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Making grants overseas – a refresher on HMRC rules for charities

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It is a hallmark of the charity sector in the UK that charities may support projects and purposes at home or abroad, and we can trace UK global grant-making back to at least the early 19th century. Yet however longstanding a practice, global activities are not without risk, and charities making grants globally must be mindful of the restrictions that charity law and taxation impose.

If this sounds ominous, the good news is that compliance is straightforward, with relatively clear guidance from the regulators. Making grants and payments overseas

Engaged charity trustees are likely aware that they are duty-bound to apply assets to projects that fall within their charity's purposes. They may carefully deliberate on proposed grantees, inform themselves with grantee 'due diligence' information, and ultimately come to an informed decision as to what projects to support for the public benefit.

Yet many boards still overlook what HMRC has to say on the subject. This is important generally – any expenditure that is not exclusively charitable can lead to a charge to tax. However, it is of particular importance where charities are making grants abroad.

Charities making grants abroad need to make sound decisions about what charitable projects to support, but they must also make sure they take – and can show they have taken – steps HMRC considers to be 'reasonable' to ensure that payments are applied for charitable purposes.

Thankfully, HMRC has issued fairly clear guidance on factors case officers are likely to take into account when considering if 'reasonable steps' have in fact been taken. This includes some examples and takes some of the uncertainty out of a wholly subjective test.

What will constitute 'reasonable steps' will depend on the circumstances, but charities can be sure that HMRC will consider:

- size and frequency of the payments – what is reasonable for a small one-off payment may not suffice for a more substantial or multi-year grant
- other risk factors – a grant to a newly formed charity in a far-flung jurisdiction where corruption is common will require a higher level of formality than a repeat gift to an entity with track record, and operating in a transparent and highly regulated jurisdiction. Trustees should also note HMRC's recommendation that they identify risks 'relating to connections between the body and other organisations' particularly where the recipient works with its own partner organisations
- relationship between the charity and its grantee – giving to a trusted affiliate or local partner is lower risk than making payments within a newer relationship, but this is only one factor among many. The local charitable or tax-exempt status of the grantee will be relevant but is not enough to constitute 'reasonable steps'
- how the charity documented the payment – while a written grant agreement is not an absolute requirement in circumstances involving lower risk, it is certainly helpful to a charity's position
- what financial controls were in place and whether the charity complied with its own procedures – The Charity Commission's guidance on Protecting charities from harm and Internal Financial Controls for Charities (CC8) charities can be helpful here

The overseas payments rules apply to all UK charities, whether they operate as traditional grant makers, or as part of an international network of operating charities. What constitutes 'reasonable steps' may be quite different for charities with different operational models, but HMRC's approach in scrutinising the overseas payments is likely to be substantially similar for all.

Anecdotally, we and other advisers are seeing an increase in compliance checks and reviews of charities' overseas payments, as well as Gift Aid audits. As the outcome of an unsuccessful review could be a tax bill for the charity (and potentially personally liability for trustees), a pro-active 'health check' of procedures and record-keeping should be on the to-do list of every charity sending funds abroad.

In some cases, it may also be possible to rectify procedural shortcomings after the fact where they are identified in good time.

When is a grant not a grant?

When it is a contract, of course, or more specifically when it is a contract to provide services. In March, HMRC substantially updated its publicly available guidance). on classifying an arrangement as either a grant or a services provision.

Despite the fact that service provision may give rise to Value Added Tax (VAT) where a grant would not, there are many instances where funding arrangements are conceived of as service provision rather than grants. This may involve, for example, payments that are structured on a per-unit (per student/per well dug/per school built etc) basis, or arrangements that specify quality, quantity, or timing in a fashion consistent with service provision. What the parties call the arrangement is not determinative, and HMRC will instead apply several criteria to identify the heart of the arrangement.

While the HMRC guidance does not mention overseas funding arrangements charities should note that these could also be implicated under the UK's VAT reverse charge mechanism. The VAT reverse charge effectively sees a UK purchaser of goods or services liable to account to HMRC for VAT where the technical 'place of supply' is the UK, even though the supplier is geographically based outside the EU.

A UK charity funder may be 'importing' services under a funding agreement with a non-EU body and if acting as a taxable person for VAT purposes, the reverse charge will apply. This issue falls away if the funding is instead genuinely structured as a grant.

The recent Wellcome Trust case in the first tier tribunal (tax chamber) was specific to its facts and would not in any event remove the risk of a cross-border funding arrangement engaging the reverse charge.

More substantial overseas activities

Of course charities doing more on the ground will need to consider the risk profile of their activities in the round. The Charity Commission's guidance on Protecting charities from harm contains some useful assessment tools. Trustees should also be sure to be up to speed with UK anti-bribery and terrorist financing rules and may find it helpful to implement, or update, a risk management policy that captures the results of their risk analysis. This should be sure to reflect the Commission's current, and more expansive, approach to 'safeguarding'.

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