
The Charity Law & Practice Review

TAXATION NEWS¹

Review of Charity Taxation

Publication of the long overdue review of charity taxation has been promised yet again - this time in conjunction with the Budget Statement, on 9th March.

Value Added Tax

Tax Avoidance

The Commissioners of Customs & Excise Business Brief 6/98 gloats over the failure of VAT planning designed to save a bona fide charity from having to pay VAT. The VAT Tribunal decision is waved before charities by way of a deterrent. It reads:

"Tribunal decision means VAT avoidance scheme fails

A recent Tribunal decision has demonstrated once again that tax avoidance schemes cannot be certain of success when tested in the Tribunals or courts. The case concerned is the University of Wales College, Newport and another ((1997) VAT Decision 15280) and involved the abuse of charitable reliefs so that higher education bodies could recover more input tax than they were entitled to. The taxpayer was represented by Ms Cargill-Thompson, instructed by Coopers & Lybrand.

Newport College bought a photocopier which it purported to donate to ACES Ltd for onward sale to Cardiff College. ACES Ltd, a wholly owned subsidiary of Newport College, had covenanted by deed to give all its profits to a charity (also Newport College).

¹ Robert Venables QC, 24 Old Buildings, Lincoln's Inn, London WC2 3UP.
Tel: (0171) 242 2744 Fax (0171) 831 8095. Taxation Editor.

The appellants contended that both the supposed donation by Newport College to ACES Ltd and the supposed sale by ACES Ltd to Cardiff College were zero-rated under VATA 1994 Sch 8 Group 15 (respectively Items 2 and 1). If they had been right, the end result would have been that Cardiff College had acquired the photocopier free of VAT. Without the scheme, the supply to Cardiff College would certainly have been liable to VAT, and that VAT would have been largely non-recoverable by the college as its activities were mainly exempt or outside the scope of VAT.

The Tribunal concluded that the transactions did not include any donation of the goods by Newport College to ACES Ltd; and that ACES Ltd never acquired title to the goods.

As a result, the reliefs under Group 15 Items 1 and 2 were both inapplicable, because there was no donation. Thus the avoidance scheme failed.

Educational bodies and other charities who have used this tax avoidance scheme should reconsider their VAT liability in the light of the Tribunal's decision. Voluntary disclosures of underdeclared VAT should be made in cases where they have incorrectly claimed zero-rating or recovered too much input tax.

Taxpayers and their advisers should also note that Customs & Excise will continue to take every opportunity to oppose tax avoidance schemes vigorously through the courts, even where, as in this case, legislation has been amended to put the legal position beyond doubt. In this area, the law was changed so that zero-rating was restricted to cases where donated goods were exported or sold through charity shops, charity auctions or similar events, because the reliefs had been used for avoidance, as explained in Budget Notice 30/96. Group 15 note 1 was amended with effect from 26 November 1996.

For further information traders and their advisers should contact their local VAT business advice centre listed under Customs & Excise in the telephone book."

What the decision shows is not that tax avoidance cannot work, but that any tax avoidance scheme must be properly implemented. Even where the Commissioners of Customs & Excise disclaim relying on the *Ramsay* principle, as they did in this case, the Tribunal can still find that the scheme was not implemented in such a way as to succeed. Where the Commissioners of Customs & Excise might find a scheme

offensive, it is particularly important that it is well thought out and that all i's are dotted and all t's crossed.

*T E Penny & Company Ltd v Commissioners of Customs & Excise*²

The appellant printed collection envelopes for charities. The question was whether the supply it made to its customer charities was zero-rated as being the publication of an advertisement for the purpose of raising money for the charities to which they were supplied (VATA 1994 Sch 8 Group 15 Item 8). These included envelopes used by the Church of England to collect weekly donations from covenantors and other donors under planned giving arrangements and envelopes supplied to a welfare charity for a local fundraising campaign. The Tribunal found that the envelopes were not within the categories of publication specified for zero-rating - newspapers, journals, posters, brochures, or pamphlets - and that the printing of a collection envelope was not the publication of an advertisement (VATA 1994 Sch 8 Group 15 Item 8(b)) or a supply of goods or services in connection with an advertisement (VATA 1994 Sch 8 Group 15 Item 8(c)). Although the envelopes were supplied for use for the purpose of raising money for the charities, in the one case the envelope for use in connection with a church's planned giving arrangements was not an advertisement as the donors had already committed themselves to giving to the church. The Tribunal held that fundraising campaign envelopes supplied to a welfare charity could be described as advertisements, but that in supplying the envelopes the appellant did not publish anything: it merely produced printed envelopes to order and delivered them to the church or charity. The appeal was dismissed.

Deeds of Covenant

The Inland Revenue, in an Interpretation of October 1998 have accepted that index-linked payments under deeds of covenant will not necessarily disqualify them from tax relief.

They point out that:

“A payment made under deed of covenant to a charity is not effective for tax purposes unless it is a “like” annual payment. We have interpreted this word, based on a series of tax cases, to mean that the covenantor must have a real and continuing commitment to make payments under the deed, and that there must be a constant element in each payment made.

A series of payments of equal amount will satisfy this interpretation, but covenantors may be concerned that the value of their donations will decrease over the period of the covenant. One way to avoid this is to make an initial payment, which is then uplifted in succeeding years by a set percentage, or in line with the retail prices index. We have, however, advised charities and donors that payments are not "like" if the deed allows for an initial fixed payment followed by payments increased in accordance with a formula.

We have reconsidered this advice. We now accept that payments under a deed of covenant which allows for an initial payment followed by payments based on a formula are "like" payments provided:

- the second and later payments are calculated under a formula which is applied to the initial payment; and
- the effect of the formula is to preserve the value of the second and later payments.

For example, we now accept that payments under a deed of covenant which allows for an initial payment of £50, with successive payments increased by a factor equal to the retail prices index, would be "like" payments."

This is in my view not a concession but in accordance with the law.

"Ministers Clarify Scope of Scottish Parliament's Tax Varying Power"³

It is planned that the new Scottish Parliament will have the power, as regards Scotland, to increase or decrease the basic rate of income tax set by the UK Parliament by a maximum of three pence. Higher taxation is normally good news for charities, as it enables larger gross donations to be made to them at the same cost to the donor, where the gift is deductible in computing the donor's taxable income for income tax or corporation tax purposes.

The Government has made clear in a technical paper its policy intentions in areas where the exercise of the tax-varying power interacts with other parts of the tax system.

As regards charitable covenants and Gift Aid, the Government notes, at paragraph

36, that “when a taxpayer makes a voluntary donation to a charity, either by covenant or through Gift Aid, the donation is made net of income tax at the basic rate, and the charity is able to claim repayment of that tax from the Revenue. Under the Gift Aid legislation, the amount paid is treated as the grossed up amount of the gift (FA 1990 s.25(6)). If the SVR was higher than the UK basic rate, certain charities would undoubtedly benefit if they could claim back more tax in relation to donations made by Scottish taxpayers. But the practical effect may be to create distortions between different charities across the UK. An extra administrative burden would also fall on the charities—it would be impractical to expect charities to monitor whether or not a particular donor is a Scottish taxpayer. Nor do the Government wish to introduce additional compliance measures in this area. Tax relief will therefore continue to apply at the UK basic rate, regardless of the tax position of the donor.”

The Government further notes, at paragraph 38, in the context of Payroll giving relief, that “Tax relief for donations made to charity under the payroll giving scheme is given at source before an employee’s PAYE tax is calculated, and is given at his or her highest marginal rate. Where the employee’s marginal rate is the SVR then the relief will apply at that rate.”

Hence, there will be no advantage to a charity in covenanted payments or Gift Aid payments having a Scottish source. The Scottish Parliament will still take its cut and the gift will simply cost the donor more. In the case of the payroll giving scheme, however, the donor will escape the SVR on his donation, so that the situation will continue as at present.