

## Tax Relief for Gifts To European Charities

### Introduction

UK tax law provides a number of reliefs and exemptions connected to charities.

For example, the Gift Aid scheme allows donations to be deducted from pre-tax income (and further benefits); gifts of capital assets may be treated as being at no gain and no loss; and gifts to charities are also exempt from inheritance tax.

However, all of these reliefs are available only where the charity in question is resident in the United Kingdom. For income tax purposes, a ‘charity’ is any body of persons or trust established for charitable purposes only: Income Tax Act 2007, section 989. Previous incarnations of this provision have been held to refer to charities established in the United Kingdom only: *Camille and Henry Dreyfus Foundation Inc. v. Inland Revenue Commissioners* [1956] 1 A.C. 39, concerning section 37(1)(b) of the Income Tax Act 1918. The legislation relating to capital gains tax gives no particular definition, but HMRC apply the same exclusion of foreign charities. The inheritance tax legislation expressly adopts the income tax definition of ‘charity’: Inheritance Tax Act 1984, section 272. HMRC’s view is that, accordingly, the case-law as to the meaning of ‘charity’ for income tax purposes applies by analogy in the field of inheritance tax: see Inheritance Tax Manual, page IHTM11112.

So far as this means that donations to charities established in other EU Member States (‘EU charities’) do not attract the various charitable reliefs, this is contrary to European law. This point has been made before (see, for example, Kessler and Kamal, *The Taxation of Charities*, 6th edn, 2007, at paragraph 1.12.1). In 2006 the European

Commission sent a reasoned opinion (a pre-litigation communication, anticipating an action raised by the Commission against a Member State for infringement of EU law) to the United Kingdom complaining about the restriction on charitable reliefs. The United Kingdom has not amended the relevant provisions. It is clear from its submissions to the European Court of Justice in the case considered below that it thought them not to be in breach of European law. Although no action has been raised by the Commission, the position has recently been made clearer, and some details of it fleshed out, by a decision of the European Court of Justice.

***Persche v. Finanzamt Lüdenscheid***

Case C-318/07 *Persche v. Finanzamt Lüdenscheid* (unreported, but available at [http://eur-](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62007J0318:EN:HTML)

[lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62007J0318:EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62007J0318:EN:HTML))

concerned a German national who donated various items to a charitable retirement and children's home in Portugal. Had the donation been to a charity established in Germany, Mr Persche could have deducted its value from his taxable income for the purposes of German income tax. But because the home was established in Portugal, a tax deduction was refused.

The Court of Justice held that (i) where a taxpayer claims a tax deduction for a gift to a charity established, and recognised as charitable, in another Member State, the provisions concerning free movement of capital are engaged, and (ii) those provisions preclude Member States from legislating to the effect that gifts to charities may be deducted for tax only if those charities are established in the relevant Member State, without the taxpayer being given an opportunity to show that a gift to a body established in another

Member State satisfies the requirements imposed by the home State's legislation for a tax deduction.

Some comment is required on the decision.

First, it is crucial to note that the foreign entity must be recognised as charitable in the Member State in which it is established. But the taxpayer's Member State need only allow deductions if its own legislative conditions (apart from as to the charity's residence) are satisfied. So the taxpayer is entitled to a deduction if and only if, were the entity established in his own Member State, it would there be recognised as a charity too (at one point the Court of Justice refers to its being merely 'likely' that the entity would satisfy the taxpayer's State's test for charity (paragraph 49), but it seems clear that the national court would simply have to decide whether or not it would satisfy the test: see in particular paragraph 63). So there is a double test, and the more restrictive regime will determine whether a body is charitable. Apart from anything else, this overcomes the United Kingdom's argument that UK and foreign charities are not in comparable situations because different legal systems apply different tests of benevolence. Any gift by a UK taxpayer to a foreign charity will not attract tax relief if the foreign entity does not satisfy the UK test for charity.

Second, *Persche* concerned donations of goods (in fact, a mix of bed linen, towels, zimmer frames and children's toys). The Court of Justice makes it clear that so far as Community law is concerned, it matters not whether the donation involved is cash or goods.

But if a Member State restricts an existing tax relief to cash payments only, the Court's decision does not require it to extend the relief to donations of goods. The Court clearly

based its decision on a difference in treatment dependent on residence, rather than the substantive content of the German rules (paragraphs 46 ff.). So the United Kingdom could not be required to extend Gift Relief to cover donations of goods, nor to extend the income tax relief relating to gifts of shares, securities or land to other non-cash assets. Moreover, it is clear that donations consisting of services (for example, legal advice) do not fall within the provisions the Court relied upon, namely those relating to free movement of capital (Article 56 EC). But they might well engage the freedom to provide services (Article 49 EC), and the same result would probably be achieved. Equally, there again does not appear to be any tax relief in the United Kingdom for a donation that consists in services, and the rules on freedom to provide services would not constrain the United Kingdom to create such a relief.

Third, the issue of evidence arises. The Court of Justice made it clear that the taxpayer's Member State can require him to provide adequate evidence to show that the foreign entity satisfies the applicable requirements (paragraphs 54 ff.). The evidence a taxpayer may be required to produce includes documents that would emanate from the EU charity. These might be, for example, its certificate of establishment, its constitution, annual reports and accounts, and any certificate of charitable status issued by its own Member State.

The question arises as to what happens when the taxpayer provides evidence that HMRC considers insufficient to establish the EU charity's status. The Court of Justice merely says that it is for Member States to determine, case-by-case, whether the information supplied by the taxpayer is adequate, and whether this justifies submitting a request to the charity's home State pursuant to the tax information exchange directive (paragraph 65).

The Advocate-General gives some more detail on this. He suggests that the taxpayer's Member State can simply refuse to allow the relief, but should consider whether the taxpayer has made enough of an effort to obtain the necessary information and, if he has, should generally use the means provided by the Directive to try to obtain what is missing, before refusing a deduction (paragraph 112, and the answer to the third question). So in practice what seems to be envisaged is that, for example, a UK taxpayer seeking tax relief for a donation to an EU charity should ask the charity for all the relevant information, and should provide the information he receives, with a copy of his request, to HMRC when claiming the relief. HMRC then has to consider whether the information is sufficient and, if not, should probably give the taxpayer a further opportunity to provide more. If thereafter HMRC thinks that the information is insufficient and the taxpayer has not tried hard enough to obtain it, relief may be refused. But if the taxpayer has at least made a serious attempt to obtain the relevant information, HMRC will probably have to request the charity's home Member State for assistance under the Directive. If that procedure does not produce adequate information then relief can be refused.

Equally, it should be said that the Court put its Judgment in fairly vague terms on this point: its answer to the German court's questions was simply that Community law precluded legislation which denied tax relief, 'without any possibility for the taxpayer to show that a gift made to a body established in another Member State satisfie[d] the requirements imposed by that legislation for the grant of such a benefit'. The Court did not go so far as to say what sort of possibility had to be granted to a taxpayer of providing such evidence.

The Court hints at one further issue, namely the extent to which the taxpayer's Member State may be required to accept a simple declaration by the foreign entity that it is charitable according to its home Member State's law. Equally, if a taxpayer is not able to obtain any more documentation than a declaration by the foreign body, it is understandable HMRC's suspicions are raised about that body's legitimacy. In any event, such a declaration would normally not be enough to demonstrate that the body falls within the UK definition of a 'charity', unless its home State's requirements for charitable status were the same as, or more restrictive than, the United Kingdom's. So although HMRC might have to take such a declaration into account, it would probably not be obliged to accept it as sufficient to establish that the EU charity would be recognised as charitable if established in the United Kingdom.

Fourth, the charity must be 'established' in a Member State. A company incorporated in such a state clearly qualifies, as does a trust established pursuant to the laws of a Member State and resident in that state. But in a European law context it may be enough if, for example, a charity incorporated outside the EU has a branch or agency in a Member State that recognises that branch as charitable. The Community law concept of 'establishment' extends to establishment via a branch or agency: see Article 43 EC. This issue is not covered by the *Persche* judgment, but is at least arguable. But to the extent that the Court's decision depended on the availability of procedures for a Member State to obtain information from the charity's home State under the Directive, the *Persche* decision would gainsay its extension to charities established in third countries with no equivalent mutual assistance provisions in force between those third countries and the taxpayer's Member State (see the Court of Justice's Judgment, paragraph 70).

## Gift Aid

Turning now to three particular reliefs conferred by UK tax, the first to consider is Gift Aid. There does not seem to be any difficulty in satisfying the general requirements, apart from the charity's residence, for a donation to qualify for Gift Aid. As mentioned above, the fact that Gift Aid is available only for cash donations, and not for donations of other assets, is not, in itself, objectionable in terms of European law (there is a separate relief for gifts of shares, securities and land, and the provisions governing those would likewise have to be applied to gifts of such assets to EU charities). The taxpayer might bear a slightly heavier burden in that a foreign charity is unlikely to have a style Gift Aid declaration for him to use. This seems unlikely to render the obtaining of relief 'virtually impossible' or 'excessively difficult', so that the requirement would be unlawful on general principles of European law (assuming these principles to apply at the stage of making a claim for relief). Certainly, not every UK charity has pre-printed declarations that are given to a donor to complete. Moreover, the decision in *Persche* is based on the (usual) assumption that the national restriction complained of will make taxpayers less likely to make cross-border donations than if such donations were tax-deductible (see the Advocate General's Opinion, paragraph 47, and the Court of Justice's Judgment, paragraph 38). So the Court pre-supposes at least some knowledge on the part of taxpayers as regards the existence of tax reliefs. On the other hand, HMRC's regulations required the Gift Aid declaration to include a statement explaining that the donor must have paid sufficient income tax and capital gains tax to cover basic rate tax on the grossed-up gift. This might make it difficult for HMRC to persuade the Court of Justice that taxpayers should be regarded as knowing enough about Gift Aid to know that they

must make a declaration. So whether the requirement for a declaration is compatible with Community law where the charity is established in a different Member State remains an open question. If seeking Gift Aid relief for a gift to an EU charity, it is clearly better for the taxpayer to make a declaration and avoid any argument.

The particular way in which Gift Aid operates, such that the donor's gift is deemed to be the net amount after basic rate tax, and HMRC pay basic rate tax on the grossed up amount to the charity, creates a little difficulty for HMRC in terms of currency exchange and additional administrative cost, but does not seem insuperable. This difficulty is clearly less disruptive than the difficulties created by any need to check whether the EU charity is actually established and operated as such, but even these difficulties were regarded by the Court of Justice in *Persche* as insufficient justification for a restriction on free movement of capital.

So far as the foreign charity is concerned, the fact that it may or may not know that a donation from a UK taxpayer may be added to if the relevant records are kept and an appropriate claim made to HMRC is no reason for depriving the UK taxpayer of relief. Rather, any failure by the foreign taxpayer to make a claim is simply a windfall gain for HMRC. It keeps money that it could have been obliged to pass on to the relevant charity. Indeed, the fact that a charity has to make a claim to HMRC in order to obtain the additional part of the donation goes some way to reducing the additional administrative burden on HMRC arising out of the fact that the charity is not established in the UK. It would not be contrary to European law to require an EU charity to submit, with its claim, relevant documents with English translations, showing the charity to be properly established, that it pursued relevant purposes, and that it was recognised by its home

Member State as charitable. If such documents were not provided, the Court of Justice makes clear that they fall within the scope of the tax information exchange directive, namely Directive 77/799 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation.

### **Capital gains tax relief**

The second relief to consider is relief from capital gains tax. So far as the taxpayer is concerned, a gift to a UK charity is treated as occurring at no gain and no loss: Taxation of Chargeable Gains Act 1992, section 257. HMRC might argue that allowing EU charities to qualify would create a tax loss for them. This is because so far as the donee is concerned, if he disposes of the asset he is treated as having acquired it when the taxpayer did, and for the taxpayer's base cost: 1992 Act, section 257(2)(b). A foreign charity is not exempt from capital gains tax, and so should pay capital gains tax if it disposes of the asset later. But it will not do so, as it is neither resident nor ordinarily resident: 1992 Act, section 2(1). However, if an EU charity were established in the United Kingdom, it would still not pay capital gains tax: 1992 Act, section 256. So the apparent movement of a gain offshore is irrelevant in this particular context, and is unobjectionable from HMRC's point of view.

### **Inheritance tax**

As regards inheritance tax, gifts to charities are exempt: section 23(1) of the Inheritance Tax Act 1984. There is no reason to refuse this relief to an EU charity.

More extreme is the question whether the restriction of other reliefs, for example the exemptions on gifts to political parties, for national purposes, and for historic buildings (sections 24, 25 and 27 of the 1984 Act), can remain confined to United Kingdom bodies.

But this goes rather beyond *Persche*, and indeed the scope of this article. It may be that the use of a list identifying relevant recipients avoids illegality under European law, but this is far from clear.

### **Practical points**

Finally, some practical points.

It is submitted that UK taxpayers are entitled to all three of the reliefs discussed above if a donation that would otherwise qualify for them has been made to an EU charity. But some due diligence should be carried out before claiming any of them. It is necessary to obtain some evidence that the EU charity is recognised in its Member State of establishment as charitable. This is probably most easily obtained from the charity itself. A copy of the charity's constitution should be checked (the charity might be willing to translate it, or might already have an English translation available) to make sure that its purposes would qualify as charitable for UK tax purposes, were it a UK charity.

So far as Gift Aid is concerned, it would be wise to disclose that the charity to which a deducted donation has been paid is established in the EU. This should be done in the white space on the self-assessment return. Any documents the taxpayer has obtained supporting the claim (in particular, in respect of the EU charity's status and as regards whether it would qualify as a charity if established in the United Kingdom) should be sent with the return. It would be wise to do the same where a self-assessment return is made up on the footing that a gift to an EU charity falls within section 257 of the 1992 Act. So far as inheritance tax is concerned, the same information should be included in the blue space in form IHT400, and the same documents sent with that form to HMRC.

### **Conclusion**

It is clear that the definition of charity for UK tax purposes is unlawful, and must be extended so as to make existing reliefs, within their existing limits, available in respect of donations to charities established in other Member States in the European Union. The fact that this arises out of directly applicable European law means that relief is presently claimable for such donations. Those advising taxpayers considering donations to EU charities must advise them of the availability of reliefs, albeit with the caveat that HMRC may not agree and that it may take litigation before the right to relief will be recognised by HMRC.

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