out by the provision of facilities for the instruction and practice of target shooting in such clubs. The tactical and technological environment of modern warfare has little in common with civilian rifle ranges.

It will be interesting to see whether this decision is challenged by the clubs who, thanks to the House of Lords decision in *Guild*, might be able to use the RCA line of authority, if target shooting is viewed as a sport.

BENEFITS FOR COVENANTS

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A Simple Question

Can a charity reclaim tax on its covenants if it provides any benefits for the person who makes the covenant?

This is a simple question without a simple answer.

There are three special cases where benefits are permitted; and to clear the ground for discussion, I should mention these briefly.

(1) The first special case concerns:

(a) charities for the preservation of property (e.g., the National Trust).

(b) charities for the conservation of wildlife (e.g., the London Zoo).

Such charities may offer rights of admission to their premises in return for covenants.[2]

(2) There is an exception for small benefits. This is sometimes called the *de minimis* exemption. The Revenue practice is to ignore

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2 Section 59 FA 1989.

benefits worth less than 25% of ordinary small subscriptions.[3]

(3) The Revenue generally disregard benefits in the form of literature, if these are relevant to the charity's work.[4]

The person making the covenant is hereafter called "the donor"; to avoid the clumsy if more accurate expression, "covenantor". Where the discussion below refers to benefits, it will be assumed that the benefits do not fall into these three special categories.

The No Consideration Rule

A cursory reading of the Taxes Act seems to provide an answer to our question. Tax relief only applies to a "covenanted payment to charity". This expression is defined; it means:

> "a payment made under a covenant *made otherwise than for consideration in money or money's worth ...* "[5]

So the covenant must not be made for "consideration in money or money's worth". If it is made for consideration, then tax relief is lost.

This rule may be described as the "no consideration rule". To understand the extent of the no consideration rule one must examine the concept of "consideration".

"Consideration" is a technical term drawn from English contract law. In a taxing statute it will bear its technical meaning.[6]

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3 See the press release of 14/2/1989. The Revenue practice takes a generous view of "*de minimis*": it probably represents an extra statutory concession.

4 This is understood to be an unpublished extra statutory concession.

5 Section 660(3) ICTA 1988. If the payment does not satisfy this condition, tax relief is withheld by, inter alia, section 347A ICTA 1988.

6 See *C&E Comrs v Apple & Pear Development Council* [1985] STC 383 at 389: "The word `consideration' is a term of art in English law, and I think that, used in an English statute, it must be assumed to bear its ordinary meaning in the law, save in so far as the provisions of the statute indicate some other meaning." This approach was held to be wrong in the VAT context, where a European concept of "consideration" prevailed. But the principle of the approach should apply in the present context. Scotland has no concept of consideration, so there is no need to trouble to investigate the Scots learning on the subject.

There is "consideration" in the true sense where the covenant forms part of a bargain, under which the charity undertakes to provide some benefit to the covenantor *in return for which* the covenantor makes the covenant. There must be a *promise* to the donor which is enforceable as a matter of contract law.

Wherever the donor is entitled to receive a benefit in return for making his covenant, therefore, the position is simple. The covenant breaches the no consideration rule, and no tax relief is available.

Whether a benefit is contractual or non-contractual is a simple question of fact. One must ascertain the agreement between the parties. Take two contrasting situations.

(1) A charity may proclaim in the literature sent to prospective members: Enter into a covenant, and you will receive the benefit of reduced admission price to conferences organised by the charity.

In this case the member is entitled to the benefit. For the charity has promised it. The covenant is made for consideration.

(2) The charity literature may say nothing about membership benefits. A member makes a covenant out of interest in the charity's objects. Having done so, he later finds that the charity organises conferences, charging a lower admission price to members than to non-members.

Alternatively, the member may be aware that the charity offers the benefit; but it is clear that the charity does not give any undertaking to do so.

In this case the covenant is not made for consideration: the benefit of reduced admission was no part of the bargain between donor and charity.

The second example illustrates a most important point: "consideration" is a concept quite distinct from "causation". The member only receives the benefit of reduced admission because he made the covenant. Yet the benefit is not in consideration of the covenant.[7]

In this article I wish to consider benefits like those in example (2): benefits which are not contractual, and which are not given in consideration of a covenant. What effect do such benefits have on the tax position? The reader may wonder whether this is a practical question. Do charities confer non-contractual benefits on donors? The answer is that it is indeed possible; and in fact this seems to be a fairly frequent occurrence.

A Stricter Rule?

It emerges on examination that the no consideration rule is narrower than one might have thought. There are many occasions where benefits may be given to a donor without breaching this rule.

The rule is also narrower than the Revenue would like. The idea that a donor might

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[7] The distinction is recognised in another context by Megarry J in *Pritchard v Arundale* 47 TC 680 at 687.

benefit from a charity to which he makes a covenant is anathema maranatha.

In the Revenue view there is a stricter rule. A donor must not receive any benefit in consequence of making the covenant.[8] The simple receipt of a benefit - the mere availability of a benefit - is fatal to the claim for tax relief.

This is a matter of very considerable importance. Many charities have provided some non-contractual benefits for donors. Such charities have reclaimed tax on their covenants since time immemorial. On more than one occasion, the author has known the Revenue to swoop on the unsuspecting charity. Six years' tax refunds are demanded. It seems to be the practice to claim interest under s.88 TMA 1970. The total sums become considerable; the charity rarely has funds in hand to raise the tax. As part of a deal, the Revenue will offer not to go back more than six years. The pressure on the charity to pay most of the tax demanded is very considerable.

There are two ways by which the Revenue attempt to introduce the stricter rule. The first is by remorseless application of the no consideration rule. Wherever the donor receives a benefit, the Revenue will argue that the benefit is in consideration of the covenant. This leads to a simple dispute of fact: is there consideration or is there not? On the basis of facts like those in example (2) above, the Revenue would lose on this point.

The *Earl Howe* Rule

The second string to the Revenue bow derives from case law. The Revenue propose a rule which I shall call the "pure bounty rule".

This is wider than the no consideration rule. Whether or not the benefit is in *consideration* of the covenant is said to be irrelevant: the mere receipt of benefits nullifies the claim for tax relief.

What is the basis of the pure bounty rule? One point is clear: the rule does not derive directly from Statute. Statute provides a no consideration rule, and that, as we have seen, is quite another thing.

For the charity to reclaim tax, the covenanted payments must be "annual payments".[9] The colourless phrase "annual payment" is not defined in the tax code. There is a considerable body of case law distinguishing payments which are or are not "annual payments". It is here that the Revenue seek the basis of the pure bounty rule.

The case law is extremely difficult. Many of the cases do not concern charities: the concept of "annual payments" has a role in the tax system which extends beyond charity tax; though since the reforms of the FA 1988, it is in the charity context where the question most commonly arises.

The starting point is to appreciate that a payment is not an annual payment merely

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[8] In practice, where a donor receives a benefit, the Revenue will allege that the benefit is in consequence of the donor's covenant; so the rule is effectively that the donor must not receive any benefits from the charity whatsoever.

[9] Section 348 ICTA 1988.

because it is paid every year. "Annual payment" is a technical term.

The classic statement of the principle is this: the annual payment must be assessed in the hands of the recipient as an annual payment. It must not be a mere item in an account from which the profits of the recipient are ascertained. This is sometimes expressed by saying the annual payment must be "pure income profit".[10]

I shall call this "the *Earl Howe* rule", from the case of that name where the rule was first propounded.

A full discussion of the *Earl Howe* rule would be a lengthy matter. The rule has been paraphrased in this way: that the covenant must not be made for "consideration, conditions or counter-stipulations relating to the supply of goods or services".[11]

The cases offer a number of illustrations of the *Earl Howe* rule, and these are a good starting point in examining the rule.

One obvious class of examples is where the recipient is carrying on a trade, and the payment is a trading receipt. The colourful examples of Scrutton LJ are in this category:

> "If a man agrees to pay a motor garage £500 a year for five years for the hire and upkeep of a car, no one suggests that the person paying can deduct income tax from each yearly payment. So if he contracted with a butcher for an annual sum to supply all his meat for a year, the annual instalment would not be subject to tax as a whole in the hands of the payee, but only that part of it which was profits."[12]

An example on the other side of the line is *IRC v Corporation of London (as Conservators of Epping Forest).*[13] Here the recipient carried on a trade, or more accurately, an activity analogous to a trade taxable under Schedule D Case VI. It received payments to cover its losses. The receipt qualified as an "annual payment".

One proposition can be maintained with certainty: the mere fact that a person receives a benefit as a consequence of making a covenant does *not* of itself breach the *Earl Howe* rule, and does *not* prevent the covenanted payment from qualifying as an annual payment.

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[10] *Earl Howe v IRC* 7 TC 289; *Re Hanbury* 38 TC 588.

[11] See *Campbell v IRC* 45 TC 427 at p. 462. As well as the cases cited elsewhere in this article, the interested reader should refer to *IRC v National Book League* 37 TC 455; *Taw & Torridge Festival Society Ltd v IRC* 38 TC 603; *Essex County Council v Ellam* 61 TC 615.

[12] 7 TC 289 at 303.

[13] 34 TC 293.

Ball v National & Grindlays Bank Limited[14] is an illustration. In this case, the bank made covenants to children of employees. The Court of Appeal noted that the bank had obtained "very considerable benefit" thereby, it had "good value for its money". Nevertheless, it was accepted that the covenanted payments were "annual payments".

Duke of Westminster v IRC[15] offers another illustration. The Duke made covenants to employees. He received a benefit in consequence: the employees accepted less than their full salary, because they received the covenanted payments. However, the Duke's payments under the covenants were "annual payments".

In *IRC v The National Book League* Lord Evershed MR made it quite clear that the mere fact that a covenantor receives benefits from a charity does not of itself prevent the payments from being annual payments:

> "I must guard myself against saying that whenever you find a covenantor in favour of a charity getting allowed to him certain privileges it therefore follows that such a covenantor no longer can say that he has paid without conditions or counter stipulations."[16]

The most important authority for present purposes is the decision of the House of Lords in *Campbell v IRC*.[17]

Campbell is one of those difficult cases in which each member of the House of Lords delivered a separate speech in different words. There is no doubt that the pure bounty rule - for which the Revenue contended - was decisively rejected. Indeed, the general impression that one receives from the case is that no benefit can fall within the *Earl Howe* rule unless it is given in consideration for the covenant in the technical English contract law sense. On this view, the *Earl Howe* rule is a subspecies of the statutory no consideration rule.

In short, there is no authority for the pure bounty rule, and compelling authority against it.

Authority aside, there is a further argument against the pure bounty rule. A donor will usually make the first payment to the charity at the time he makes the covenant. He must know at that time whether or not the payment is an annual payment. For he may only deduct tax at source if it is an annual payment.[18] He will know whether or not the covenant is for consideration. He may not know whether or not the charity intends to or will confer benefits on donors. A change in the facts cannot change the nature of the payments.

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14 47 TC 287.

15 19 TC 490.

16 37 TC 455 at p 473. Lord Hodson "wholeheartedly agreed" with this statement: *Campbell v IRC* 45 TC at 467.

17 45 TC 466.

18 Section 348 ICTA 1988.

Conclusion and Commentary

A charity should not undertake to provide benefits to covenantors. If, however, it chooses to provide benefits - without being under an obligation to do so - it does not forfeit tax relief on the covenants. The contrary view, propounded by the Revenue, is not supported by the authorities and should be resisted.

This means that the position for Deeds of Covenant is quite unlike that for Gift Aid. The rule for Gift Aid is that:

> "Neither the donor nor any person connected with him receives a benefit in consequence of making the gift."[19]

There are of course many other ways in which the Gift Aid rules differ from the Covenant rules. For Gift Aid relief, the donor must be UK resident. There is no precisely equivalent rule for Covenants.[20] Likewise, the Gift Aid rule that the gift does not form part of an arrangement involving the acquisition of property from the donor or a connected person.[21] The Covenant rule is not at all the same.[22]

Now - as a matter of fiscal policy - it seems sensible that similar rules should where possible govern Gift Aid and Deeds of Covenant. The present situation arises because Gift Aid is contained in a modern statutory code; Covenants are governed partly by a bewildering jumble of statutory provisions and partly by case law.

There is something to be said for introducing Gift Aid principles into the Deed of Covenant régime. However, once one starts to look at possible reforms nothing less than a root and branch review will stand up. Statutory reform should do away with "grossing up" in covenants: what layman ever understands that? Best of all, it is submitted, would be to reduce the minimum gift aid level substantially - say, to £30 - and to abolish deeds of covenant altogether. That is a topic for another article.

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19 Section 25(2)(e) FA 1990. There is an exception for small benefits, elaborately defined.

20 However, the payments under the covenant must fall within Schedule D Case III; exactly what that entails is a matter of controversy.

21 Section 25(2)(f) FA 1990.

22 The Covenant rule is that the payments must be income, not capital; as to which see *Campbell v IRC* 45 TC 427, discussed at length in the author's *Tax Planning & Fundraising for Charities.*