pem.

July 2023.

Charities & Non-profit newsletter

HMRC charity tax compliance consultation

At the end of April HMRC released a consultation considering charities tax compliance. This focuses on areas in which HMRC believes there is currently a lack of compliance. These are expanded on below.

The consultation document sets out four areas for change:

Self-assessment tax returns

At the moment HMRC usually requests a tax return every few years, although some charities are asked to file each year. HMRC are concerned that some charities do not respond to the notices. The filing of returns gives comfort to HMRC that charities are considering their tax position and are comfortable that they are still eligible for the reliefs. HMRC's concern is that without these returns, some charities may be continuing to claim reliefs, such as Gift Aid, when they may not be eligible. HMRC is proposing to withhold Gift Aid and disapply other tax reliefs from charities that have fallen behind on their filing obligations. HMRC are interested in views on this approach, including, for example, whether small charities should be treated differently to larger charities.

Non-charitable expenditure

When a charity incurs expenditure that is not charitable, HMRC is entitled to claw back some or all of the tax relief given to the charity equal to the amount of the non-charitable expenditure (NCE). HMRC is concerned that there are some circumstances where it is not able to claw back enough past tax reliefs and wants to alter rules to address this. They give the following example:

A charity has Gift Aid income of £20,000, bank interest of £5,000 and legacy income of £10,000. If the charity spends £15,000 on charitable expenditure and £40,000 on a non-charitable loan, it would lose all the available tax relief (£25,000) but it will have an excess of non-charitable expenditure of £15,000. In these circumstances HMRC is entitled to 'carry back' the excess non-charitable expenditure to an earlier accounting period for further claw back of tax relief from the earlier period(s). However, rather than being able to claw back the full £15,000 in this example, it can only seek a claw back of £5,000. This is because £10,000 out of the £15,000 is 'matched' to the legacy income (which did not receive any tax relief in the first place).

HMRC has two areas it would like to address:

- It would like to be able to claw back what they refer to as the 'right amount' (in the above case, the full £40,000) by extending the definition of the charity's income that is subject to claw back.
- It can only go back 6 years, so HMRC may not be able to claw back all of the tax relief.

HMRC says that it would like to consider amending the current rules "to ensure HMRC are able to collect the right amount of tax due should there be significant excess non-charitable expenditure".

Investments that are 'qualifying' as charitable expenditure

A charity's loans and investments must be classed as 'qualifying' if the investment is not also to be classed as 'non-charitable expenditure'. For example, an investment in a risky private venture could potentially be an unapproved investment. Charities should invest excess funds responsibly to generate a financial return, which provides funds to advance their charitable purposes.

The income and corporation tax legislation has a list of 12 types of approved charitable investments. Charity investments under Types 1 to 11 are automatically approved by HMRC and are exempt from rules on non-charitable expenditure. Type 12 (any loan or other investment made for the benefit of the charity) requires an officer of HMRC to be satisfied, on a claim, that the loan/investment is made for the benefit of the charity and not for the avoidance of tax.

HMRC has highlighted that there are some investments within Types 1 to 11 that really should not be treated as 'qualifying' (or 'charitable') expenditure'. For example, a charity purchases a foreign property which is used as a holiday home by the charity's trustees for their sole use, whilst providing no benefit to the charity. This is a Type 3 investment, being land/property and the wording of the legislation makes it difficult for HMRC to challenge the investment.

HMRC's proposed change is to make it a requirement that all Types must be made for the benefit of the charity and not for the avoidance of tax. Types 1 to 11 will still qualify without needing a claim but charities will be required, if asked, to justify any investment they make and demonstrate how this benefits the charity.

Tainted charity donations

A donor should not receive a benefit from their donation, other than the de-minimis benefits that form part of the Gift Aid rules which are there for largely administrative convenience.

HMRC is however always concerned about elaborate ways in which a donor or someone close to them may receive a benefit from a donation while still receiving tax relief.

The Tainted Charity Donations (TCD) rules are designed to catch those donations that meet three tests:

- Condition A – the donation to the charity and arrangements entered into by the donor are connected
- Condition B – the main purpose of entering into the arrangements is for the donor, or someone connected to the donor, to receive a financial advantage directly or indirectly from the charity
- Condition C – the donation is not made by a qualifying charity-owned company or relevant housing provider linked with the charity to which the donation is made.

Where the conditions are satisfied, tax relief on the donation can be denied (including higher rate relief otherwise claimable by a higher or additional rate taxpayer). As long as the charity is not a party to tainted donation arrangements, it is not required to repay any Gift Aid.

HMRC gives a couple of examples of problem areas:

- a donor makes a significant donation to a charity that they control, which allows the donor to claim higher rate relief and the charity to claim Gift Aid on the donation and the charity then returns the funds to the donor, or a connected person, by way of a loan with a commercial rate of interest. The loan may never be repaid and is eventually written off.
- donated funds are reinvested into a donor-controlled company or fund. Although investments are a legitimate way for charities to generate additional income on any excess funds, the donor can claim higher rate relief on the donation even though the arrangements may not benefit the charitable purpose as the donation may have been made solely to claim relief, before re-investing the donation in a donor controlled company or fund. (If, on objective grounds, the investment is a good solid one then the donation it may not be tainted).

HMRC proposes three possible alternatives:

1. Replacing the TCD rules with a new rule that would:
   a. Ensure that arrangements made in relation to a donation are for the benefit of the charity and not the donor.
   b. Potentially limit the amount of financial assistance provided to a donor. Where these limits are breached, the donation would be treated as chargeable income and charitable reliefs would be reduced by a corresponding amount.

2. Remove Condition B, above. Removing the need to show that the main purpose of the arrangements is to benefit the donor would mean that HMRC could challenge any donation that provides anything more than an incidental benefit for the donor.
3. By changing the current wording of Condition B, in particular the reference to ‘financial advantage’ and replacing it with ‘financial assistance’ or ‘financial benefit’, allowing HMRC to challenge an arrangement made to benefit the donor, rather than the charity.

The full consultation can be found here. If you have any comments which you would like to make please contact info@charitytaxgroup.org.uk. The consultation closes on 20th July 2023.

Judith Pederzolli
Director, Business Tax

e. jpederzolli@pem.co.uk

Charities Act 2022 – new guidance issued

The next tranche of changes to legislation as a result of the Charities Act 2022, as described in our previous newsletter, came into force on 14 June 2023.

The Charity Commission has updated its guidance to reflect these changes, of which the most significant are land transactions and permanent endowment. If these are relevant to your charity make sure you consult the latest guidance.

- Sales, leases, transfers or mortgages: what trustees need to know about disposing of charity land (CC28)
- Permanent endowment: rules for charities

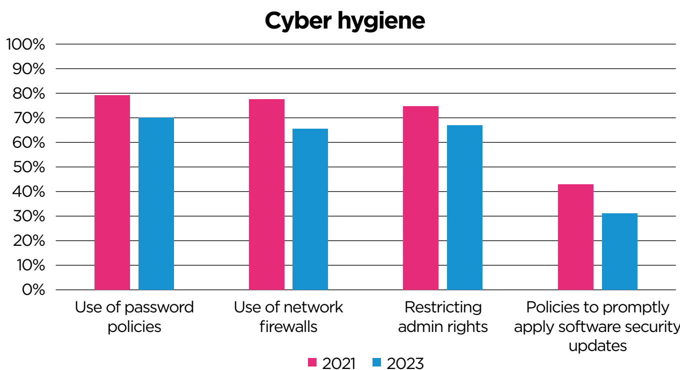
Nikki Loan
Partner, Charities & Non-profit

e. nloan@pem.co.uk

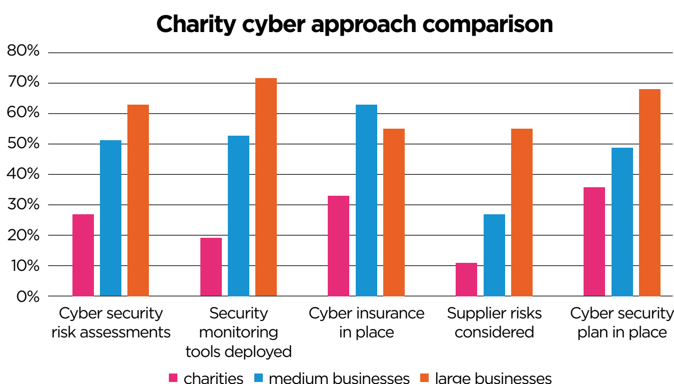
Cyber security breaches survey 2023

The cyber security breaches survey is a research study for UK cyber resilience, aligning with the National Cyber Strategy. It has been published annually since 2016 and has separately identified charity trends from general business activity since 2018. Whilst it is primarily used to inform government policy on cyber security, it provides useful insight by sector on the policies, processes and approach to cyber security. It also considers the different cyber-attacks and cyber-crimes these organisations face, as well as how these organisations are impacted and respond.

Worryingly the survey found that practices around certain cyber hygiene factors have declined over the last few years for all respondents, charities and businesses.



The survey also looked at risk assessment and use of monitoring tools and noted that charities (as a whole sector) are being medium and large businesses. For charities there may be a sense that their mission will protect them – however there is also the risk that they are seen as an easy(ier) target.



Awareness of cyber security for boards is rising among survey respondents and cyber essentials provides useful guidance for businesses of all sizes.

The survey found that formal incident response plans were not widespread among respondents (21% of businesses and 16% of charities had them). Although that rose to 47% of medium-sized businesses, 64% of large businesses and 38% of high-income charities. For charities, the damage to reputation and lasting impact could be significantly greater than the loss from an attack (the survey found that the average charity loss was just over £500), and therefore managing the response to a cyber incident, with liaison and communication between IT and general staff, is as key to managing the risk as preventative measures.

The survey methodology was broadened this year and new questions were added to establish the extent to which the breaches or attacks that organisations experience could be defined as cyber-crimes committed. There is therefore no comparative data for these statistics, however, among the 32% businesses and 24% of charities identifying any cyber security breaches or attacks, around a third (34% for businesses and 32% for charities) ended up being victims of cyber-crime. The annual cost of cyber-crime (rather than losses) could not be calculated due to the sample size.

We would recommend that all trustees annually reconsider the data held and those related risks and responses covering prevention, detection and reaction to cyber incidents.

PEM are hosting a working lunch on 27 July 12:30pm-2pm where we'll be talking about where the real cyber threats are coming from, why your password will never be strong enough and the practical steps every charity can take to protect their data. Register here.

Nikki Loan
Partner, Charities & Non-profit

e. nloan@pem.co.uk

New HMRC charities newsletter

On 5th June HMRC issued its first newsletter aimed particularly at charities. This can be accessed here and you can sign up for future publications on this page.

The areas covered in the newsletter are:

Restriction of tax reliefs – from 15 March 2023, tax reliefs and exemptions will be restricted to UK charities, although those non-UK charities already registered with HMRC can continue to claim until 5 April 2024.

Charity compliance consultation – this is covered in more detail in a separate article earlier in this newsletter.

Future of Gift Aid – HMRC are looking at ways to improve the Gift Aid process using digital technology to minimise administrative processes. HMRC are interested in hearing from charities who use the Gift Aid service. If you would be interested in taking part, or have any questions about the research, the letter has details of who to contact at HMRC.

There were also some useful reminders:

- Use the online form ChV1 to tell HMRC about any changes to your charity, for example new officials or change of bank account.
- When the status of a charity changes, for example changing from an unincorporated to incorporated charity, the relevant charity regulator may let the charity retain their registration number. However, as the change creates a new legal entity you cannot continue using your existing HMRC reference number. You will need to make a new application to HMRC and a new reference number will be provided.
- When you make a claim for Gift Aid, there is an option to include a tax adjustment, so you can repay any previously overpaid Gift Aid. The amount in the adjustment box should be the tax amount rather than the donation amount (e.g. a donation of £20 on which Gift Aid was claimed but this donation no longer qualifies, so £5 should be repaid, the amount to enter in the tax adjustment is £5.00). The amount entered into the tax adjustment box must not be greater than the amount you are claiming. If you have an overpayment which is larger than your next claim, then contact at charitiesrepaymentqueries@hmrc.gov.uk with full details.
- A reminder that the deadline for submission of a claim under the Gift Aid Small Donations Scheme (GASDS) is 2 years from the end of the tax year in which the small donation was made. Any donations collected under the GASDS should not be included within the Gift Aid schedules.

Judith Pederzolli
Director, Business Tax

e. jpederzolli@pem.co.uk

Watch out for loan waivers and Gift Aid with a corporate lender

Where repayment of a loan to a charity is subsequently waived by an individual who has lent funds to the charity, the individual may claim Gift Aid on the amount waived if certain conditions are met.

However, HMRC recently removed a section of its online guidance in this area while an internal review was conducted and a new technical point has emerged as a result of this. Where a loan is made to charity by a body that is subject to corporation tax (rather than income tax), corporation tax rules mean that it is not possible for the amount waived to qualify for charitable donations relief (the corporation tax equivalent of Gift Aid). The corporation tax loan relationships rules prevent this. Instead, the corporate lender will need to ask the charity to repay its loan and then make a separate cash donation back to the charity.

The donation will then qualify for tax relief in the normal way. Bodies that are subject to corporation tax include limited companies (including trading subsidiaries of a charity) and unincorporated associations.

Judith Pederzolli
Director, Business Tax

e. jpederzolli@pem.co.uk

PEM celebrate during National Volunteers’ Week

At PEM we are proud of our team who make a difference in their local community by volunteering.

This National Volunteers’ Week (1-7 June) we wanted to spotlight our volunteers and find out more about what they get up to and how they help the people around them.

We had a chat on camera with Shaun (a volunteer Police Special Constable), Philip (School Governor, Trustee and Mentor), Michael (Scout Leader) and Amy (Dance Teacher) about their volunteer roles and how they make a difference in the local community.

Hear their stories here – **Shaun**, **Philip**, **Michael**, **Amy**.

We also spoke to **Judith** and **Laurence** about their volunteer roles as Parkrun Marshall and Therapy Dog Volunteer.

“My favourite part of my role as Special Constable is helping out people when they are at their most vulnerable...It’s giving people words of reassurance or taking them to a place of safety...it's just helping people in need.” **- Shaun Nichols, PEM Business Development Manager and Volunteer Special Constable**

Kelly Bretherick
kbretherick@pem.co.uk

Nikki Loan
nloan@pem.co.uk

Michael Hewett
mhewett@pem.co.uk

Kathryn Hebden
khebden@pem.co.uk

Gemma Baratte
gbaratte@pem.co.uk

Judith Pederzolli
jpederzolli@pem.co.uk

Kate Millard
cmillard@pem.co.uk

Robert Plumbly
rplumbly@pem.co.uk

PEM
Salisbury House
Station Road
Cambridge CB1 2LA

t. 01223 728222
e. pem@pem.co.uk

pem.co.uk

For General Information Purposes only
Please note that this brochure is not intended to give specific technical advice and it should not be construed as doing so. It is designed merely to alert clients to some issues. It is not intended to give exhaustive coverage of the topics. Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein. The firm's full name and a full list of Partners is available on our website.