Tax Faculty

Tax Representation

# TAXREP 20/05

# CHARITABLE TRUSTS: TAX LAW REWRITE: BILL 4

*Memorandum submitted in April 2005 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation to comment issued in February 2005 by HMRC Tax Law Rewrite Team*

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# CHARITABLE TRUSTS: TAX LAW REWRITE: BILL 4

## INTRODUCTION

1. We welcome the opportunity to comment on Paper CC(05)04 published on 2 February 2005 by HMRC Tax Law Rewrite Team at http://www.hmrc.gov.uk/rewrite/exposure/menu.htm.

## WHO WE ARE

2. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are in the Annex.

## GENERAL COMMENTS

3. We note that the rules for charitable companies will be rewritten in the context of the rewrite of corporation tax, but that Bill 4 will in due course make appropriate consequential amendments to the source legislation for charitable companies etc. We have responded separately to the draft rewritten clauses regarding the income tax rules about gift aid, which have been issued for consultation in Paper CC(05)03.

4. It might be argued that clauses 20-34 more logically follow clauses 1-11, as certain of the latter clauses only are subject to the restrictions in clauses 20-22 (to which clauses 23-34 relate), with clauses 12-17 (exemptions not subject to restrictions), 18 and 19 then concluding the Charitable Trusts etc Part. We hold no strong view on this, however, clauses 20-34 being a rather bulky amount of material to move around. Generally we are content with the way the source material has been rewritten.

5. As currently drafted the Introduction deals explicitly with the clauses up to clause 22 only. It may be appropriate to refer in some general introductory way to clauses 23-34 as supplementing clauses 20-22, and as relating fundamentally to the calculation of the clause 20 'non-exempt amount', as the reader may not otherwise readily appreciate that this is the effect of these quite lengthy rewritten clauses.

## ANSWERS TO QUESTIONS

6. **Q1** We support the approach adopted in the structure of clauses 3-5, combining the charging provision and the related exemption rather than separating these. We agree that this approach does better support the dominant idea, and the reader's expectation, that charitable trusts will generally be exempt from income tax. As mentioned in Explanatory Notes paragraph 7, it follows that no mention need be made that in the absence of the charging provisions in clauses 3, 4 and 5, the gifts concerned are exempt under general income tax principles.

7. We note that the material about the mechanics of the computation of a charitable trust's overall liability to income tax will be located elsewhere in Bill 4, together with the material addressing this in relation to trusts generally and in relation to other persons liable to income tax.

8. **Q2** Although no Associations having as their object the undertaking of scientific research have yet been constituted as a trust, and the likelihood of this is considered remote, these are not conclusive reasons for now excluding any such future entities. This is particularly so if the Secretary of State has not made public a policy to reject an application from any such future trust for approval under s 508 ICTA (Scientific research organisations).

9. **Q3** We consider that it is helpful to make clear in clause 5(7) (Payments to charitable trusts by charities) that s 687 ICTA (Payments under discretionary trusts) first applies to establish the amount charged as the grossed-up amount of the payment received. This also assists understanding of the meaning of 'the full amount' in clause 5(6), where such discretionary payments arise.

10. **Q4** We welcome clause 7 (Exemption for post-cessation receipts of trade) which introduces an exemption from income tax for the post-cessation receipts of what was a primary purpose trade whose profits would be exempt if the trade had not ceased, in accordance with current Inland Revenue practice.

11. **Q5** We agree that the use of the accounting term "incoming resources" is appropriate, as a more direct and accessible way of capturing the meaning of "gross income" in the s 46 FA 2000 source legislation.

12. We also agree that it is appropriate, for the purposes of clause 14, that incoming resources from an activity should be included irrespective of whether there is a profit or a loss.

13. For the avoidance of doubt it would be preferable to explicitly provide, in accordance with practice, that balancing charges are to be excluded when calculating incoming resources.

14. We agree that the requisite limit calculation should take account of trading incoming resources for the relevant basis period for the tax year and other incoming resources from all other sources for the tax year. In this context, it might be clearer to the reader to insert 'of its basis period' after 'incoming resources' in the second line of clause 14(2).

15. **Q6** We support the giving of statutory effect, in clause 15 (Exemption for profits of fund-raising events), to Extra-Statutory Concession C4.

16. The reference to raising funds for charities in clause 15(1)(b) might be superficially read as relating to other charities only. Would it be prudent to add ', including itself' after 'charities' at the end of sub-clause 15(1)(b)?

17. **Q7** We agree the proposal to replace references to "the Board" with "the Inland Revenue" in the Charitable Trusts etc Part.

18. **Q8** The definitions of charitable expenditure and non-charitable expenditure, which are relevant for the purpose of calculating a charitable trust's clause 20 (taxable) non-exempt amount for a tax year, do reflect Inland Revenue practice, as explained in Explanatory Notes paragraphs 69 and 72, and provide clearer guidance in this context.

19. The calculation of 'charitable expenditure' and 'non-charitable expenditure', as now defined in clauses 24 (Meaning of 'charitable expenditure') and 25 (Meaning of non-charitable expenditure') respectively specifically includes where appropriate, in accordance with Inland Revenue practice, capital expenditure and investments and loans made, whilst excluding notional deductions in respect of goods or services provided to the charitable trust at less than market value and any proportion of fixed overheads or costs relating to trading activities. In this respect the definitions are clearer. The previous use of the terms 'qualifying' and 'non-qualifying' expenditure, as amounting on the face of it to the total of the charitable trust's expenditure, might not have led the reader to expect capital expenditure to be included nor, in the case of non-charitable expenditure, the inclusion of investments and loans made that were not approved charitable investments.

20. It appears correct that the disposition of a charitable trust's income and gains, whenever arising, in part as capital expenditure, investments and loans should be taken into account in the calculation of 'charitable expenditure' and 'non-charitable expenditure'. The definitions, however, evidently also include any such expenditure financed out of the trust's originally settled capital. Should an exception be made in this respect?

21. The relationship of 'charitable expenditure' and 'non-charitable expenditure' to the charitable trust's overall financial position in a tax year is not obvious to the reader. Clauses 24 and 25 as re-written are mutually exclusive. A loss in clause 24 relates to charitable income and expenditure (both revenue and capital), whereas a loss in clause 25 relates to non-charitable income and expenditure (of both a revenue and capital nature and including any investments and loans). To the extent that relevant income 'franks' relevant expenditure it is effectively ignored, only a net loss being taken into account. In defining the terms by reference to losses incurred it is reasonably assumed that the financing of the total net charitable and non-charitable expenditure will be out of the sufficient availability of other income (including 'non-taxable sums' as in clause 28(4) and presumably any profits arising under clause 24(1)(a), (b) and (c) and clause 25(1)(a), (b) and (c)), or of capital gains together if necessary with other settled trust resources. In this context the structure of clause 20(2) does recognise that the charitable trust's total available income and gains in a tax year (as defined in clause 23) can exceed the total of the charitable and non-charitable expenditure.

22. The approach in Explanatory Notes paragraph 74 appears anomalous. In the case of the £12,000 expenditure full credit is effectively given for the £4,000 repaid. Were £6,000 repaid why should not full credit be similarly given for it, such that the expenditure in the tax year would be £8,000 (equal to the net outgoing for the tax year) and not £10,000?

23. **Q9** For the specific purposes of the definitions of charitable expenditure (clause 24) and non-charitable expenditure (clause 25) it would be simpler, in accordance with existing practice, to have regard to a single property business which either is or is not primary purpose; but it will be more accurate to have regard to particular interests in land as clause 26(3) is currently drafted. The latter appears preferable in accordance with the specific structure adopted in clauses 24 and 25.

24. **Q10** We agree that clause 27 (Tax year in which certain expenditure treated as incurred), with particular reference to sub-clauses 27(3) and (4), should explicitly reflect current generally accepted accounting practice (UK GAAP) about the time expenditure is taken

into account. As stated in Change {jc 468} the source s 506(2) ICTA now implicitly mirrors current UK GAAP. Although there is no legal or other obligation requiring all charitable trusts to prepare their accounts in accordance with UK GAAP, and the Charities SORP is not mandatory in Scotland and Northern Ireland, it must be correct for the purposes of clause 27 (and sub-clauses 24(1)(d) and 25(1)(d)) to have parity of treatment as between charitable trusts throughout the UK and that such treatment should accord with UK GAAP.

25. **Q11** We welcome the simplification in drafting clause 28 (Treating excess expenditure as non-charitable expenditure of earlier years), in clause 28(3) Step 4, of removing the paragraph 12(1) Schedule 20 ICTA obligation upon a charitable trust to show the use to which non-taxable sums are put and instead assuming that non-taxable sums fund excess non-charitable expenditure.

26. **Q12** It is appropriate that clause 33(3) and (4) (Trades exercised in the course of the carrying-out of more than one purpose),with the ability to increase the sum specified in clause 33(4)(a) by Treasury Order under clause 33(6), should give statutory effect to Inland Revenue guidance as to what level of non-primary purpose trading activity can be carried out by a charitable trust before the right to exemption for the profits of a dual purpose trade is lost.

**SPECIFIC COMMENTS ON DRAFT LEGISLATION**

**Clause 4: Gifts of sums of money to charitable trusts by companies**

27. In 4(6), is it sufficiently clear what is meant by 'the full amount' of the gifts chargeable? We assume that it is intended to mean the total of all gifts received by the charitable trust in the tax year. This may confuse the reader if any gifts (as sums of money) might conceivably be paid under deduction of income tax, however unlikely (as referred to in Explanatory Notes paragraph 22). If such payments are normally made gross, would it be better to refer simply to 'the total amount' of the gift (as a sum of money) and make further reference to tax being chargeable on the grossed-up amount of a gift where income tax had for any reason (and however unlikely) been deducted on its payment (as with clause 5(7))?

28. The term 'the total amount' would then also replace 'the full amount' in clause 5(6) (Payments to charitable trusts by charities) where it is arguably more necessary, in view of the grossing-up of the payments in clause 5(7).

**Clause 6: Exemption for profits of trade**

29. In clause (4)(a) it would be helpful to define 'primary purpose', as set out in Explanatory Notes paragraph 28.

30. We agree the approach adopted in clause 6(4) of stating that the exemption for a tax year in respect of the profits of a primary purpose trade depends upon that trade being carried on for a primary purpose 'throughout the basis period for the tax year to which the profits relate'.

**Clause 7: Exemption for post-cessation receipts of trade**

31. In clause 7(6) in the third line would it be prudent to include 'of that Act' after the words 'see sections 246 to 253' within the brackets, being sections in ITTOIA?

**Clause 9: Exemption for savings and investment income**

32. Some of the signposting in clause 9(5), concerning definitions, appears cumbersome. We hold no strong view; but the definitions of 'disposal', 'purchased life annuity' and 'relevant telecommunication right' might refer directly to the ITTOIA section without also stating the Chapter and Part of the Act. This would also perhaps make it clearer that the sections referred to are those in ITTOIA. The other definitions in clause 9(5) do need to refer to the relevant Chapter and Part in ITTOIA.

**Clause 23: Meaning of "available income and gains"**

33. In clause 23(c) it might be clearer to simply refer to 'any other chargeable gains'.

34. It might also be helpful to make it clearer for the reader that the amount of income in clause 23(a) is net of attributable expenditure. This would also facilitate understanding the calculation of the 'non-exempt amount' in clause 20 (Restrictions on exemptions and in relation to s 256 of TCGA 1992).

**Clause 26: Provisions supplementary to sections 24 and 25**

35. With reference to Explanatory Notes paragraph 76 how will it be evident to the reader from the rewritten legislation that, in calculating the profit or loss from a trade, a deduction can be made for the notional market price of any goods or services provided to the charitable trust for free or at less than market value and for a proportion of any fixed overheads or costs which relate both to trading activities and to the general administration of the charitable trust?

36. Where is it provided that such deductions are to be excluded in calculating charitable expenditure or non-charitable expenditure? In particular, why should any share of fixed overheads or costs, which are actually incurred, be excluded?

37. Will the reader be obliged to refer to the Inland Revenue Guidance Notes: Technical Annex "Trading by Charities", Section G-1V 28, which may not be readily to hand, for the answers these questions?

**DETAILED COMMENTS ON DRAFTING**

**Clause 31: Approved charitable investments**

38. In 31(2), in the third line, 'or' should be 'of' (before 'tax').

TJH/PCB
20.4.05

**ANNEX**

## WHO WE ARE

The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.