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Legal update ——— March 2015

Charity
Charity tax planning

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In the current climate of heightened public awareness of how our High Street businesses arrange their tax affairs, particularly in the international arena, it might be tempting for charity trustees to adopt a cautious approach and take no action to minimise the charity's tax exposure. Is this the right strategy?

A recently published policy paper from the Charity Commission explains that such a defensive strategy is not in fact the correct approach in the context of the trustees' duty towards the charity.

In broad terms, the paper makes the point that the duty of trustees makes it appropriate for them to engage in "reasonable and prudent tax planning" and to "take advantage of available statutory tax reliefs". In addition, trustees "may properly seek to organise their charity's affairs when carrying out particular activities or transactions in a way which minimises the charity's liability to tax."

This begs the question as to what is "reasonable and prudent tax planning". The paper explains that this could involve "structuring transactions to make the best use of relevant tax provisions that apply to charities, companies and individuals. For example, charities will often undertake trading activities through wholly owned trading subsidiaries and gift aid some or all of the profits of the trade to the parent charity to fund the charity and reduce the subsidiary's exposure to corporation tax."

Another example of "reasonable and prudent tax planning" given in the paper is structuring transactions so as to minimise VAT costs for the charity. Many charities suffer significant VAT costs in carrying out their activities, so it is helpful to know that HM Revenue & Customs (HMRC) will not instinctively look to undermine planning around this.

We set out some examples below of what we believe to be "reasonable and prudent tax planning":

- The use of a trading subsidiary which gift aids its profits to its parent charity to mitigate corporation tax, for example to undertake open market property transactions
- The use of a group construction company and shared services vehicles to mitigate VAT costs
- Tax efficient joint venture structures, for example limited liability partnerships
- Tax efficient exit routes from commercial transactions, for example via a trading subsidiary.

But at some point, at least according to HMRC, reasonable and prudent tax planning becomes unacceptable tax avoidance, and this will be challenged by HMRC. The Charity Commission paper includes some examples, such as manipulation of the gift aid and business rates regimes by undertaking artificial transactions in which "any benefit to the charity [is] a by-product of the scheme rather than its principal aim". HMRC defines unacceptable tax avoidance as follows:

"..bending the rules of the tax system to gain a tax advantage that Parliament never intended. It often involves contrived, artificial transactions that serve little

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or no purpose other than to produce a tax advantage. It involves operating within the letter - but not the spirit - of the law."

The paper also reminds trustees that engaging in unacceptable tax planning is highly likely to result in reputational damage to the charity. For example, in the context of Registered Providers, the attitude of the Homes & Communities Agency must be also be borne in mind.

Another potential consequence of HMRC successfully challenging unacceptable tax planning is not only having to pay interest and penalties on tax, but also possible breach of loan covenants.

Where does this leave trustees? In broad terms, their duty towards the charity requires them to act in the best interests of the charity. This can be done in many ways, including minimising the charity's tax costs. In order to achieve this, trustees should undertake "reasonable and prudent tax planning". What is "reasonable and prudent" in this context is a matter of judgement, there is no hard and fast rule, but the Charity Commission paper includes helpful guidance in this area. Trustees must be careful not to cross the line into unacceptable (at least according to HMRC) tax avoidance.

What trustees must not do is take the view that a charity should not engage in any kind of tax planning, no matter what. This would be a breach of the trustees' duty towards the charity.

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