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Tainted Charity Donation rules — Draft legislation released for the Finance Bill 2011

09 DECEMBER 2010

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CATEGORY:
ARTICLE

Many charities and donors will by now be familiar with the onerous Substantial Donor Rules introduced in the Finance Act 2006 without prior consultation. Under these rules, charities can face a charge to tax when they enter into 'relevant transactions' with 'substantial donors'. To access our detailed briefing on these rules, please click here .

The Substantial Donor Rules generated significant negative feedback from charities and advisers, the main criticisms being: the unintended consequences on charities and donors, increased administrative burden and the potential to discourage large but wholly legitimate donations to charity. A working party, with which our Charities and Philanthropy team has been involved, was constituted in 2009 to assist HMRC in the development of new anti-avoidance rules to replace the problematic Substantial Donor Rules.

After a period of informal sector consultation, draft legislation to be included in the Finance Bill 2011 has this morning been released. This includes anti-avoidance rules that will replace the Substantial Donor Rules with a 'purpose test' designed to catch 'Tainted Charity Donations' (TCD).

Tainted donations

The existing Substantial Donor Rules were heavily criticised for being drafted in such a way that donations that provided no benefit to the donor were nevertheless caught as tax avoidance.

The draft TCD rules seek to address this by introducing a new 'purpose test'. This test seeks to catch donations that are linked to 'arrangements' which have as their aim (or one of their aims) to provide direct or indirect benefit to a donor or a person connected to him or her. This benefit could come from the charity that receives the donation or a 'connected charity', though benefits which are acceptable under the Gift Aid scheme are ignored. Key to this test is whether the donation and the 'arrangements' would have been entered into independently of one another.

Breaching the rules – new liability for the donor

One aspect of the existing law which has been the source of particular criticism was the fact that the burden of breaching the rules fell squarely with the charity and not the substantial donor.

In describing the new TCD rules, HMRC's new approach is that the donor (as opposed to the charity) is the 'primary target for recovery' of any tax relief that should not have been given. However, the draft legislation does not entirely shift the burden from charities, which can remain jointly and severally liable for a new tax charge in certain circumstances.

A new concept of 'associated donations' is also introduced. A donation of this sort is connected to the 'arrangements' and can become ineligible for tax relief by association even if not in fact 'tainted' itself.

The end of 'substantial' donors

The draft legislation removes the minimum threshold of £25,000 given in one year or £150,000 over a period of 6 years. This means that in principle, a donation of any size could be caught as a 'tainted' donation.

Timetable

The legislation will have effect in respect of donations made on or after 1 April 2011 and the guidance issued by HMRC indicates that no new 'substantial donors' will arise from that date.

Complexity

The TCD rules are designed to introduce an element of common sense into an area that has been fraught with complexity and uncertainty.

Whether on close analysis they achieve this is yet to be seen.

The draft legislation is complex and not particularly easy to follow. This new regime must be translated in a way that enables charity trustees, donors and fundraisers to be clear about what is and what is not permissible.

The draft legislation is now subject to a period of consultation which closes 9 February 2011. We will be responding to this consultation and will continue to provide updates on its development.

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