



CHARITIES TAX COMPLIANCE

Issued 18 July 2023

ICAEW welcomes the opportunity to comment on the Charities tax compliance published by HM Revenue & Customs on 27 April 2023, a copy of which is available from this [link](#).

For questions on this response please contact ICAEW Tax Faculty at taxfac@icaew.com quoting ICAEW REP 70/23.

This response of 18 July 2023 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the ICAEW Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business. ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark the tax system and changes to it, are summarised in Appendix 1.

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For clarity ICAEW responses are set out in the numbered paragraphs. Unnumbered paragraphs replicate wording from the consultation document.

KEY POINTS

1. The majority of charities and non-profit entities do not want to see abuse of charity tax reliefs. It is important that any reforms of the charity tax rules are proportionate to the tax avoided, given that changes will affect the future running of all charities and CASCs. We would caution against reforms that make it more difficult for volunteers to undertake key charity roles, eg, additional administration, as charities already struggle to recruit qualified volunteers. Additionally, donors may be more reluctant to make legitimate donations if tax rules affecting donors are overly onerous or present uncertainty.
2. Much of the abuse of charity tax rules that HMRC seeks to reduce may be addressed by increased education for the charity sector, in particular for charities that do not engage an accountant or tax advisor. Additional guidance from HMRC, in particular in relation to completion of the CT600E, is needed to help charities correctly complete their tax returns.
3. HMRC may wish to explore introducing an annual declaration or checklist to engage charities on a yearly basis when a full tax return is not required. This would help increase compliance and oversight on a more regular basis. Any such requirement should be designed to be simple and understandable to non-technical staff or volunteers, to minimise the additional administrative burden that such a declaration or checklist would present.
4. HMRC already has considerable powers to raise enquiries into charity tax returns and to impose penalties where tax returns are late or contain errors. Charities are also regulated by the Charity Commission, which adds another layer of oversight to their running. We would not consider giving HMRC additional powers proportionate to the scale of the issue it seeks to counter. While such powers would initially be granted to police a sub-section of charities who fall foul of tax rules, those powers would nonetheless affect the whole charity and CASCs sector. It would be onerous for charities to potentially lose their charitable reliefs due to late filing of tax returns, especially where this affects smaller charities that may lack the knowledge and resource to make timely filings. We consider that compliance can be adequately encouraged through the powers that HMRC already holds and could be furthered through educational means.
5. Any reforms must be developed in conjunction with policy on Making Tax Digital for Corporation Tax, given that it is anticipated that charities will be within its scope.

GENERAL POINTS

6. ICAEW supports HMRC's efforts to counter tax avoidance. However, it is unclear from the consultation document to what extent the current anti-avoidance rules are being abused. Without this information it is difficult to assess whether the proposed reforms to charity tax rules are justified. We have heard from members that charities are already struggling to recruit and retain qualified volunteers and trustees to enable the running of the charity. The vast majority of charities are trying to do the right thing and do not engage in wilful abuse of the charity tax rules. We would caution against any changes that risk making it harder for volunteers to undertake key charity roles, eg, treasurer or secretary. Therefore, we urge HMRC to update provisions and procedures in a manner proportionate to the amount of tax avoided. Any additional administration will be burdensome on the whole charity and CASCs sector. There is a risk that policy changes intended to improve tax compliance could dissuade volunteer engagement, leading to reduced compliance and moreover damaging the vital role that charities play in society. Changes to the anti-avoidance rules for charities may

also have an impact on exempt entities within the scope of the charities legislation, eg, housing associations, educational institutions and museums.

7. Much of the perceived non-compliance with charity tax rules may be resolved through increased education for the charity sector, in particular for charities that do not engage an accountant or tax advisor. Comments from our members express the view that there is a lot of misinformation regarding charity tax status, and the associated filing requirements. A lot of non-compliance in the sector is likely to stem from misunderstanding of tax rules and obligations, rather than deliberate behaviour. This is especially due to the number of charities that rely on volunteers who do not necessarily have finance or tax knowledge. Additional guidance from HMRC would help charities correctly complete tax returns.
8. We have not responded to all questions in the consultation document.

ANSWERS TO SPECIFIC QUESTIONS

Preventing donors from obtaining a financial advantage from their donation

Question 1: Do you foresee any unintended consequences on legitimate charities from introducing this rule?

9. It would be preferable to explore how abuse of charitable giving rules could be dealt with within the boundaries of existing tainted donation rules (ie, Option 3) instead of introducing new rules. The tainted donation rules were introduced after extensive and careful consultation with the charities sector, donors and professional bodies and are broadly considered fit for purpose. Introducing new rules would create uncertainty for both charities and donors and may dissuade donors from donating if they are worried about potentially being penalised under new rules.

Question 2: Do you foresee any significant challenges for charities to maintain appropriate records of any arrangements, such as substantial loans, they make?

10. This would add an administrative burden for charities, as this work would in most cases fall to volunteers. Charities would also need to navigate HMRC record keeping requirements against the backdrop of General Data Protection Requirements (GDPR), which may expose charities to additional risk of penalties from one of these regimes in pursuit of compliance with the other.

Question 3: Do you foresee any unintended consequences on legitimate arrangements from changing the rules in this way?

11. No response.

Question 4: Do you believe proposed changes to the current wording would achieve our objectives or do you believe there will still be room for abuse?

12. Removing Condition B, as in Option 2, would widen the scope of the tainted donations rules such that they may potentially apply to any donation. This would bring the provisions back to a 'catch-all' position, as in the previous substantial donor legislation that the tainted donations rules replaced. This wider scope would be overly onerous for charities to navigate and would potentially dissuade legitimate donors from making donations due to uncertainty of how their donation would be treated by HMRC.
13. As set out in Para 9 it would be preferable for HMRC to work within or amend the existing tainted donation rules per Option 3. This option would provide constancy in the rules, while allowing a wider scope for HMRC to counter tainted donations. However, changing the

wording of 'financial advantage' without providing additional definition may, in time, present the same issue that HMRC are currently trying to counter, ie, that the interpretation of the phrase is too narrow to stop perceived abuse of the rules.

14. Alternatively, for HMRC to challenge arrangements more effectively, a definition of 'financial advantage' could be added to provide more flexibility and clarity regarding what it applies to. This could be worded in such a way as to set out what 'financial advantage' may include without being limited by any such list.

Preventing abuse of the charitable investment rules

Question 5: Are there any circumstances where a charity may need to make an investment or loan for reasons other than benefitting the charity?

15. Most charities make investments for the benefit of the charity. However, those investments may serve multiple purposes, some of which may not directly benefit the charity. For example, a charity may purchase an investment property with the intent to realise a long-term capital gain; the charity may also allow charity trustees to use that property as a holiday home. If amending the current rules, it must be considered that, though there may be non-charitable use for an investment or loan, there may be another charitable purpose that it fulfils, though this may be difficult to quantify. Although there may be a benefit to a donor or trustee, an investment or loan may provide a greater benefit to the charity at large due to this. In this way, HMRC may perceive mischief where, from the charity's standpoint, none exists.
16. The Charity Commission is responsible for regulating charities, part of this being ensuring that they are investing their funds for charitable purposes and taking enforcement action where this is not the case. It therefore seems a partial duplication of duties for HMRC to also check that investments are made for the benefit of the charity.

Question 6: Do you foresee any significant challenges retaining records and documents to justify, if requested by HMRC, the investment decision process and demonstrate how the investment benefits the charity?

17. We question whether records and documents need to be retained for all Type 1 to 11 investments, as some classes of investment present less scope for risk than others. We suggest that HMRC considers each type of investment discretely, and imposes a statutory requirement to retain records only where a specific risk is identified.
18. Requiring charities to retain records and documents would increase the administrative burden for charities. This would likely impact smaller charities more than larger ones, as they may lack adequate resource or may have a higher turnover of volunteers.
19. If this change is made, clear guidance must be provided regarding records and documents to be kept for each type of investment. Each class of investment should be considered on its own merits and HMRC should only ask for records and documents to be kept where they are specifically relevant to that class of investment, to help ease administrative burdens for charities. HMRC should also provide guidance of what is, in HMRC's opinion, broadly accepted usage of each asset class.
20. We note that HMRC does not propose that a claim would need to be made for Type 1 to 11 investments. This is sensible given the additional administrative burden on both HMRC and charities that would be created by both making and checking the claims.

Closing a gap in non-charitable expenditure rules

Question 7: Do you agree that it is rational and proportionate to review ways to close the tax gap here? If not, please provide reasons why?

21. Regarding a review of the definition of 'attributable income and gains', we note that HMRC perceives that there should be tax due on income that does not qualify for a tax exemption, in suggesting that this income should be included within the definition of 'attributable income and gains'. Seeing that this income may not benefit from tax relief in the first place, and may not be subject to tax by virtue of a number of other provisions (eg, falling within a deceased person's estate nil rate band), we question whether HMRC is correct to assert that tax is due on this income. HMRC's argument for its inclusion should be justified in more detail before reforms are made in this manner.
22. As more widely commented on in Para 6, it is unclear to what extent HMRC is seeing abuse of the non-charitable expenditure rules. Without further detail, it is difficult to see that extending the record keeping requirements to over 6 years would be a proportionate action to counter abuse.
23. Regarding a review of the 6-year carry back period, we would consider that any extension further than 6 years would move the charitable giving rules out of alignment with other record keeping requirements for tax purposes and be a disproportionate response to the perceived problem.
24. The 6-year time limit for keeping records is well known throughout tax and accounting, and is also understood by non-technical individuals. Given that many charities are run by volunteers, extending the 6-year time limit would increase the scope for misunderstanding and error. This may potentially expose charities to additional penalties where new rules are not fully understood.
25. Extending the 6-year carry back period would increase the administrative burden on charities, as additional records and documentation would need to be kept.

Sanctioning charities that do not meet their filing and payment obligations

Question 8: What are the barriers to some charities not filing tax returns when requested to?

26. We have heard from members that there is a persistent misunderstanding that charities are not subject to tax and therefore do not need to file tax returns. As many smaller or unrepresented charities are staffed by non-technical individuals, often they are not aware of the obligations that the charity must comply with if faced with a notice to file. There is also often high staff turnover. A charity's finance function may not realise that a tax return was due to have been filed until the charity is faced with penalties.
27. Newly formed charities may particularly not be aware of their filing obligations or may have difficulty accessing the relevant accounts and documents on a timely basis in the first year.
28. Greater education is needed in the charity sector to improve compliance in filing tax returns. This could be in the form of improving guidance or increasing proactive communication with charities through charity umbrella bodies.
29. Members have commented that HMRC does not consistently apply the same tax return requirements to charities. Some charities are given notice to file a tax return annually, while others are given notice only once every few years on a regular or irregular basis. This makes it more difficult for charities, many of which have a high turnover of staff or volunteers, to track their tax return obligations.
30. It would be helpful if charities were able to understand HMRC's policy regarding the frequency of returns required from a charity, eg, whether this is driven by risk profile, size

etc. Increased transparency may help a charity to plan appropriately for completing its tax returns in the face of ad hoc notices from HMRC and staff turnover.

31. It might also help charities to track their compliance if HMRC applied a more consistent approach, eg, letting a charity know in advance that it is required to file tax returns regularly once every certain number of years. This may give the charity certainty over which years of tax returns are required, and new staff or volunteers would be kept informed appropriately. However, this may also increase administration required by the charity.

Question 9: Do you think that this would adversely affect the operations of charities or CASCs and what might be the consequences of this?

32. HMRC already has considerable powers to require tax returns to be filed, as well as a widely understood penalties system for late or non-filing, including significant penalties for deliberate non-filing of a tax return. Additionally, charities are required to submit an annual return and, in some cases annual accounts, to the Charity Commission or other equivalent bodies. We consider that there are already authoritative bodies with regulations and requirements that charities must comply with. As such, giving HMRC additional powers to withhold payments of gift aid and disapply other tax reliefs seems disproportionate in light of the behaviour it is trying to counter.
33. If additional powers were given to HMRC, this would require additional resource for tax inspectors to check the compliance of charities and enforce sanctions against them. Given current service standards across HMRC, with many services being negatively impacted by staff cuts, we would also question whether it would be a good allocation of resource by HMRC.

Question 10: How should changes be targeted to ensure they encourage charities to meet their obligations to file a tax return when required to do so – for example should small charities be treated differently to larger ones?

34. If reforms give HMRC more powers to withhold or disapply tax reliefs, these powers should only be enforced once all other options have been exhausted. As commented on in Paras 26 to 28, a lot of non-compliance is driven by a lack of comprehension of charity tax rules and obligations.
35. For smaller charities we suggest that HMRC should make every effort to proactively communicate with the charity to help them understand their obligations, prior to implementing any sanctions.
36. Larger charities are more likely to file tax returns on an annual basis and are more likely to have a trained finance function or engage an agent. Therefore, a failure to file a tax return is less likely to stem from misunderstanding. In this case we consider that it would be reasonable for sanctions to be applied with less prior attempted communication with the charity.

Question 11: How would it be best to educate the sector about any new rules ahead of their introduction?

37. As mentioned in Paras 7 and 28, a comprehensive education campaign would go a long way in improving compliance with the tax rules among charities, whether or not new rules are introduced.
38. If new rules are introduced, charities should be informed well in advance of those new rules coming into effect so that they have as much opportunity as possible to rectify any failures. It is important for HMRC to consult with charity umbrella groups to understand how to proactively engage with charities regarding reforms.

Other related issues and questions

Question 12: Are there any changes which could be made to the charity and CASCs regimes which would ease the burden on the sector?

39. Members have expressed that the biggest contributor to non-compliance in the charity sector is ignorance and misunderstanding of the tax rules and filing obligations to which charities are subject. This particularly affects small charities, which are more often staffed by volunteers, and new charities that may not be familiar with processes and requirements. To improve understanding, new charities could be issued a starter pack explaining tax and reporting obligations. This could be produced by HMRC or in conjunction with the Charity Commission.
40. We have heard from members that where charities are aware of the need to do a tax return, there is confusion over how the CT600E form should be completed, even among professionals. The CT600E requires details of balance sheet and other technical items that non-technical volunteers or staff may struggle to understand. The existing guidance for completion of the CT600E frequently refers readers to legislation, which is similarly difficult for non-technical individuals to interpret. This guidance should be improved and expanded to help charities fulfil their compliance obligations correctly.
41. Instead of requiring a charity to complete a tax return in some years on an ad hoc basis, and no returns in other years, HMRC could implement a new annual declaration or checklist in years in which a full tax return is not required. Such a declaration or checklist should be simple to understand and complete for a non-technical user. This could incorporate statements confirming that the charity has only made investments for the benefit of the charity, as well as covering other areas of perceived risk. The Charity Commission already requires an annual declaration, and HMRC may wish to explore whether there is scope for declarations to be combined. This would help engage charities with an annual tax compliance process and keep up a regular filing in years in which a full tax return is not required.
42. Alternatively, a more wholesale review could be conducted of the tax return forms required for charities, ie, the CT600E. Feedback from members indicates that this form is too complicated for the purpose that it seeks to fulfil for HMRC, and that very few enquiries are raised following tax return submissions. A more streamlined form for smaller charities, with sections to address high risk areas, may be more appropriate. This may help to save time for both charities filling out the forms and HMRC in reviewing them.

Question 13: Will any administrative or other burdens be created if any of the above measures are introduced? If so, what are they?

43. No response.

Question 14: What are the estimated costs of any additional burdens?

44. No response.

Question 15: Are there any other points you would like to raise or suggestions you would like to make to improve compliance in the Charity or CASC sector?

45. Any reforms must be developed in conjunction with policy on Making Tax Digital for Corporation Tax, given that it is anticipated that charities will be within its scope.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <https://goo.gl/x6UjJ5>).