

CHARITY **comment**

WINTER 2007

Charity tax changes for substantial donors

The issue at stake

HMRC have been worried that certain donors to charities (whether they have obtained tax relief for their donations or not) have been able to exploit the charities they have made donations to, and have received benefits back. In 2006, therefore, they introduced new rules that restrict the tax breaks that charities get in circumstances where such perceived abuse is possible. Note, however, that the rules apply regardless of whether there is any actual abuse, and can cause tax problems for the charity even where the transactions are completely innocent

Who is caught and when?

The rules apply when there are substantial "substantial donors". You are a substantial donor if you give the charity at least £25,000 in a twelve month period or £100,000 in a period of 6 years.

They kick in when a substantial donor enters into certain kinds of transaction with the charity. These include:

- Property transactions between the substantial donor and the charity;
- The provision of services between the two (in either direction);
- The provision of "financial assistance" between the two (again either way); or
- Investment by the charity in the substantial donor's business.

What happens?

If there is a transaction that is caught, what happens depends on whether payment passes from the charity to the donor, or vice versa.

If the payment passes from the charity to the donor, it is treated as "non-charitable expenditure". The result is that an amount of its tax-free income equal to this amount loses its tax-free status and the charity will have to pay tax on it.

If the payment is from the donor to the charity, the problem is only if the donor pays less than the full value for what he gets. If that happens, the undervalue is treated as "non-charitable expenditure", giving rise to an equal amount of the charity's otherwise exempt income that is therefore treated as taxable.

Exceptions

The rules are intended to stop exploitation of charitable status, and so they have exceptions where it is patently clear that there is no tax avoidance intended. These include the following (although this list is not exhaustive):

Where the charity payment to the donor is on arm's length terms (or more generous to the charity) in respect of a business that the donor carries on;

Where the transfer of property to the charity qualifies for tax relief in the donor's hands as a disposal of real property or shares at undervalue;

Where a service provided by the charity to the donor is part of its prime purpose, and the donor pays at least the same as everyone else who uses those services; or

Where the donor gets benefits that are considered small enough not to invalidate any gift aid that could be claimed on a gift.

Examples

Mr X is a substantial donor to a charity. In addition, he sells a property to the charity for £250,000, its full value. Clearly, he doesn't get any benefit from this transaction. Nevertheless, the £250,000 he receives is caught by these rules so that £250,000 of the charity's income is treated as taxable.

If Mr X sold the property for £240,000, not only could he claim £10,000 tax relief but also the transaction would be outside the new rules.

Mrs Y is a substantial donor to a charity which operates a school. She sends her child to the school. But she pays the same fees as everyone else does. This in itself does not seem to cause a problem with these new rules.

But what if Mrs Y's child was admitted to the school without having to take an entrance test, while other applicants did have to? The rules aren't clear, but we consider that this implies terms which are more beneficial to the donor. Nevertheless, there is no payment for less than full value to be taken into account.

Mr Z identifies an excellent business opportunity, and allows a charity to which he is a substantial donor to invest in it, as an investment of £50,000 in his business. Even though it turns out to be a sound investment as far as the charity is concerned, the investment is treated as "non-charitable expenditure" and £50,000 of its income loses its tax exemption.

Need more information?

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