CIPFA The Chartered Institute of Public Finance & Accountancy

CHARITY TAX COMMISSION:

CALL FOR EVIDENCE

Response by the Chartered Institute of Public Finance and Accountancy

June 2018

the people in public finance

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Please find attached to these cover sheets the CIPFA response to this call for evidence, presented using the Charity Tax Commission’s ‘Call for Evidence response template’.

CHARITY TAX COMMISSION - CALL FOR EVIDENCE

About the Charity Tax Commission

In October 2017, NCVO established an independent Charity Tax Commission to undertake a full review of the impact of the tax system on charities. The commission is chaired by Sir Nicholas Montagu, a former chair of the Inland Revenue, working alongside a board of six commissioners with extensive charity, economic and fiscal policy expertise. NCVO is providing secretariat support for the commission. Read more on the Charity Tax Commission website.

Rationale for a review of charitable tax reliefs

Tax reliefs for charities are estimated to be worth £3.77bn a year, the main ones being business rates relief, Gift Aid and VAT relief, while reliefs for individuals are worth £1.47bn. The last comprehensive review of charity taxation and reliefs took place over 20 years ago. Since then, the voluntary sector and the environment in which it operates have changed significantly. The sector has grown in scale and charities now do far more, including playing a bigger role in the delivery of public services. Britain's departure from the EU also presents potential opportunities to review a number of issues related to the tax treatment of charities. Against this backdrop and ongoing pressures on local authority spending and other funding streams for the voluntary sector, we believe it is a good time to do an in-depth assessment of how the tax system functions in relation to charities and what – if any – changes could help position them better to fulfil their long term strategic role in society.

About this call for evidence

This call for evidence seeks views and evidence from anyone with relevant knowledge, expertise or experience of the system of charitable tax reliefs in the UK, including charities, donors, academics, think tanks, representative bodies, accountants, philanthropy and financial advisers, tax professionals and members of the public.

In particular, we are keen to receive thoughts about the effectiveness of current reliefs, which are summarised below, and whether the existing system could be improved in order for charities to better serve their beneficiaries. We welcome all ideas about how the tax system can help to create an operating environment in which charities can maximise the public benefit they generate. Respondents should in their comments reflect the commission's determination to make practical, evidence-based recommendations focussed on increasing the efficiency and effectiveness of the current tax system. To help get a sense of priorities, we would like you to demonstrate how ideas for reform keep within the current fiscal settlement by indicating what other areas of charity tax relief or spending might be deprioritised in order to provide expenditure in other areas. The secretariat will be arranging meetings with stakeholders during the call for evidence period and will also host open sessions for interested parties in different parts of the UK. Further details will be published on the Charity Tax Commission website in due course.

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Call for evidence

The subheadings below indicate the specific areas of taxation on which thoughts would be particularly welcome, but feel free to include other relevant comments at the end. Please use the headings provided and keep your responses concise as possible: we want to keep replies to a reasonable length, and we will follow up orally for evidence that needs amplification. Where possible, provide data and/or examples to support your answers. Information that supports analysis or validates conclusions (especially lengthy information), should be included in an appendix to your main submission.

When responding, the commission would be particularly interested in receiving views on how far the current system of charity taxation succeeds in benefiting beneficiaries and what, if anything, needs to change to create maximum public benefit. We are also keen to receive views on whether the current system directs the activities of charities and encourages certain behaviour.

The purpose of charity taxation

Please use this section to provide general thoughts on the principles that should underpin the tax treatment of charities. For example, to what extent should tax reliefs be used to support charities to provide public services, to promote certain values such as voluntarism, or to encourage donations. Or do fiscal privileges amount to a grant of public money without democratic control and represent an inappropriate forgoing of tax by the exchequer?

CIPFA believes the following principles should underpin the tax system for charities and used in the development of charitable tax reliefs:

- To encourage philanthropy and public giving for the social good
- To encourage the serving of the broader social good through activities that benefit society (e.g. volunteering, recreation, and community endeavour)
- To encourage activities that have a social benefit through specific forms of not-for-profit organisations (e.g. charities and other public benefit entities)
- To encourage the provision of certain goods at affordable prices (e.g. goods and services for disabled people)

The tax treatment of charities should be firmly based in and measured against these principles. However, the system must be balanced against the following potential consequences:

- The erosion and forgone growth of the tax base
- Developing an overly disadvantageous tax treatments for for-profit commerce
- Abuse of concessions through tax avoidance
- The complexity caused by the interface which charities have to navigate to obtain these reliefs (i.e. understanding and applying the tax rules for both for-profit and not-for-profits) to avoid abuse of these concessions

CIPFA observes that no approach will mitigate all of these consequences and form the idea tax system. However, it is believed as a result of its complexity that the existing tax system is not achieving the correct balance and fails to reflect the principles set out above. The current number and nature of charitable reliefs has contributed to a complicated and intricate tax system for charities. The system is forbidding for charities to manage without support, guidance and professional advice. This limits the accessibility of charitable reliefs to the sector.

However, CIPFA acknowledges the contribution which the current tax system has made towards UK's vibrant charitable sector. Tax reliefs continue to benefit large numbers of charities that make a vital social contribution to life in the UK. This contrasts with other countries where there is no relief is available to charitable organisations potentially limiting the contribution of their voluntary sector.

The Charity Tax Commission notes the charity sector's increased role in the delivery of public services which it cites as a driver for its review of charitable tax reliefs. However, tax reliefs should not be used as a means to support charities to deliver public services. CIPFA considers that this approach takes a narrow view of the role of the charity sector: a role which extends beyond being merely a provider of statutory public services. Instead, tax reliefs should one of many factors which shapes greater collaboration between the charitable and public sector in order for them to foster the right types of partnerships in order to provide such services.

Comments on individual tax reliefs

Please use the headings below to comment on the effectiveness and efficiency of individual tax reliefs and provide suggestions for reform.

Comments offered on individual tax reliefs are limited to the most significant charitable reliefs which CIPFA believes impact on the interface between the charity and public sector in the provision of public services.

Value Added Tax (VAT)

While there is no general VAT relief for charities, a number of special reliefs, exemptions, zero ratings and concessions exist which cover many supplies to and made by charities. The current regime treats charities differently depending on the types of service they provide and whether or not they charge for their services. Those that do not charge are treated as the final consumer even when they are not. As a result, they are unable to recover VAT on purchases (input VAT) made to support their activities. Most of the charities that charge for their services are unable to recover input VAT because their services are exempt (estimated to cost £1.5bn a year). VAT relief was worth approximately £400m to charities in 2016-17.

Charities that receive funding from central or local government have to determine the VAT status of the activities that are being supported. This impacts on whether output VAT is payable by the charity on the funding awarded.

Generally, funding provided under contract is within the scope of VAT and grants are outside the scope of VAT. However, whether the funding is classified as a grant or contract is not the determining factor in establishing the funding's VAT status. There are a range of other factors which influence the VAT treatment of the funding received. Many of these are dependent on the nature of the charity and the activity being funded, as well as the specific terms and conditions of the funding agreement. As a result, the decision on whether the funding is a contract or grant for VAT purposes is subjective and open to interpretation. It is common for restricted grants and service level agreements which are similar in substance to be treated differently for VAT purposes between charities and their funders.

Although the issue is commonly encountered, it remains a complex area where the rules and application are poorly understood by charities and funders. This is partly due to the current funding environment, where agreement are often hybrids of grants and contracts (for example performance-related grants). It is also a result of HMRC's current guidance which remains poor and lacks clarity. Despite recently issued guidance now covering this area in greater detail, it is length and language means it is impenetrable to those without a thorough technical understanding of the subject.

The ambiguity of the VAT treatment of funding means that charities are recommended to assess whether funding is within the scope of VAT or not before entering into any agreements with public funders. Charities typically wish for funding to fall outside the scope of VAT to avoid having to register for VAT and/or incurring a VAT liability. This assessment will therefore influence the drafting of funding agreement.

CIPFA has believes these difficulties impacting on charities interactions with public sector. Concerns about the VAT treatment of funding adds an unnecessary element of administrative complication to the funding process. This can discourage charities from applying for funding or contract opportunities with central and local government.

This is especially relevant for smaller charities. An assessment of the VAT implications of funding is likely to require specialist advice which can be expensive. This inadvertently disadvantages those charities wishing to partner with government funders but who are unable to access the expertise to ensure they are not inadvertently exposed to a tax liability. This risks stifling smaller charities participation in the delivery of public services.

Concerns about the VAT treatment places unnecessary strain on the charities negotiations with funding bodies. Charities often aim for contracts or agreements to be drafted in particular way in order for the funds being treated either as a grant or contract for VAT purposes and to avoid any VAT liability being passed on to the charity. This can result in agreements being significantly delayed in order to incorporate such clauses, prompting strains between charities relationships with funders.

Business rates relief

Business rates are a tax on occupancy, which any charity that owns or rents a property is liable to pay. Charities receive a mandatory relief of 80% of their business rates bill. Local authorities are able to grant discretionary relief on the remaining 20% that charities have to pay, although on average they only receive a further 2.5% relief. Business rates relief was worth approximately £1.87bn to charities in 2016-17.

Business rates relief represents the single biggest tax relief for the charitable sector. Similarly, business rates remain one of the main sources of income for local authorities. CIPFA recognises that both charities and local authorities may have differing views regarding this relief. However, our overall objective is to inform this discussion and consider the impact of this relief for both stakeholder groups.

The 20 per cent discretionary element of the relief of a charity's business rates bill is partly funded by local authorities. This element is granted by local authorities on a case-by-case basis and using their own criteria. As authorities continue experience financial pressures, the maximisation of business rate collection is becoming increasingly important for the stability of their budgets. Therefore tougher choices are now having to be made by many local authorities in choosing to continue to fund this relief.

However, withdrawing the 20 per cent discretionary rate relief results in a cost which has to be borne by charities. This can raise the costs for charities providing services and lead to increase prices for those individuals and organisations purchasing these services. Local authorities themselves are impacted by this as they also purchase services from charity groups.

CIPFA acknowledges the importance of this relief for smaller charities which work flexibly and directly with those in the local community. Withdrawing this relief undermines the creation of an environment which allows these charities to thrive. This can limit the pool of organisations that local authorities will be able to work with in delivering local services, excluding small charities which may be more flexible and agile in responding to local needs than other organisations.

However, the need for local authorities to have the choice to award the discretionary element of this relief remains. These decisions should be made in the context of the authority's budgetary constraints, and will require the authority to balance the needs of the authority's community and voluntary sector with other financial priorities. Therefore CIPFA believes local authorities should continue to manage the criteria and administration of this relief.

It is observed that processing this relief is administratively simple for authorities, however, the fairness, simplicity and consistency of this process could be improved for charities. For example, the criteria for the award of discretionary rate relief should be published and easily accessible on all authority websites. The criteria should be clear and designed in a way that shows an understanding of the charitable sector. Similarly, as we expect the number of combined authorities to increase, we would expect to see consistent criteria and aligned policies for the award of this relief between councils. These changes would ensure authorities are not inadvertently creating a barrier for charities wishing to receive discretionary rate relief.

Social Investment Tax Relief

Individuals that invest in charities can receive a reduction in their tax bill to provide an extra incentive to socially invest. Social Investment Tax Relief works by reducing the income tax bill of an investor by 30% on shares they buy in Community Interest Companies (CICs) or loans that they provide to charities, CICs or community benefit societies.

SITR was designed to enable charities and social enterprises to diversify their funding base. It encourages public benefit entities to raise new investment to support their trading services through social investment. Social investment has been central to the UK government's approach to opening up public service delivery and encouraging innovation.

The relief can be used in the creation of social impact bonds, where by social investors provide the upfront capital required for a provider to set up and deliver a service set up to achieve measurable outcomes established by a commissioning authority. Social investment bonds are one option available to local authorities as they look to and seek alternative models of providing public services and delivering differently. CIPFA acknowledges that social investment bonds represent an attractive approach to commissioning public services. However, they are an approach to outcome based commissioning which may not necessarily appropriate in all situations.

Whilst CIPFA supports the principles of SITR, it understands that there has been low uptake of the relief. This trend corresponds with the low level of interest in social impact investing seen in the UK generally.

CIPFA has worked with local authorities to offer support and guidance in this area. Whilst social investment may appear attractive, authorities are not always clear on how investment models should be applied in practice. Defining 'social value' in a commissioning context is difficult, and establishing and reporting on outcomes remains challenging. SITR can benefit investors, commissioners and service providers, however, it applies to an inherently complex area and one where understanding and common practice around social investment itself is developing.

Therefore CIPFA would like to see greater support being given to commissioners and public benefit entities to explain and encourage social investment. We would recommend initiatives which help both groups to understand the mechanics and different models of social investment, as a preliminary to SITR. Without this practical support, the relief risks having a low level of uptake and failing to achieve its intended outcomes.

Transparency

The UK regime of tax reliefs can seem out of step with the general trend towards greater transparency in other countries. For example, in the USA and Canada, the government publishes data about the extent and nature of charity tax reliefs. To what extent is the public benefit from UK tax reliefs plainly visible? How can the UK system be made more transparent without increasing burdens on charities?

Whilst no specific comments are offered, we direct the Charity Tax Commission to the recent work of the All-Party Parliamentary Group (APPG) on Responsible Tax which is supported by CIPFA.

The APPG was established to contribute to the ongoing debate on responsible tax and recently discussed how Parliament can help build a transparent tax system. It made a number of recommendation in around how the UK tax system could be made more transparent globally in its report '*A more responsible global tax system or a 'sticking plaster'?*'. Whilst the report is focused on the OECD's Base Erosion and Profit Shifting process, it provides a range of principle-based recommendations for how the transparency of the global tax system could be improved.

Submitting evidence to the Charity Tax Commission

Please submit your completed forms to info@charitytaxcommission.org.uk. Please include your name, or where applicable, your organisation name in the subject line.

Please submit your evidence by 17.00, Friday 6 July 2018. Unless respondents indicate to the contrary, it will be assumed that they have no objection to their response being made public. If you have any questions about the Charity Tax Commission or this document, please contact paul.winyard@ncvo.org.uk