briefing.

## **TAX CREDITS ON DIVIDENDS AND OTHER DISTRIBUTIONS FROM UK COMPANIES**

Currently, charities are in general able to claim repayment of the tax credit of 20% of the grossed up amount (25% of the net amount) attached to the payment of dividends and other "qualifying distributions" from UK companies. As from April 1999, tax credits will no longer be payable to shareholders with no tax liability. Charities will receive some compensation, through public expenditure, for the loss of tax credits. This compensation will take the form of a payment to a charity of a percentage of the net dividends it receives, and will be phased out over five years from 6th April 1999. The percentage will be for 1999-2000 21%; for 2000-1 17%; for 2001-2 13%; for 2002-3 8%; and for 2003-4 4%.

In due course, the abolition of this relief could have a marked effect on charities' investment policies.

Covenanted donations and gift aid payments from companies are unaffected. Where a charity owns a charitable subsidiary, it will be more important than ever for profits to be extracted by one of these routes rather than by the payment of a dividend.

## **REVIEW OF CHARITY TAXATION**

A review of the taxation of charities was announced by the Chancellor on 2nd July 1997. It now seems the review will not be complete until July 1998. Welcoming the review, the Financial Secretary to the Treasury, Dawn Primarolo, said:

"Charities contribute a great deal to society and this is reflected in their favourable tax treatment. However, the system can be complex and charities have for some time called for a review to reduce the administrative burden on them, freeing them to concentrate on their charitable activities. The Chancellor's announcement provides an opportunity to see if we can modernise the taxation of charities to produce a system which reflects the needs of charities today. We shall now consult charities to seek options for a clear, simple and fair tax treatment."

A Treasury Press Statement stated:

"The review is an opportunity for Government and charities to work together to see if it is possible to create a system which:

- is more coherent and consistent;
- is simpler to administer;
- reduces charities' compliance costs;

reduces the scope for the charity tax reliefs to be exploited for tax avoidance purposes;  
is more receptive to the needs of today's charities.

"The main focus of the review will be the current VAT arrangements. However, charities may also raise any concerns they have about direct taxes or business rates.

"The first consultation period will run from today and charities are invited to contribute initial views before the deadline of 1 December 1997. Government will consider the views submitted and will publish a consultation document in Spring 1998 which will consider options for possible change. These will be discussed with representatives from the charitable sector during 1998."

The Notes to the Statement gave an interesting insight into the scope and cost of tax concessions to charities:

"1 Charities currently benefit from tax reliefs worth £1.75 billion. These consist of about £1 billion direct tax relief, £200 million VAT relief and the balance on relief from business rates.

2 Arrangements on the direct tax side focus on relieving charities' income from tax and encouraging giving to charities. The main reliefs are currently as follows:

charities' investment income and capital gains are in general exempt from tax provided that these are applied for charitable purposes;

some trading income is also exempt if the profits come from carrying out a primary purpose of the charity;

individuals or companies donating to charity under a deed of covenant can claim tax relief for donations;

gift aid provides tax relief for large, single cash gifts of at least £250;

payroll giving allows employees tax relief on charitable donations made through their pay;

inheritance tax relief on bequests to charities.

3 On the indirect tax side, there are currently four categories of VAT relief for charities:

all charities are able to purchase some goods and services without paying VAT (eg advertising for fund-raising purposes);

particular charities can purchase specific goods without paying VAT (eg medical equipment for medical research);

supplies such as welfare are exempt from VAT; this means that the charity does not charge VAT but cannot reclaim VAT on any goods or services it has to buy to make the supply;

particular charities can make specific types of sales which are taxed at the zero-rate, eg sales of donated goods in charity shops. This means that VAT incurred in running the shop can be reclaimed.

- 4 UK VAT operates within a framework laid down in EU law (the Sixth VAT Directive as amended). There is not a complete "fit" between the UK and EU VAT law affecting charities, but in broad terms the same types of activity benefit from relief. Many of the UK VAT reliefs affecting charities are covered by EU VAT exemptions, which include relief for education, health care and welfare services.
- 5 The UK's zero rates can be retained (though not extended) until such time as there is unanimous agreement by EU member states on alternative VAT arrangements to replace the "transitional system" set up at the time of the Single Market.
- 6 In 1996 the European Commission presented a draft programme of reviews and legislative reform aimed at producing a Common VAT system. The details and the timescale for any agreed changes are uncertain but as part of the Common VAT system programme, the VAT exemptions will be reviewed.
- 7 The aims of the taxation review announced today are:  
  
to see if there is scope for simplification of charities' taxation.  
  
to inform the Government's negotiation position in the forthcoming EC review of VAT social reliefs.  
  
It will be important to ensure that any outcome of the review does not unfairly advantage charities with regard to the commercial operators with whom they may compete.
- 8 The Government is therefore inviting constructive comments on how the taxation of charities might be improved. Although the main focus of the



review is likely to be on VAT, comments are invited on any aspect of the tax system.

Comments on any element of this review (direct and indirect taxes) should be sent to Mrs Mary Cooper, HM Customs and Excise, 4th Floor Central, New Kings Beam House, 22 Upper Ground, London, SE1 9PJ, by 1 December 1997."

## REPORTED CASES

### INCOME TAX: GIFT AID

In *St Dunstan's v Major (Inspector of Taxes)* the Special Commissioners for Income Tax Purposes held ineffective a strategy intended to enable a beneficiary under a will to redirect part of his inheritance while both avoiding a charge to inheritance tax and obtaining Gift Aid income tax treatment for his gift.

W, who was the sole residuary legatee under his mother's will, executed a deed of variation by which he declared that the will should have effect as if it had included a legacy of £20,000 to St Dunstan's, a registered charity. W elected that Inheritance Tax Act 1984 section 142(1) should apply to the variation, with the result that for inheritance tax purposes the legacy was deemed to have been given by his mother in her will. The deed varied a disposition of property comprised in her estate immediately before her death. The transfer of value on her death was exempt from inheritance tax to the extent that the value was attributable to property which was given to a charity. A sum of £20,000 was paid to St Dunstan's on completion of the administration of the estate. Later, in order to claim relief under the "Gift Aid" scheme, W signed a certificate of a single payment by an individual to a charity stating that he had made a payment of £26,666.67 representing £20,000 grossed up at the basic rate to St Dunstan's, and that he satisfied all the conditions for relief.

St Dunstan's claimed repayment of income tax at the basic rate. The Revenue concluded that the sum of £20,000 received by St Dunstan's was not a "qualifying donation", *inter alia*, on the grounds that that sum was paid by W in his capacity as personal representative under the will as varied, and was not therefore "a gift to a charity by an individual" within FA 1990 s.25(1), and that W had failed to satisfy the requirement in FA 1990 s.25(2)(e) that neither he nor any person connected with him had received "a benefit in consequence of making [the gift]".

The Special Commissioner noted that for purposes other than inheritance tax the deed of variation was made by W and did not therefore alter the will. On 30th October 1992 there had undoubtedly been "a payment of a sum of money" to St Dunstan's within FA 1990 s.25(2)(a). By virtue of the deed of variation W had bound himself to make a gift of £20,000 to St Dunstan's which he would pay out

of the estate, and he had made the payment when the estate had been wound up. There would have been "a gift to a charity by an individual" if W had written to St Dunstan's on the date on which he had executed the deed of variation, or had made a deed, to the effect that, when the estate had been wound up, he would send St Dunstan's £20,000. The Commissioner considered that the elaboration of the gift in the deed of variation did not prevent the gift from being "a gift to a charity by an individual" for the purposes of the Gift Aid legislation, since it was only for inheritance tax purposes that the gift to St Dunstan's, made by means of the variation, had to be treated as if made by W's mother under her will.

The Special Commissioner found, however, that W had failed to satisfy the requirement that "neither the donor nor any person connected with him receives a benefit in consequence of making [the gift]", by executing the deed of variation and making an election for inheritance tax purposes. The Commissioner noted that, in the instant case, by reason of the deed of variation of the will providing for a legacy of £20,000 for St Dunstan's there was a saving of £8,000 representing inheritance tax at 40% on £20,000 of residue, which was the subject of an exempt transfer of value attributable to property given to charity. W's personal liability to inheritance tax as the personal representative was reduced by £8,000. The residue of the estate was £8,000 more than it would have been had the gift to St Dunstan's been made without taking advantage of IHTA 1984 s.142. Since W was the sole residuary beneficiary of the estate, he ultimately benefited from the inheritance tax saving. Although the residue was reduced by £12,000 (the gift of £20,000 less the inheritance tax saving of £8,000), the benefit of £8,000 to W greatly exceeded the amount of benefit permitted by FA 1990 s.25(2)(e) if the gift was to be a qualifying donation. That benefit arose "in consequence of making [the gift]" to St Dunstan's by means of the deed of variation. Accordingly, St Dunstan's appeal would be dismissed.

This decision is in my respectful view wrong. As a result of making the variation W was, income tax considerations apart, £12,000 worse off, even if the charity was £20,000 better off. Although as personal representative his liability to inheritance tax was reduced by £8,000, the whole of that saving enured for the benefit of the charity and not for himself in his personal capacity. While it is true that if Gift Aid relief was available, W would, if he were a higher-rate taxpayer, be better off (as would be the charity), that is clearly not such a benefit as would prevent the relief being available.