

## **CHARITY TAX GROUP: BUDGET SUBMISSION JANUARY 2023**

### **About the Charity Tax Group**

The Charity Tax Group [CTG] was founded over 40 years ago to make representations to Government on the impact of the tax regime on charities and it has since become the leading voice for charities on tax matters. Through working with officials in HMRC, CTG strives to make recommendations to improve the fiscal environment for charities. CTG is also keen to work with officials to ensure that the administration of the tax system is as simple and effective as possible and that appropriate guidance is developed, thereby helping both charities and officials.

### **Background to our submission**

We are very conscious that the economy and the public finances are under considerable strain and that this may not be perceived to be the best time to make a submission asking for changes in the tax regime that will have an adverse effect on revenues. However, the voluntary sector itself is under severe financial pressures and yet is trying to ensure that it can maximise the contribution that it makes to the wider community, either by helping people who are themselves experiencing financial hardship or by providing a range of services that are vital to the wellbeing of society as a whole. We fear that not supporting this vital work will only result in diminished public services that will have a long-term financial cost far beyond the fiscal cost of measures we propose now.

The contribution of the sector encompasses a wide range of activities: education, scientific and medical research, support for vulnerable or disabled people to name but three. We would argue that supporting the sector is not only in the interests of society as a whole but also in the interests of maintaining a healthy economy and functioning health and care services: the NCVO suggests that in 2021/22, the sector contributed £20.2 billion to the UK economy. We would also note that, under the current regime of reliefs for charities, about £500 million of Gift Aid repayments goes unclaimed every year – a figure which, we hope, would give HM Treasury a certain amount of headroom when looking at our proposals.

We would welcome the opportunity to discuss our proposals in more detail and would be happy to provide further information if required.

## **1. Future of Gift Aid Project**

### ***Proposal: For the Government to provide investment to realise the aims of the Future of Gift Aid Project***

The current Gift Aid system was introduced at the turn of the century. It was largely introduced as a paper-based scheme and is in need of urgent reform to make it fit for purpose for the digital age and to recognise the impact of new payment methods. A number of Gift Aid tax reliefs also require modernisation and simplification. We strongly believe in the importance of future-proofing the tax system. As a result, CTG has developed a cross-sector “Future of Gift Aid” project in which charities, HMRC and businesses are collaborating to use technology to reduce the nearly £200 million of relief that is claimed in error each year and to maximise tax reliefs that currently go unclaimed. The aims of the project are entirely consistent with the Government’s intentions of moving to a digital tax system. We have previously submitted a Budget representation that calls for specific investment in this project and we again urge that action be taken on this. We hope that with Government support, we can work with HMRC to modernise this important relief.

## **2. Irrecoverable VAT**

### ***Proposal: Introduction of a lower VAT rate on purchases made by charities***

Irrecoverable VAT has always been a serious problem for the voluntary sector. Because charities cannot always pass on the cost of the VAT on the goods and services that they purchase, they are unable to reclaim the input tax in full. The result is that they are obliged to pay the irrecoverable VAT out of their charity funds instead of using those funds for their charitable purposes. This is no small matter: research commissioned by us from London Economics in December 2020 estimated the burden of irrecoverable VAT at £1.8 billion annually and we estimate that the figure is probably now over £2 billion.

We appreciate the steps taken by the Government to provide relief in certain areas by introducing VAT refunds via relief under s33 of the VAT Act. However, this does not address the problem facing many other charities which do not qualify for such relief despite also providing essential services. Our contention is that the best way to resolve this long-running distortion would be to introduce a lower VAT rate on purchases made by charities: this would be a simple and effective solution and would give the Government the reassurance that it could control the level of assistance given to the sector. For example, setting a charity purchase rate of 10% would reduce the VAT burden by £1 billion. If it were 15%, the cost would be £500 million and so on. If the standard rate needed to be increased in the future, this arrangement, if already established by that time, could allow such an increase not to be imposed on charity purchases.

Given the current financial climate, we appreciate that this may not be a top priority for Government, but we urge the Government to set up a formal dialogue with the sector about finding a solution to this issue and to explore our proposal in more detail. Not to do so reduces the sector’s ability to reinvest in providing much-needed services and, in some cases,

jeopardises the existence of some charities which are struggling to find the extra 20% needed to pay their VAT bill.

### **3. Relevant Charitable Purpose for charity buildings**

***Proposal: Restore the original intention of, and impact of ‘Relevant Charitable Purpose’ so that charity buildings can be utilised more efficiently without the burden of irrecoverable VAT***

The steady and inexorable erosion of the scope and application of Relevant Charitable Purpose [RCP] is a matter of considerable concern to the charity sector, as we explain below. We strongly advocate allowing the RCP reliefs to apply where the use is solely for primary purpose activities. This would align RCP with the direct tax exemption for primary purpose trade, thus significantly improving simplicity and consistency between the charity tax regimes. Since it is now possible to adapt VAT rules to fit our domestic UK arrangements, this (along with other rationalisations of conflicting tax/VAT positions) should be treated as an important priority.

The background is this: since 2016, the effective scope of the definition of RCP has become severely limited because it is based on the definition of “business”, which itself is based on the EU concept of “economic activity”. This has replaced the longstanding reliance on what have been called the “Lord Fisher tests”, which gave more scope for charities potentially to qualify as carrying out RCP activities, particularly by reference to the then criterion applicable to a charity whose activity was “predominantly concerned” with something other than the making of supplies for a consideration.

It seems clear that, as a consequence, the original intention behind the RCP definition has been subverted. We propose that consideration be given to a new definition of RCP to restore the original intention of this important relief, the value of which has diminished considerably.

For the most part, a definition simply based on the primary purpose activity of the charity would be a satisfactory replacement. This has the merit of aligning the VAT relief definition with the comparable direct tax charity exemption. It is therefore also based on a definition under charity law which is widely recognised and can therefore be applied without the need for considering completely new concepts.

We acknowledge, however, that this would cause a significant increase in the breadth of the definition that originally applied, and that there may be certain ‘unintended consequences’ which could discourage Government from taking this step. It is, of course, possible to create a general definition from which exceptions are carved out. We do not wish to put forward these exceptions, because CTG represents the entire charity sector. Nonetheless, we make this point to demonstrate that the adoption of this definition does not automatically lead to problems if government chooses to apply certain exceptions.

Alternatively, the original scope could be simply reinstated by virtue of changing the ‘otherwise than business’ criterion into one that reflected the main Lord Fisher test which has been impugned. So long as the activity is predominantly concerned with providing services of a charitable nature to the public, and not predominantly concerned with generating revenues, this is sufficient to form the basis of RCP qualification. There is no obligation, now that the UK is no longer in the EU, to apply EU principles or to be limited in the scope of zero/reduced rates applicable for social purposes.

Separately, we believe that the deemed self-supply often referred to as the “claw back”, if a charity starts to use a zero-rated relieved property for non-qualifying purposes in the 10-year period, ought to be entirely remodelled so that there is no cliff-edge liability. It should be based instead on the principles governing the capital goods scheme [CGS]. The current position is entirely disproportionate, and particularly disastrous where mistakes are made. A system analogous to the CGS would be far more balanced and would provide a great deal of help to many charities.

#### **4. Partial Exemption**

##### ***Proposals:***

##### ***Expand / amend the Partial Exemption (PE) ‘Standard Method’ to:***

- ***include non-business income***
- ***allow operating units to use separate PE cost centre calculations.***
- ***treat all input VAT as residual where turnover is below a specified threshold***

##### ***Introduce customer flexibility to amend their Special Method, within defined limits***

CTG has already made detailed representations in regard to the partial exemption rules when responding to the Government’s call for evidence issued in connection with the proposed simplification of the rules.

CTG accepts that simplification has benefits, but it does not accept that the benefits of simplification override the increased fiscal costs for charities, or for particular sectors of the charity community. However, there are some simplifications that would not involve additional fiscal costs.

There should be an option for charities to expand the current standard method for partial exemption so that it automatically includes non-business activity, on the basis that non-business income (where that acts as a genuine proxy for the value/scale of non-business activity) can be treated as non-taxable income, and thus included in the same category as exempt income, just as it is with a partial exemption special method as negotiated under the combined method rules. This should be permissive and not mandatory.

The standard method should be expanded to allow for separate operating units to be treated as separate cost centres for partial exemption calculations such that the turnover from each

separate operating unit is used solely in determining the apportionment of costs which are particular to that operating unit. At the moment, this is only available as a suggested special method via discussion with HMRC, but we suggest it become an allowable form of standard method.

One of the key complications of partial exemption methods is the categorisation of costs as between directly attributable costs and apportionable costs. We suggest allowing taxpayers below a certain level of turnover the option of applying the standard method by treating all input tax as residual (and where the non-business aspect applies, all VAT on purchases to be treated also as residual). Perhaps this threshold could be set at £500k turnover per year.

Where there is the need for a special partial exemption method, we suggest that it be possible to apply for an adaptation to the standard method, without risking HMRC seeking to apply a more full-blown different methodology as part of the special method negotiations. The taxpayer should have the right to determine an aspect which is special, leaving the remainder under the usual standard method conditions.

Where a charity already has a special partial exemption method, it should be able to suggest changes to aspects of that method without HMRC seeking to renegotiate the method entirely.

Where HMRC is able to develop a sector-related template method, it should be possible to adopt this without negotiation with HMRC. As mentioned in our previous submission, for such sectoral methods to prove successful, considerable care must be exercised in their formulation, and the more information and detail that is present in the method, the more likely it is to fulfil its purpose.

Separately, a useful administrative change would be for HMRC to accept that rounding up to the next 1% is acceptable within a business/non-business methodology, following partial exemption rules.

## **5. VAT**

### ***Proposal: Extend existing VAT relief on advertising to social media advertising***

HMRC has previously accepted that VAT zero rating could apply to most digital advertising by charities, with the exception of advertising on social media, on the basis that it targets individuals by a digital address. CTG does not believe that this limitation is necessary and has obtained legal advice confirming that the sector has a strong case. This is a clear example of a relief which, as with Gift Aid, needs modernising to ensure that it supports the original intention of the relief: to ensure that charities do not pay VAT on advertising. Given the growth of social media advertising year on year, it is important that legislation and HMRC guidance keeps up with commercial practices and is appropriate for the digital age. The resistance to modernising this relief is costing charities millions of pounds in additional VAT.

## 6. VAT relief on Charitable Donations

### ***Proposal: VAT relief for goods gifted to support people in need***

CTG believes that there should be a relief on all gifts of goods to charities for any charitable purpose including use within the charity. We recognise that this would be a significant expansion of the current relief so, in the current fiscal climate, we are supporting the limited proposal made by others to extend the existing VAT relief to include all goods donated to charities where the goods are used for the direct support of people in need. In 2021, between 16% and 20% of the population was assessed to be living in poverty and this figure is believed to have risen significantly due to cost-of-living increases. This relief could therefore make a marked difference to the ability of charities to help those most in need at a time when there is limited other support available.

## 7. VAT relief on Listed Places of Worship

### ***Proposal: Replace the cumbersome Listed Places of Worship Grant Scheme with a more straightforward exemption or zero rating for relevant repairs etc.***

The Listed Places of Worship Grant Scheme (LPWGS), first introduced in 2001, refunds the VAT applied to repairs, maintenance and alteration works to listed places of worship. It was designed in the way that it was because it was not possible under the terms of the Principal VAT Directive simply to exempt repairs to listed places of worship from VAT or to introduce a zero-rate of VAT on the costs – hence the slightly cumbersome system of matching grant. The Principal VAT Directive is no longer relevant to UK VAT law, and we support the proposal that the Scheme be replaced by introducing zero-rating of repairs to listed places of worship instead of the current matching grant. Indeed, we would argue that listed building alterations and renovations of unused buildings of all kinds should be zero rated or reduced rated where the proposed use of the building is RCP.

## 8. Other VAT measures

### ***Proposals: Introduce a Zero rate on:***

- ***charity care sector fees***
- ***supplies of goods and services connected with the removal of dangerous cladding***

The following measures would help target specific acute needs where charities are providing vital services directly and, in one case, where they are treated less favourably than commercial suppliers.

Notwithstanding our call for a wider review of the irrecoverable VAT problems facing charities, we want specifically to argue for the following measures:

- There is an acute need for more care facilities in the UK and yet charities are having to pay 20% in VAT on the costs of providing these services – costs which are

reimbursed to public sector care facilities. We contend that charity care sector fees should be zero rated to allow input tax recovery.

- Given the huge costs involved and the urgent need to tackle the problem of dangerous cladding, we urge the Government to allow housing charities to certificate zero rated supplies of goods and services connected with removal of this cladding.

**Charity Tax Group**  
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