

Avoiding abuse

In his 2006 Budget, Gordon Brown laid out a number of measures to close loopholes which could lead to the abuse of charitable reliefs. Allan Holmes highlights these anti-avoidance measures, and warns charities to be diligent in their future transactions with companies or individuals

The Government has moved to end the exploitation of charity reliefs for tax avoidance purposes. With a whiff of abuse fresh in his nostrils, the champion of charitable giving Gordon Brown has acted decisively to head off any miasmatic threat to the reputation of charities and their donors. His package of new measures aims to protect existing charitable tax reliefs from abuse and to ensure that the high public regard for charities is maintained.

HMRC have become increasingly concerned that individuals are securing tax relief on large donations to charity and then extracting value from the charity in a variety of ways. They have identified a number of loopholes which the Chancellor has sought to close in his Budget by the introduction of the following three anti-avoidance measures.

Transactions with substantial donors

In return for a substantial donation to a charity, individuals and companies sometimes look for some benefit to themselves. This first new measure aims to stop any mischief involving transactions by a substantial donor with the charity on uncommercial terms. The new rules mean that the charity will lose its tax relief on income according to the benefit received by the substantial donor.

A substantial donor is a person who gives £25,000 or more to a charity in a year or £100,000 or more over six years. To prevent donations being made in one chargeable period and a transaction that returns value to the donor occurring in the next period, the substantial donor tag will stick for a number of years.

The transactions in question include the sale or letting of property, provision of services, the provision of financial assistance (such as a loan or guarantee), or investment in the business of the donor.

It is worth noting that a company which is wholly owned by a charity will not be treated as a substantial donor. This could be an issue for charities entering into transactions with a wholly owned trading subsidiary or a joint venture company, for example.

Generally speaking, certain transactions will be exempt from the new rules if they are undertaken for genuine commercial reasons or on arm's length terms, provided they are not part of an arrangement for the avoidance of tax. These rules apply to transactions taking place on or after 22 March 2006.

Non-charitable expenditure

This second measure provides a direct link between non-charitable expenditure incurred by a charity and loss of tax relief. It works by restricting the income and gains eligible for tax relief by £1 for every £1 of non-charitable expenditure incurred.

Under the previous scheme exempt income and gains were compared to qualifying (charitable) expenditure, and any excess was taxed to the extent that the charity had non-charitable expenditure. Now, in the majority of cases, non-charitable expenditure will be treated effectively as if it were taxable income.

The measure also scraps the de minimis limit of £10,000 applying to the charity's exempt income.

These rules apply to such expenditure incurred in any accounting period commencing on or after 22 March 2006.

Non-close Companies

Rules presently exist to restrict the benefits that a close company can receive in return for a donation to charity that is eligible for tax relief. The maximum benefit that can be received is £250 a year in respect of any gift, with lower limits for donations of below £1,000. This third measure extends this restriction to all companies.

In addition, non-close companies will become subject to the same rules as close companies and individuals where a donation is potentially repayable, or are part of a scheme involving the acquisition of property by the charity.

These new rules have effect in relation to payments to charity made on or after 1 April 2006.

The Chancellor's new measures to protect the reputation of charitable giving and stem the loss of revenue to the Exchequer have been broadly welcomed. It is thought they will have no impact on genuine charitable giving or on a charity's use of its funds for the benefit of charity.

Clearly charities will need to be careful in the future about what transactions they enter into with individuals or companies, especially with donors of substantial amounts. Where they enter into such transactions, by letting property for example, they will now need to ensure that they keep adequate records or formal documentation, and take steps to ensure that they have done so on commercial terms. We will need to wait and see if the rules throw up any significant administrative burdens in practice.

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