



**HM Revenue
& Customs**

Substantial donors to charity

**Consultation Responses Document
2 January 2009**

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1. Executive Summary

- 1.1 The consultation on “substantial donors to charity”, published on 15 July 2008, sought views on the operation of the current substantial donor regime and proposed changes that attempt to deal with concerns that had been raised by the charitable sector.
- 1.2 The main aim of the consultation was to obtain evidence from stakeholders on the impacts of the substantial donor regime to ensure that it best reflects the needs of both Government and the charitable sector. These are deterring avoidance whilst exempting all transactions that a charity has cause to carry out in the course of its charitable activities and minimising the administration burden on charities.
- 1.3 In addition to the main aim, views were sought on a number of specific issues, particularly proposals to;
 - introduce additional exempt transactions to the rules;
 - introduce a de minimis limit for relievable gifts;
 - disregard small payments or benefits to substantial donors;
 - amend the thresholds for defining substantial donors; and,
 - apply the above proposals from 22 March 2006.
- 1.4 The majority of respondents understood the need for anti-avoidance provisions to prevent charity and donor tax reliefs from being abused by people who are in a position to influence charities. However, they were also critical of the current regime, stating that it is complex, insufficiently targeted, places a significant administrative burden on charities, prevents certain transactions from taking place and does not help foster an environment of giving between charities and their major donors.
- 1.5 HMRC are currently considering these responses and will continue to engage directly with a number of stakeholders over the coming months. HMRC seeks to refine its understanding of and the evidence base for substantiating the views expressed both in respect of the impact of the current legislation and the proposed changes on charities and their donors.
- 1.6 A further announcement will be made by Budget 2009 providing the Government’s response to the consultation.
- 1.7 HMRC wishes to thank those who responded to the consultation document. We recognise the time and effort that went into the comments and contributions. A list of respondents and contributors to the consultation can be found at Annex A.

2. Introduction

- 2.1 The substantial donor legislation was introduced in 2006 (now at sections 506A, 506B and 506C Income and Corporation Taxes Act 1988 and sections 549 to 557 Income Taxes Act 2007) to tackle those who influence or set up charitable structures with a view to exploiting the generous tax reliefs for charities and donors. It is targeted at transactions between charities and those in a position of influence – i.e. the largest donors.
- 2.2 The rules apply to transactions between all charities and their largest donors (or persons “connected” to them) where tax relief is available on their donation(s). The rules start from the premise that all transactions between these parties potentially return value to the donor so will result in “non-charitable expenditure” by the charity and the charity will lose its exemption from tax on an equivalent amount of its income or gains. The rules then provide a number of exemptions to carve out the vast majority of transactions a charity normally undertakes.
- 2.3 The substantial donor legislation specifies what constitutes non-charitable expenditure in respect of transactions between a charity and its largest donors. It is therefore vital that the legislation exempts the appropriate transactions thus providing tax relief for transactions a charity normally undertakes. It is also important that charities do not suffer a significant administration burden.
- 2.4 Since the introduction of the substantial donor legislation, a number of charities and stakeholder bodies have approached HMRC with concerns over how the rules are working in practice. At Budget 2008, Government announced that HMRC would consult with stakeholders on this anti-avoidance legislation with a view to simplifying the system for charities and to prevent innocent transactions from being caught.
- 2.5 A formal consultation document seeking views of the existing legislation, suggesting ways this legislation could be amended and inviting further comment was published on 15 July 2008. In suggesting how the concerns raised might be met the consultation included draft legislation to:
 - exempt additional innocent transactions that are currently caught; and,
 - reduce the administration burden on charities.
- 2.6 The aim of the consultation is to ensure that the substantial donor regime best reflects the needs of both Government and the charitable sector. That is one that deters avoidance but that exempts all transactions that a charity has reason to carry out in the course of its charitable activities and which minimises their administration burden.
- 2.7 The consultation document attracted 54 responses from charities, businesses, representative bodies and individuals.
- 2.8 This document summarises the points that were raised through the consultation, and explains what initial action the Government intends to take in response.

3. Responses

- 3.1 This chapter summarises the 54 representations received during the consultation. One third of the responses received provided written endorsement of the representation submitted by one representative body.
- 3.2 None of the responses received recommended doing nothing. Whilst recognising the need for anti-avoidance provisions, most of the representations expressed discontent with the existing substantial donor rules and would prefer revisions to the rules or a total repeal of the legislation.
- 3.3 In summarising the responses to the consultation, please note that not all respondents commented on all of the proposals in the consultation. Therefore the proportions stated below will not add up to 100 per cent.

Chapter 2 – Exempt transactions

- 3.4 This chapter suggested additional transactions between a charity and its substantial donors that could be exempt from the substantial donor rules. The Government believes that if all transactions that charities can be reasonably expected to carry out with their substantial donors are exempt, charities will not incur a charge under these rules. Nor should there be a significant administration burden as there will be no “caught” transactions for a charity to monitor and report.
- 3.5 The additional proposed exempt transactions are:
- genuine arm’s length remuneration paid to a substantial donor (or person connected with a substantial donor) in his capacity as an employee who genuinely works for the charity shall not be treated as non-charitable expenditure; and,
 - the provision of financial assistance by a charity to a substantial donor (or person connected with a substantial donor) where that financial assistance takes the form of a charitable grant provided by the charity in the course of the actual carrying out of a primary purpose of the charity.
- 3.6 The consultation document asked:
- if these additional exempt transactions would be welcomed;
 - how many transactions would become exempt that are currently not exempt;
 - what the reduction in tax liability or other cost savings would be as a result of the proposed exemptions;
 - if there were any issues or concerns as to how the proposed exemptions would operate in practice;
 - if there were any other likely costs; and,
 - if there were any additional transactions that are currently not exempt but which the Government should now consider providing exemptions for.
- 3.7 The majority of respondents welcomed the proposed extensions to exempt these specified transactions. However there was some concern about the extent of the proposals and how HMRC would operate them in practice.

- 3.8 Many respondents believed that the “arm’s length” test for the remuneration exemption is difficult to satisfy in their particular sectors and could be open to interpretation. One respondent made the point that charities “are not obliged to buy the cheapest services” and so may provide a generous remuneration package to a member of staff who has a unique skill set which is required by that charity. Additionally, a few charities queried whether the exemption would include expenses paid to volunteers who are substantial donors.
- 3.9 The majority of respondents welcomed the proposed exemption for the provision of financial assistance to substantial donors that takes the form of a charitable grant provided in the actual course of the charity carrying out its primary purpose. However, there was some uncertainty expressed over how HMRC would determine whether a grant is made in the course of a charity carrying out its primary purpose and where the dividing line between a charitable grant and a loan lies.
- 3.10 Some respondents stated that the proposed additional exempt transactions would eliminate any tax charges potentially arising on their charity and therefore, the substantial donor rules as amended would be highly unlikely to catch them. But other respondents were concerned that the proposals introduce more complexity to the rules and may add to their administration burden.
- 3.11 About a third of respondents stated that they did not think that the proposals went far enough. Those respondents suggested extending the list of exempt transactions to include all loans to substantial donors made at arm’s length, and property sales and the provision of services by substantial donors to the charity made at market rate or at undervalue. It was also suggested that it was not the “type” of transaction that was the issue, rather the motivation behind the transaction.
- 3.12 A common theme in many responses is that there is a large administration burden associated with the substantial donor rules, in particular in identifying those people who are connected to a substantial donor. A number of charities described the connected persons rule as an “impossible requirement”, a “substantial administrative burden” and a “compliance nightmare”. Some responses suggested limiting the scope of the connected persons rule to spouses or partners.
- 3.13 One charitable umbrella body stated that their members could, in total, potentially make administrative savings of £100,000 per year if the exempt transactions were extended to cover other forms of financial assistance or if the current rules were repealed. They estimated that around 150 fewer transactions would be caught if the arm’s length remuneration exemption were introduced. No further evidence was provided by the respondents of the estimated number of transactions that would be exempted under the proposal or the corresponding cost savings.

Chapter 3 – De minimis limit for relievable gifts

- 3.14 This chapter suggested introducing a de minimis limit of £1,000 per year below which relievable gifts to a charity will not count towards the amounts which create a substantial donor. Charities have suggested that tracking and monitoring each individual relievable gift involves a disproportionate administration cost. With this

proposal the Government wants to explore how small relievably gifts could be disregarded in order to reduce the administration costs for charities.

3.15 The consultation document asked:

- what proportion of donors make donations of less than £1,000 per charity per year;
- if the proposed de minimis £1,000 limit would help charities reduce their administration costs around the substantial donor rules and, if so, what the value of their savings would be; and,
- if the proposed limit of £1,000 is set appropriately as opposed to an alternative limit.

3.16 Just under 20% of respondents stated that they rejected this proposal arguing that the de minimis limit would not reduce their administration burdens associated with record keeping; all donations would need to continue to be monitored in order to establish when the de minimis limit had been reached.

3.17 However, about 30% of respondents stated that in principle they were in favour of the setting of a de minimis limit for relievably gifts, although many reported that the £1,000 limit is set at too low a level to reduce their administration costs. According to some charities, limits which they think would have an “appreciable” effect in reducing administration burdens ranged between £2,500 and £12,000. Certain sectors, because of the nature of the donations they receive, appear to face a greater administration burden than others, however, a suitable de minimis limit could make a big difference to their monitoring costs.

3.18 No estimates were provided of the reductions in administration costs associated with the introduction of a de minimis limit at £1,000 or any of the other limits suggested by the respondents during the consultation.

Chapter 4 – Disregarding small payments or benefits

3.19 This chapter proposed a de minimis limit of £500 per year below which the value of payments or benefits provided to a substantial donor or person connected with a substantial donor shall be disregarded. Currently, application of the Gift Aid benefit limits mean that benefits or payments up to a total of £500 provided to a substantial donor in respect of a particular donation will not result in a tax charge on the charity. The proposed de minimis limit would extend the disregarded amount so that payments or benefits of up to £500 provided to a donor in any tax year or chargeable period for which they are treated as a substantial donor can be disregarded and not treated as non-charitable expenditure.

3.20 The consultation document asked:

- if the proposed de minimis limit would be welcome;
- how many donors would be affected by the proposal;
- what the likely savings to the charity would be and if there would be other benefits or costs; and,
- if the proposed £500 limit was set appropriately.

- 3.21 Around 25% of respondents stated that they welcomed this proposal in principle but did not believe that it would significantly reduce administration costs as the value was set too low. Only two respondents agreed that the £500 limit was set appropriately. Some charities thought that more appropriate limits would be in the range of £1,000 to £5,000.
- 3.22 About 15% of respondents stated that they thought a de minimis limit for benefits would not be helpful.
- 3.23 None of the respondents provided indicative estimates or evidence of the costs associated with tracking benefits paid to substantial donors or persons connected with them or the likely reduction in administration costs if the de minimis limit were introduced at £500 or a higher value.

Chapter 5 – Revised thresholds for defining substantial donors

- 3.24 This chapter proposed introducing a shorter period of time and a larger monetary threshold of relievable gift for assessing whether or not a donor is a substantial donor. It proposed amending the definition of a substantial donor to refer to a charity receiving relievable gifts of at least £50,000 in a period of 12 months (a change from the current £25,000 threshold in a period of 12 months) and to refer to a charity receiving relievable gifts of at least £125,000 in 3 years (a change from the current threshold of £100,000 in 6 years).
- 3.25 The consultation document asked:
- if the proposed revised thresholds would be welcomed by charities;
 - what the current administration costs to charities are of monitoring donations under the current definition of a substantial donor;
 - if the proposed revised thresholds would reduce administration costs for charities and by how much;
 - how much of the administration cost is for monitoring individuals and how much for corporate donors; and,
 - if there are alternative limits or measures that charities would prefer to see in place for defining substantial donors.
- 3.26 Just under 40% of respondents welcomed in principle the proposed revised thresholds for defining substantial donors. However, not all of them were happy with all of the details of the proposal. Four respondents fully supported the proposal, welcoming the new value thresholds and the halving of the six year period to a three year period. On the other hand, only three respondents expressly rejected the proposal outright as they believed that the definition contributes too much towards charities' administration costs without sufficiently targeting the donors that do extract money from charities.
- 3.27 Some respondents suggested increasing the monetary thresholds and decreasing the time period during which donations are taken into account. A number of respondents suggested that the proposed new monetary thresholds should be used as a lower limit, but that for larger charities the limits should be linked to a percentage of the gross annual income of the charity.
- 3.28 However, none of the respondents provided evidence indicative of the costs associated with identifying and monitoring substantial donors over a period of time

at the current or proposed new thresholds. Neither did they provide any evidence for recommending the introduction of thresholds that are higher than those proposed in the consultation document.

- 3.29 Many of the organisations that stated that the thresholds were set too low also thought that the need to track donations from and transactions with substantial donors and connected persons for an additional five chargeable periods poses too high an administration burden on charities and creates an environment that is not conducive towards encouraging donations from large donors. There was some confusion over how long transactions would need to be monitored under the proposals and several respondents highlighted what they thought was the “unnecessary complexity” of this proposal.
- 3.30 A small number of respondents thought that the rules should not take donations made prior to March 2006 into account when establishing whether someone is a substantial donor.

Chapter 6 – Date of proposed legislation taking effect

- 3.31 This chapter suggested that the proposals in the consultation document should take effect in relation to transactions on or after 22 March 2006, which is the date from which the substantial donor rules initially came into force.
- 3.32 The majority of respondents who commented on this chapter welcomed the proposal, although there were some suggestions that donations made before March 2006 should not be taken into consideration for the substantial donor rules. Additionally, some respondents suggested that there should be a provision to compensate charities that have suffered a tax charge under the current substantial donor rules for transactions which under the proposed changes in the draft legislation would become exempt.

Additional representations made during the consultation

- 3.33 Whilst many of the representations received provided commentary on the current substantial donor rules and the proposed changes to them, many organisations provided further comments and made additional proposals for dealing with the issues surrounding substantial donors to charity.
- 3.34 About 50% of responses called for the repeal of the current legislation. Many of these respondents thought that the arrangements the substantial donor rules are designed to prevent are already tackled by existing legislation and that the current rules were disproportionate to the risks involved and create dual regulation between HMRC and the UK charity regulators.
- 3.35 Approximately 40% of respondents suggested interest in introducing a motive test either as a part of the substantial donor rules or as a replacement to the current rules if they were repealed, stating that this would ensure that the anti-avoidance provisions are better targeted.
- 3.36 A number of charities complained that the tax charge that arises when the substantial donor rules are breached is targeted at the wrong party and is disproportionate to any benefit the substantial donor may have received as a result of their donation. Currently, the rules potentially impose a tax charge on a charity

that enters into a non-exempt transaction with a substantial donor, by treating the value of that transaction as non-charitable expenditure. Charities have argued that the tax charge should arise on the substantial donor and should relate to the value of any tax relief they have obtained on the donation.

- 3.37 A small number of charities suggested that, if the tax charge remains with the charity, they should be able to reclaim that tax if the substantial donor fulfils their obligations to the charity and the charity is left in the same or a better position than before the transaction was entered into. For example, if the charity makes a loan to a substantial donor that is caught by the rules, a tax charge would arise. However, once the substantial donor has repaid the loan including interest at the market rate, that tax could be repaid to the charity.
- 3.38 Many respondents stated that the perceived complexity of the current legislation means that charities need to obtain professional advice before entering into specific transactions. A charitable umbrella body gave an example of a member charity incurring between £15,000 and £20,000 on legal fees to restructure themselves, in order to be able to proceed with a transaction that had a genuinely charitable motive that would otherwise have been caught by the current rules.
- 3.39 A number of charities complained that the rules, whether in their current form or if the proposed amendments are introduced, work against the Government's objective to encourage giving because they act as a disincentive to giving to charity. They said that donors may reduce the value of their donations in order to fall below the thresholds for becoming a substantial donor. One charity claimed that it had refused donations worth £2 million because it was concerned that it would otherwise have been caught by the substantial donor rules.

4. Next Steps

- 4.1 The Government will take account of the messages in the responses as it considers how best to take forward possible changes to the substantial donor legislation. In particular:
- There is demand for the substantial donor rules to be more targeted;
 - The rules should not create an administrative burden on charities that is disproportionate to the risks involved;
 - The exemptions should cover all transactions that charities should reasonably need to take in fulfilling their primary purpose;
 - The definition of a substantial donor should be set at a level that is proportionate to the risks involved without creating an unnecessary administration burden on charities or their donors.
- 4.2 HMRC will continue to engage directly with a number of stakeholders over the coming months on an informal basis. HMRC will seek to obtain further information and detailed evidence to substantiate stakeholders' concerns about the current legislation and the proposed amendments, including detailed information relating to the administration costs incurred by charities in complying with the rules.
- 4.3 A further announcement will be made by Budget 2009, providing the Government's response to the consultation.

A List of Respondents

Below is a list of charities, businesses and representative bodies that responded to the consultation.

1. Association of International Accountants
2. Baker Tilly
3. Bircham Dyson Bell
4. British Heart Foundation
5. British Universities Finance Directors Group (BUFDG)
6. Cancer Research UK
7. Changing Faces
8. Charities Aid Foundation (CAF)
9. Charity Commission
10. Charity Finance Directors Group (CFDG)
11. Charity Law Association
12. Charity Tax Group
13. Chartered Institute of Taxation (CIOT)
14. Community Foundation Network
15. Deloitte & Touche
16. European Association for Planned Giving (EAPG)
17. Fellowship of Independent Evangelical Churches (FIEC)
18. Grant Thornton
19. Higher Education Funding Council for England (HEFCE)
20. Horsey Lightly
21. Institute of Chartered Accountants in England and Wales (ICAEW)
22. Institute of Chartered Accountants of Scotland (ICAS)
23. Institute of Fundraising
24. Kingston Smith
25. KPMG
26. London Society of Chartered Accountants
27. London Symphony Orchestra
28. Macmillan Cancer Support
29. Marie Curie Cancer Care
30. National Church Institutions
31. National Governing Bodies of Sport – Submitted on behalf of England and Wales Cricket Board, Football Association, Lawn Tennis Association, Rugby Football League and Rugby Football Union
32. National Housing Federation
33. National Trust
34. Office of the Scottish Charity Regulator (OSCR)
35. Philanthropy UK and the Association of Charitable Foundations
36. Save the Children UK
37. Sheen Stickland
38. Slaughter & May
39. Society of Trust & Estate Practitioners (STEP)
40. Stewardship
41. The Law Society Charity

42. The Law Society of England and Wales
43. Universities UK
44. Universities UK and GuildHE
45. WEC International
46. Wellcome Trust
47. Withers LLP
48. Wrigleys
49. WWF-UK

In addition there were 5 individuals who formally responded to the consultation document.