Charity Budget Insight

As described in our summary of the Chancellor's 2010 Budget Report (available on our website) very few significant changes were announced in the Budget held on 24 March. However, there were a few announcements made which impact directly on the charity and general not-for-profit sector.

Unfortunately, no amendments have as yet been published in relation to the somewhat controversial Substantial Donors Anti-Avoidance legislation which the sector has eagerly awaited following the Government's consultation paper on Substantial Donors.

Payments to bodies outside the UK: non-charitable expenditure

The Government announced in its Budget Day press releases "the rules requiring UK charities that make payments to bodies outside the UK to take reasonable steps to ensure the monies are used for genuine charitable purposes will be strengthened".

Currently, payments made or due to be made to overseas bodies, including bodies recognised locally as charities, will only be considered as charitable expenditure if the payee charity has taken reasonable steps in the circumstances to ensure that the payment will be applied for charitable purposes.

The Finance Bill 2010 amends the legislation by directly awarding the Commissioners for HM Revenue & Customs (HMRC) the power to consider what are reasonable steps within the circumstances.

This effectively brings HMRC's current guidance on overseas payments into the legislation.

It will come as no surprise if HMRC decides to extend the ongoing monitoring requirements whilst taking the opportunity to tighten the prior steps and evidence required to demonstrate the use of funds for charitable purposes. However, we hope these powers will make HMRC more flexible where urgent humanitarian issues are at stake, such as emergency disaster funds.

"It has been clear for some time that HMRC were becoming increasingly interested in overseas payments"

Many of our charity clients make payments overseas for a variety of reasons and it has been clear for some time that HMRC were becoming increasingly interested in these. The new powers announced in the Budget mean that trustees and management must take seriously the need to follow up on the application of funds sent abroad and ensure they have documentary evidence in the form of a narrative report etc to support the use of such funds.

Read HMRC's guidance notes regarding overseas payments on their website:

www.hmrc.gov.uk/charities/guidance-notes/annex2/annex_ii.htm#9

Charity definitions: Extension of UK tax reliefs to EU & EEA

Following on from the January 2009 decision in the European Court of Justice in the case of Hein Persche v Finanzamt Lüdenscheid [2008] ECJ (GC) C318/07, significant legislation has been introduced extending tax reliefs currently available to UK donors, charities and Community Amateur Sports Clubs (CASCs) to qualifying organisations in the EU, Norway and Iceland. This is to be done by the introduction of a new definition of a charity for tax purposes.

Under this definition, the Finance Act sets out a "Registration Condition" that all entities will need to be registered with the relevant charity regulator in their jurisdiction and also meet the UK charitable purposes condition as set out in the Charities Act 2006. The entity must also meet the "Management condition" i.e. that the general control and management of the administration of the charity/body is carried out by "fit and proper persons". This latter requirement gives powers to the Commissioners of HMRC to judge whether the management and control is by fit and proper persons and so safeguard charitable tax reliefs for non-charitable purposes from exploitation. However, the Commissioners of HMRC will not automatically deny tax relief where a manager does not pass the test if they consider failure has not prejudiced the charitable purposes of the entity.

Although the legislation applies from 1 April 2010, it is understood that relief will be given to donations made to other EU/EEA bodies from 27 January 2009 in line with the ECJ case ruling. This will be possible if the recipient would have qualified as a charity under English and Welsh law at the time of the gift.

This change is a welcome amendment for UK taxpayer donors as it will enable them to support non-UK organisations in the same tax efficient way as when they support charities registered in England and Wales.

It will impact also on new charities seeking registration with the Charity Commission for the first time and wishing to benefit from tax reliefs as the trustees and management of such organisations will need to satisfy the "fit and proper persons" test.

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Gifts of qualifying investments to charities

Legislation drafted in December 2009, is now incorporated in the Finance Act 2010, designed to stop exploitation of the rules on gifts of certain shares, securities and land/buildings to charities under section 587B Income and Corporation Taxes Act (ICTA) 1988 and section 431 Income Tax Act (ITA) 2007. The new rules are effective from 15 December 2009.

The Income Tax Act 2007 provides that where gifts of qualifying investments are made to charities, the donor obtains tax relief based on the value of the benefit received by the charity by having his/her income reduced in the year of the gift by the value of the benefit received by the charity plus the costs of disposal.

The new anti-avoidance legislation targets donors receiving higher rate tax relief on the full market value of the qualifying investments at the date of a gift to charity where:

- The donor acquired the investments at below market value as part of a scheme or arrangement; or
- The market value of the investment is artificially inflated at the date of the gift to charity.

These new rules adjust the amount of relief given to the donor to be the cost of acquisition by the donor (i.e. not the value of the benefit received by the charity) where:

- The donor acquired the investment within a 4 year period ending on the date of disposal;
- Acquisition was made as part of a scheme or arrangement; and
- The main purpose, or one of the main purposes, for entering into the scheme or arrangement was to obtain tax relief.

Payroll Giving Changes

The Finance Act has brought in a minor change to donations made directly through an employee's payroll. The change is designed to bring payroll giving donations in line with other tax effective donations.

Under the new law, to the extent that income from payroll giving is being spent on non-charitable expenditure, the charity will be denied tax relief. In other words, the tax exemption will apply only to the extent that the charity applies the donation for charitable purposes.

Gift Aid claims where a donor has not paid enough UK tax to cover the claim

To date where a donor has provided a Gift Aid declaration but has not paid sufficient UK tax to cover the tax relief claimed, it is for the charity and the donor to decide between them who will refund tax incorrectly reclaimed. In practice, it is often the charity that foots the bill.

However, changes are being introduced so that, for both non-UK resident donors and UK resident donors, HMRC will recover the tax from the donor where the donor has not paid a sufficient amount of tax to cover the amount reclaimed by the charity.

PAYE/National Insurance late payment penalties

New late payments penalties apply for charities and all employers and contractors from May 2010 regardless of whether the charity has only one or several hundreds of employees.

The penalties apply to monthly, quarterly and annual periods of PAYE starting on or after 6 April 2010 and could be charged on any PAYE amount due if it is not paid in full on time, including monthly or quarterly PAYE (Pay As You Earn), NICs, PAYE Settlement Agreements, Student loan deductions, CIS payments and PAYE determinations or charges raised.

Charity employers will not be charged a penalty if only one PAYE amount is late in a tax year - unless that payment is over 6 months late.

Penalty charges for late monthly and quarterly PAYE payments

No. of times payments are late in a tax year	Penalty percentage	Amount to which penalty percentages apply
1	No penalty (as long as they are less than 6 months late)	Total amount that is late in the tax year (ignoring the first late payment in that tax year)
2-4	1%	
5-7	2%	
8-10	3%	
11 or more	4%	

If a charity employer has still not paid a monthly or quarterly amount in full after six months, it may have to pay a penalty of 5%. A further penalty of 5% may be charged if it has not paid after 12 months. These penalties apply even where only one payment in the tax year is late and, therefore, are severe.

In addition, a charity employer may be charged a late payment penalty if it pays less than is actually due. A charity employer may have to pay a penalty of 5% of the amount that is late if it has not paid the full amount by the date known as the ‘penalty date’. It may also have to pay an additional 5% penalty if it has still not paid the full amount within five months of the penalty date. Further, it may have to pay further 5% penalty if it still has not paid the full amount within 11 months of the penalty date. The penalty date varies according to the type of payment. For payments such as Class 1A and 1B NICs; HMRC determinations and assessments; and amendments or corrections to returns the ‘penalty date’ is 30 days after the due date.

HMRC may forgive penalties where there is “reasonable” cause but these are pretty strict and will only include extreme cases such as serious illness or death of a close relative.

VAT and Charities

There were a number of announcements in the budget relating to VAT that could affect charities. Some of these were expected as they had already been announced and some others have been forced on the UK government by EC Court Case rulings.

A brief summary of the changes are listed below but please note this is not a complete list of VAT measures simply the ones most relevant to charities:

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VAT Registration and Deregistration Limits

The above limits have changed to £70,000 and £68,000 respectively with affect from 1 April 2010.

These limits apply to the rolling backward turnover in any 12 month period as well as the “forward” look for the next 30 days alone, as well as the value of services and goods bought in from outside the UK.

Fuel Scale Charges

The fuel scale charges have changed. The fuel scale charge is used to reflect any private use of fuel bought which might be used for both business and private use. Charities applying the fuel scale charge should alter the amounts paid. HMRC hope to have updates available by May 2010.

Lennartz

This change had already been announced.

The Lennartz principle was the ability to recover all the VAT on items used for “private” use and pay an output tax charge over a period of 5 to 10 years. The previous announcement confirmed the decision made in the ECJ that non business use by a charity did not qualify as “private” use.

Measures are being introduced to ensure where a charity had used the Lennartz approach that payments will continue to be made.

Postal Services

This was another announcement that followed an ECJ case. From 1 January 2011 the ECJ has ruled that certain services supplied by the Royal Mail are liable to VAT at the standard rate of VAT (17.5%) and will no longer qualify for exemption. Essentially any services supplied by the Royal Mail that it is not required to make under its licence, and services provided on terms and conditions that have been freely negotiated, will from 1 January 2011 be subject to VAT. There could be an opportunity to recover “embedded” VAT in services previously supplied but at present the HMRC stance on this is not clear.

Shared Services Exemption

Under EU law, there is the provision for an exemption from VAT for the provision of shared services between not for profit bodies provided they meet certain conditions. HMRC has never implemented this section of the law fully. The announcement in the budget merely states that “the government will work with charities and other affected sectors to consider options for implementing the EU cost sharing exemption”.

Contact us

If you need any further information or help please speak to your usual Buzzacott contact.