

**Response to discussion paper on approaches to preventing
charities being set up to avoid tax**

**Association of Charitable Foundations
Charity Finance Group
National Council for Voluntary Organisations**

About us

Association of Charitable Foundations (ACF) is the UK wide support organisation for grant-making trusts and foundations of all types.

Our membership of over 300 includes many large independent foundations; local and community trusts; family trusts; corporate foundations; and broadcasting appeals.

Charity Finance Group (CFG) is the charity that champions best practice in finance management in the voluntary sector.

Founded in 1987 Charity Finance Group's training and development programmes enable finance managers to give the essential leadership on finance strategy and management that their charities need. With more than 2,200 members, managing over £19.3 billion, (which represents almost one third of the sector's income), we are uniquely placed to challenge regulation which threatens the effective use of charity funds.

The National Council for Voluntary Organisations (NCVO) champions and strengthens the voluntary sector, with over 10,000 members, from the largest charities to the smallest community organisations. We make sure the voluntary sector can do what it does best.

Executive summary

- We fully support the Government’s objective to reduce tax avoidance and prevent charities from being exploited for such purposes.
- Accurate data on the cost to the Government on the use of charitable tax reliefs for tax avoidance is not available.
- Both proposed changes could potentially discourage wealthy individuals from setting up new charitable foundations at a time when funding for the voluntary sector is tight.
- Both proposed changes are unclear about how tax advantages such as Gift Aid would be affected and whether donors legitimately using Gift Aid to increase the impact of their donations would be prevented from doing so.
- Both proposed changes also focus on “tax advantage” rather than tax avoidance and it is not clear why HMRC has adopted this approach.
- Version A is particularly broad and would give sweeping powers to HMRC to refuse registration to any charitable foundation. This would create considerable confusion for donors and their advisors, with significant negative impact on the sector.
- Version B would not add any additional protection for either the taxpayer or charities as HMRC notes in its discussion paper and is thus unnecessary.
- **Given this, we strongly recommend that HMRC abandons attempts to amend existing legislation to prevent the formation of charities for tax avoidance purposes and instead focuses efforts on collaboration with the Charity Commission and the voluntary sector to enforce existing legislation.**

General comments

We fully support the Government’s objective to reduce tax avoidance and prevent charities from being exploited for such purposes.

The credibility of our sector depends on money given to it being used for public benefit and we are committed to working with government and the Charity Commission to ensure that an effective regulatory regime is in place. That being said, the scale of tax avoidance is unknown. For example, the National Audit Office’s report on Gift Aid noted that HMRC does not have an accurate estimate of how much tax is lost through avoidance, fraud and error in respect to reliefs on donations.¹ We believe that discussion on this issue would be improved if HMRC gathered better data on tax avoidance in relation to charitable tax reliefs.

However, after receiving legal advice, we do not believe that the specific legislative changes proposed are necessary in order to achieve the Government’s aim.

Under existing legislation a charity has to exist for charitable purposes only.² An organisation set up with the purpose of providing private benefit to an individual cannot be a charity’. The authority to prevent the formation of charities in order to avoid tax avoidance or solely to gain tax advantages already exists.

¹ “Gift Aid and reliefs on donations”, National Audit Office, 21st November 2013
<http://www.nao.org.uk/wp-content/uploads/2013/11/10302-001-Gift-Aid-Book1.pdf>

² Charities Act 2011 Section 1 “Meaning of a “Charity”:
For the purposes of the law of England and Wales, “charity” means an institution which –
(a) is established for charitable purposes only

We believe, therefore, that additional changes to the definition of a charity for tax purposes are unnecessary and would only cause confusion – potentially discouraging wealthy individuals from setting up new charitable foundations or making use of tax advantages when making donations. However, we have considered the merits of the proposals as outlined in HMRC’s discussion paper and our views are contained below.

The role of charitable foundations

Charitable foundations play a critical role in the funding of the voluntary sector and supporting activities that generate public benefit. According to the latest data³, the voluntary sector spent over £4bn in grants to other voluntary organisations, individuals and statutory organisations – much of this through charitable foundations.

Moreover, the voluntary sector as a whole is operating in a tough economic climate. Funding for the sector has remained relatively static since 2008. On the other hand, demand for the sector’s services has risen since the recession. **Given this environment, the greatest possible care should be exercised when considering any measures that may affect the funding of the sector.**

As currently drafted Version A would give HMRC complete freedom to refuse to register a charitable foundation. Such foundations enable the donor to make tax-effective donations that will subsequently be applied for charitable purposes. One of the main reasons to establish a foundation must be the obtaining of a tax advantage; specifically the relief from Gift Aid.

We are concerned that Version A, as currently drafted, could therefore prevent or discourage the establishment of charity foundations, at a time when the voluntary sector is already experiencing significant funding pressures.

This would also be in opposition to the Government’s stated ambition to encourage and support higher levels of philanthropy.

Lack of clarity

Version A creates significant uncertainty as it is currently drafted around the issue of whether establishing an organisation in the form of a charity in order to access tax reliefs (i.e. Gift Aid) to secure additional charitable income would be illegal.

HMRC’s discussion paper notes that it “*would make it clear when arrangements would be considered abusive by HMRC through the Explanatory Notes published with the clause and in guidance.*”

Version A has a very broad scope and we believe that as drafted would give HMRC the right to refuse to register any charitable foundation. While we understand that HMRC needs to have sufficient flexibility given the variety of schemes that are used for tax avoidance, we believe that HMRC should make clear in the clause itself what arrangements will be considered abusive or what criteria it will use to judge whether an arrangement is abusive. Unless there is greater clarity, then there is likely to be confusion amongst donors and their advisors which at best may create potential opportunity costs to the voluntary sector from the delays caused in the formation of new foundations and at worse would dissuade some individuals and corporations from setting up new foundations.

³ UK Civil Society Almanac 2012, NCVO

We are also concerned about the use of the term ‘tax advantage’ rather than ‘tax avoidance’. It is clear from the discussion paper that HMRC’s focus is to reduce tax avoidance (i.e. taking steps to gain tax advantages that were not intended by Parliament). We believe that any legislative changes should be expressly targeted at ‘tax avoidance’ rather than ‘tax advantage’.

Effect on donor perception of securing tax advantage

We are also concerned that use of the term ‘tax advantage’ may create a perception amongst donors that securing a tax advantage when making charitable donations is suspicious or makes a donation less laudable. This may dissuade donors from making use of available reliefs more widely which would be both in opposition to the principle that giving for public benefit should not be taxed and the Government’s objective that donors should be encouraged to give by increasing the value of their donation⁴. Focusing on ‘tax avoidance’ rather than ‘tax advantage’ would ensure that securing tax advantages in the course of charitable giving is not stigmatised.

Version B

Version B is an improvement on Version A to the extent that it limits the issue of securing ‘tax advantage’ for any person to be the main purpose, rather than one of the main purposes, of any arrangements undertaken by a charity.

However Version B still contains the same flaws as Version A and as HMRC’s discussion paper notes “would seem to add little, if anything, to the existing anti-avoidance defences for charity reliefs”.

Given the lack of protection it would offer charities or the taxpayer coupled with the potential risks, Version B is unnecessary and should not be taken forward.

Recommendations

While we support the intention behind these proposals to reduce tax avoidance, we do not believe that either amendment to existing legislation is necessary. At best, neither amendment would give significant additional protection to the sector, and at worst, both amendments could prevent the formation of new charitable foundations – negatively impacting the sector.

More research into the costs of tax avoidance arising from abuse of charitable tax reliefs would be necessary in order to better inform a debate around what additional steps should be taken.

However as has been demonstrated by previous regulatory failings, the issue is not the strength of the existing legal framework but the resources available to enforce this framework. Greater collaboration between the Charity Commission and HMRC would be a more effective way of tackling tax avoidance – an issue which was raised by the NAO’s report into Gift Aid⁵. Moreover, it is vital that regulators such as the Charity Commission have the resources to properly police existing regulations and close down abuses of the system.

⁴ “Gift Aid and Digital Giving consultation”, HM Treasury, July 2013 p.6
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/210423/consult_gift_aid_and_digital_giving.pdf

⁵ “Gift Aid and reliefs on donations”, National Audit Office, 21st November 2013 p.13
<http://www.nao.org.uk/wp-content/uploads/2013/11/10302-001-Gift-Aid-Book1.pdf>

In conclusion, we strongly recommend that HMRC abandons attempts to amend existing legislation to prevent the formation of charities for tax avoidance purposes and instead focuses efforts on collaboration with the Charity Commission and the voluntary sector to enforce existing legislation.