

# IFA REPRESENTATION 09/23



## Charities tax compliance

The Institute of Financial Accountants welcomes the opportunity to comment on the Consultation published on 27 April 2023. This representation has been written with input from IFA members and other expert correspondents, most notably Kay Wightman FFA FTA (Accounting for Good) and Alison Cook FCA (AJC Accountancy).

We would be happy to discuss any aspect of our response and to take part in any further consultations in this area.

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## **Questions raised in the Consultation**

### **Preventing donors from obtaining a financial advantage from their donation**

#### **Question 1: Do you foresee any unintended consequences on legitimate charities from introducing this rule?**

1. In general, the IFA and its correspondents approve of efforts to minimise and prevent abuse of charitable tax relief and charitable investment rules. However, we would strongly caution that a proportional approach should be taken, particularly as pertains to smaller charities. This is to avoid placing an undue administrative burden on said smaller charities, without any commensurate benefit.
2. Regarding Tainted Charity Donations (TCDs), the examples given in the consultation document will mostly (if not entirely) apply to larger donations and therefore larger charities. We would advise HMRC to take care to avoid action which might restrict charitable giving to smaller charities.
3. Regarding the example of a charity making a loan to a donor which is never repaid and ultimately written off, an alternative approach to combatting this abuse of reliefs on charitable giving could be to introduce a rule (in concert with the Charity Commission) whereby loans made by a charity cannot be written off without Charity Commission approval.
4. The proposal to replace TCD rules with a new rule limiting the amount of financial assistance a charity can provide to a donor would be unlikely to impact smaller charities, especially if the limit is defined as a hard threshold and not proportionate to a charity's income and/or expenditure. There may be an adverse unintended consequence for a small number of larger charities with a legitimate reason to invest in projects or services operated by a genuine donor.

#### **Question 2: Do you foresee any significant challenges for charities to maintain appropriate records of any arrangements, such as substantial loans, they make?**

5. Record-keeping is unlikely to present a significant challenge, as charities with sufficient budget to make substantial loans could reasonably be expected to have sufficient internal resource to maintain appropriate records and audit trails.
6. The more pressing issue with the proposals in this section of the consultation document is how the limit on financial assistance provided to a donor is defined. As stated in paragraph 4, there may be corner cases where a larger charity has a legitimate reason to invest in or provide custom to a donor's business: HMRC should provide the opportunity for the charity and donor to make the case that such activity should be excluded from any investment cap.
7. If the cap or limit is defined as a hard threshold, this will be unlikely to impact smaller charities. If the cap or limit is defined as a proportion of total income or expenditure, this would place an unfair and unrealistic administrative burden on the smallest charities. We would argue against this approach, and if it is taken would suggest a minimum income threshold below which the rule is not applied. Charities with income under £25,000 do not need an independent examination of their accounts, and so should be excluded by default; but we would suggest a higher threshold of at least £50,000 annual income, as charities below this threshold are highly unlikely to have any internal finance capacity. The cost-benefit for HMRC of applying this rule to the smallest charities should also be considered.

#### **Question 3: Do you foresee any unintended consequences on legitimate arrangements from changing the rules in this way?**

8. The proposals to remove or tweak condition B of the TCD rules, to make the TCD rules less prescriptive and give HMRC more leeway to challenge donations providing anything more than an incidental benefit for the donor, are preferable to the proposal to replace the TCD rules with a new limit on financial assistance provided to a donor. These proposals avoid the potential corner case outlined in paragraphs 4 and 6, and empower HMRC to focus on the highest-profile and highest-value TCD cases without placing an undue administrative burden on the smallest charities (see paragraphs 1 and 7).
9. HMRC should nonetheless educate officers to administer updated TCD rules effectively and fairly, including giving due consideration to legitimate reasons a charity might (for example) give business to a donor.

**Question 4: Do you believe proposed changes to the current wording would achieve our objectives or do you believe there will still be room for abuse?**

10. Eliminating room for abuse entirely is a tall order, and by making TCD rules less prescriptive HMRC will increase the importance of adequately training officers and providing them time and resource to conduct competent investigations. The question ultimately comes down to cost-benefit and available resource: does HMRC have the resources to do this, and/or could those resources be more effectively deployed elsewhere? What is the cost-benefit argument, given the consultation document presents these proposals as achieving net zero impact on the Exchequer?

**Preventing abuse of the charitable investment rules**

**Question 5: Are there any circumstances where a charity may need to make an investment or loan for reasons other than benefitting the charity?**

11. The IFA and its correspondents recognise that some of the examples given in the consultation document (including purchase of properties for use by trustees, and making bank deposits or investments for an individual to benefit from a charity's preferential rates) have occurred, and doubtless continue to occur in some charities. As previously stated, these examples tend to apply only to larger charities, so we would advocate for a materiality threshold (in terms of a charity's annual income) to be applied to any rules intended to combat abuse in this space. That said, we support HMRC efforts to challenge charity investments which do not benefit the charity.

**Question 6: Do you foresee any significant challenges retaining records and documents to justify, if requested by HMRC, the investment decision process and demonstrate how the investment benefits the charity?**

12. Any investment decision should be discussed at documented board meetings, so the decision process itself should by default be documented. Demonstrating how an investment benefits the charity may be easier to do in some cases than others, and in every case will involve keeping detailed records (for example, to show that a property is only being used by a charity's beneficiaries). The record-keeping itself should not be unduly onerous, but training and education for responsible persons may be necessary given this will be an adjustment to some charities' standard operating practices.

**Closing a gap in non-charitable expenditure rules**

**Question 7: Do you agree that it is rational and proportionate to review ways to close the tax gap here? If not, please provide reasons why?**

13. In terms of proportionality, we would welcome greater transparency from HMRC on the size of this particular tax gap, and how it stands in relation to other areas of tax policy and administration in need of reform. We do not object in principle to closing this loophole, but the IFA and its correspondents are not aware of any cases fitting this definition relating to charities with income under the £1 million audit threshold. The question of proportionality is one HMRC is ultimately best placed to answer, but we would argue that the materiality threshold for this proposal should be set alongside the current charity audit threshold.

**Sanctioning charities that do not meet their filing and payment obligations**

**Question 8: What are the barriers to some charities not filing tax returns when requested to?**

14. For the vast majority of small charities not generating a profit, barriers to filing tax returns include: lack of internal expertise, lack of capacity, lack of resource, lacking adequate software, needing to engage the services of external accountant, and confusion and/or nervousness when receiving a request for the first time (or the first time in several years).

15. These barriers are compounded by confusing and inconsistent guidance from HMRC on charity filing obligations, with trustees variously believing they need to file every 3 years, or only if they have taxable income, or only if they are directly asked to by HMRC.

**Question 9: Do you think that this would adversely affect the operations of charities or CASCs and what might be the consequences of this?**

16. The most significant adverse impact of enhanced enforcement of charity filing obligations would be the administrative burden placed on charities facing the barriers outlined in paragraph 14.
17. We would again raise the cost-benefit question. What benefit does HMRC expect to gain, in terms of increasing tax revenue, by focusing on tax returns from small charities which do not generate a profit? It is reasonable to assume that some small proportion of those charities might be involved in non-compliant behaviour, and some commensurately small amount of additional tax revenue might be generated by improving compliance in this space – but the enforcement cost to HMRC could very well outweigh the benefit, to say nothing of the increased administrative burden on the vast majority of small charities which are behaving properly.
18. Furthermore, we would caution against treating all CASCs as not-for-profits (NFPs). CASCs can be administered in different ways, and while all CASCs have charitable aspects some are incorrectly classified or treated as NFPs when they are not (for example, CASCs which are Community Interest Companies).

**Question 10: How should changes be targeted to ensure they encourage charities to meet their obligations to file a tax return when required to do so – for example should small charities be treated differently to larger ones?**

19. In line with current independent examination and audit thresholds, and as aforementioned, smaller charities should logically face lesser filing obligations than larger charities. This is in recognition of their proportionally lower level of financial activity, and lower resourcing and capacity (especially for the smallest charities which are unlikely to have any internal finance function).
20. With reference to paragraph 17, it could be argued that the cost to HMRC of enforcing filing obligations for the smallest charities (e.g. those under the £50,000 income threshold proposed in paragraph 7) would outweigh any benefit realised. If this argument was accepted, charities under this materiality threshold could be deemed exempt from filing obligations (except at HMRC request, should HMRC suspect non-compliant behaviour).
21. One alternative would be to limit the frequency of requests to file for charities under a materiality threshold (e.g. no more than once every 3 or 4 years).
22. One of the IFA's correspondents proposed another alternative: making an annual tax return a requirement for all charities, even the smallest charities not turning a profit. The rationale for this proposal is that making filing a regular obligation will eventually remove many of the barriers outlined in paragraphs 14 and 15, with charities and their trustees better understanding their obligations and how to fulfil them. With adequate education (see question 11) this approach could yield the benefits suggested: the question then is whether HMRC have the resource to educate and administer charity tax returns at this scale and regularity.

**Question 11: How would it be best to educate the sector about any new rules ahead of their introduction?**

23. As noted in paragraphs 14 and 15, many smaller charities are under-informed on their obligations regarding filing and payment. If sanctions were introduced too quickly and without adequate communication and education, some smaller charities would struggle to function and survive if reliefs were withheld too quickly.
24. Therefore, any change to HMRC policy in this space will require significant lead-in time, communication and education. Ideally HMRC would conduct this through a variety of media, including interactive training materials, and would offer grants or additional reliefs to resource charities to develop their finance function where appropriate.

25. Given the importance of compliance culture coming “from the top”, we would advise that HMRC work with the Charity Commission to target charity trustees and ensure their financial literacy and understanding of their obligations are adequate. This could include producing a short course (compulsory or optional), to be disseminated to incoming trustees as part of the introductory materials provided by the Charity Commission.

### **General comments**

26. The IFA would like to raise a concern about the volume and proximity of HMRC consultations opened on “Tax Administration and Maintenance Day”, 27th April 2023. In total 11 consultations were opened 27th April, with deadlines falling in either June or July. This gives professional bodies and other interested parties approximately 8-12 weeks to respond to up to 11 consultations.
27. For professional bodies, providing meaningful representation requires engagement with members (which itself takes time, as members cannot be expected to respond immediately upon their professional body’s request), collation of member responses and internal deliberation before a representation can be written, assured and submitted.
28. Professional bodies like the IFA are therefore left facing difficult decisions over where to focus attention and resource – decisions which would not be necessary if HMRC consultations were spaced more evenly throughout the year, and/or deadlines were extended where necessary in recognition of the proximity of so many consultations opening at once.
29. Labelling 27th April “Tax Administration and Maintenance Day” suggests that HMRC are considering making this mass release of consultations a regular annual event: the IFA would strongly caution against this, and request HMRC consider a more reasonable approach to stakeholder consultation. If this approach is maintained over time, inevitably consultation responses will skew further towards the largest professional bodies, whose interests are not always necessarily aligned with smaller accountancy practices and their small business (and charity) clients.

### **Contact details**

Should you wish to discuss this response further, please contact Matt Barton, IFA Technical Manager, at [mattb@ifa.org.uk](mailto:mattb@ifa.org.uk).