Charitynews

May 2009

PricewaterhouseCoopers

Contents

Introduction

Welcome to our May edition of CharityNews. You won't be surprised to see that it includes a summary of the tax and VAT measures in the Budget announcements. It is also timely for us to include an article on public benefit as many charities will be including disclosures for the first time in their 2009 Annual Reports. Thank you to Moira Protani of Wilsons Solicitors for this article.

On a personal note I have been very proud to share the 'Joint' in the role of National Charities Group Leader with Bob Humphreys for the last couple of years. Bob has been, and will continue to be, an inspiration for many of us both in and outside PwC; he will be sorely missed when he takes his early retirement in a few weeks time. However he's not lost to the sector and I'm sure you will want to join with me in wishing him every happiness and success as he takes up his new role as FD of Oxfam GB later in the year.

I am taking the PwC Charities Group forward in the full knowledge that PwC as a firm is absolutely committed to the sector. We have a client base to be proud of, a strong and enthusiastic team and are looking forward to continuing to work with you in the years to come.

Very best wishes

Liz Hazell
National Charities Group Leader

01

Charities and public benefit reporting

Reporting on public benefit in a charity's annual report is a legal requirement for charity trustees in years commencing on or after 1 April 2008. You must provide a summary of the aims of your charity and the main activities and achievements of the charity in relation to those aims. For larger (auditable) charities, charity trustees must also provide a review of the significant activities undertaken; details of your aims and objectives; the strategies adopted and activities undertaken to achieve those aims and objectives and details of the achievements by reference to the aims and objectives set.

Charity trustees have a legal duty to have regard to the Commission's guidance on public benefit and you must confirm that you have done so in the annual report. In order to comply with the reporting obligations and confirm that you have had regard to the guidance, you must begin this process when you set the aims and objectives for the charity. There is no point trying to comply with the reporting obligations when you are drafting the annual report – by then it is too late!

The Charity Commission guidance entitled "Charities and Public Benefit" sets out the applicable principles of public benefit and contains a checklist for trustees to assist you to report on public benefit. There is additional guidance for charities which prevent or relieve poverty, advance education, advance religion, charge fees, as well as helpful sample annual reports demonstrating how to report on public benefit.

There are two principles of public benefit. Each principle has a number of sub-rules. The principles and sub-rules should be addressed by the charity trustees in your annual report whether or not they are relevant to your charity. If some of the sub-rules are not applicable, it is preferable for you to explain why in the annual report. It is for the charity trustees to decide how much detail you think is appropriate to provide given your charity's circumstances. However, if nothing is said on public benefit, or you produce only the briefest explanation of your charity's activities, with no detail at all, you would be in breach of the reporting requirement.

The principles (and sub-rules) with commentary which you should address when setting your strategies and aims as well as in the narrative for the annual report are set out below:

Principle 1: There must be an identifiable benefit.

The sub-rules are

a) It must be clear what the benefits are. Benefits may be tangible or intangible depending upon whether a charity provides medical care to the sick or an educational resource or preserves/conserves the environment. However, the benefits must be identifiable. In some cases you may need to obtain expert evidence to identify the benefits which you provide and this should be cited in your report – for example on the architectural merit of a building which is being preserved.

b) The benefits must be related to the aims. If, for example, your charity's aims are solely to provide medical care for the sick, the benefits may be easily stated. However, incidental benefits such as the preservation of a historical hospital building would not be related to the aims of the charity. Incidental benefits may not carry much weight.

c) The benefits must be balanced against any detriment or harm. A few years ago the Charity Commission refused to register as a charity an organisation established to reintroduce wolves to the Scottish countryside as a means of preserving an endangered species. The Charity Commission took the view that the benefits would be outweighed by the harm to the general public if wolves were released into the countryside. If charity trustees are aware of potential dangers or harm from their aims and activities you should address them in the annual report and explain why the benefits outweigh the harm.

Principle 2: Benefit must be to the public, or a section of the public.

The sub-rules are

a) The beneficiaries must be appropriate to the aims. What constitutes an appropriate section of the public will depend upon a charity's aims. The actual number of beneficiaries can be quite small as long as anyone who qualifies as a beneficiary is eligible to be considered. So in the case of a care home with a finite number of places, the report should explain how beneficiaries are selected.

b) Where benefit is to a section of the public, the opportunity to benefit must not be unreasonably restricted either by geographical or other restrictions or by ability to pay any fees charged. Any restriction on the widest class of beneficiaries must be justifiable. It is justifiable where the beneficiaries have a particular need, eg, a disability. A geographical restriction should be clearly defined. A village hall for the use of residents of a village with only four houses in it would be an inadequate section of the public and the restriction would need to be lifted to include people in a wider geographical area.

c) People in poverty must not be excluded from the opportunity to benefit. The Charity Commission has placed emphasis on the need for charities which charge high fees for their services to find ways of ensuring that people in poverty have a material opportunity to benefit from those services. This area is contentious and the author of this article does not agree with the Commission's interpretation of the law. Charities operating in the independent school and care home sectors are thought to be most affected by the Commission's views. The Charity Commission's interpretation is based, in part, on its view that it can re-interpret the law following the removal of the presumption of public benefit and that there is existing legal authority for their proposition in Re Resch, an Australian case heard, on appeal, by the Privy Council. On the other hand, I believe that the Commission is bound by existing case law and that its interpretation of the decision in Re Resch is not justified. Ultimately, this question will come up for decision by the Charity Tribunal.

d) Any private benefits must be incidental. Personal benefits are not precluded so long as in providing these benefits, a charity's aims are being fulfilled. For example, in the case of grants made to relieve the poverty of members of the public there will be a private benefit to the individuals who receive the money but the public benefit would be greater in that poverty is being relieved. If, however, benefits are only available to the members of a charity, the private benefit may outweigh the public benefit.

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03

Could pension legacies provide a new source of funds for your charity?

Since April 2006 members of certain types of pension arrangements who die after the age of 75 with no dependants can leave their remaining pension fund to charity tax-free. We explain who may be able to take advantage of this option, and how your charity could benefit.

The background

Members of a money purchase pension scheme who are in what is known as “Income Withdrawal” or “Income Drawdown” can leave their pension funds to a nominated charity upon death after age 75 if they have no surviving dependants. This payment is called a Charity Lump Sum Death Benefit and is paid tax-free.

Income Drawdown was introduced in the 1990s as an alternative to the traditional option of using a pension fund to buy a pension for life with an insurance company (also called buying an annuity). The table below summarises the features of annuities and Income Drawdown arrangements.

	Annuity	Income Drawdown
Types of arrangements that can offer these options	• Personal Pensions and Group Personal Pensions (GPPs) • Stakeholder Pension Plans • Self-invested Personal Pension Plans (SIPPs) • All work-based money purchase pension schemes	• Personal Pensions and Group Personal Pensions (GPPs) • Stakeholder Pension Plans • Self-invested Personal Pension Plans (SIPPs) • Some work-based money purchase pension schemes
Tax free cash available	Can take up to 25% of the fund as tax free cash before purchasing annuity.	Can take up to 25% of the fund as tax free cash before going into Income Drawdown.
Level of income available	The level of income depends on many factors, including: • Size of pension fund • Age • Sex • Health Options selected e.g. • Spouse’s pension • Increases in payment • Guaranteed period Once options have been selected and the annuity has been purchased, the options taken cannot be changed at a later date. For example, a spouse’s pension of 50% selected when annuity was purchased, spouse dies and spouse’s pension is no longer needed, but the annuity cannot be changed to a single life annuity.	Flexible – a level of income between the minimum and maximum can be selected each year. Before age 75: Minimum income is zero. Maximum income is roughly equivalent to 120% of the annual income the fund could buy as a level single life annuity. Maximum income re-calculated every 5 years. After age 75: Minimum income is roughly equivalent to 55% of the annual income the fund could buy as a level single life annuity. Maximum income is roughly equivalent to 90% of the annual income the fund could buy as a level single life annuity. Maximum income re-calculated annually.

	Annuity	Income Drawdown
What happens to the pension fund?	Paid to annuity provider in exchange for the annuity. Annuity provider invests the fund and may benefit from good investment returns.	Pension fund remains invested and can benefit from good investment returns, but could also suffer if investment returns are poor. Remaining fund can be used to purchase an annuity at a later date.
How income is taxed	Taxed as earned income under PAYE.	Taxed as earned income under PAYE.
Death benefits	Depends on options selected when annuity was purchased. If a spouse's pension was selected, an income will be paid to the surviving spouse for the rest of their life. If a guaranteed period was selected and death occurs during that period, the remaining pension instalments to the end of the guaranteed period would be paid to the beneficiaries.	Before age 75: Pension for a dependant through Income Drawdown or annuity purchase, or Fund value paid as a lump sum to beneficiaries, taxed at 35%. After age 75: Pension for a dependant through Income Drawdown or annuity purchase, or Payment of fund value to charity tax-free, or Fund value to be left to a beneficiary, possible effective tax rate of up to 82%.

These are some of the many factors which individuals would need to take into consideration before deciding whether an annuity or Income Drawdown would be most suitable for them. In particular, it is important to note that there are a number of investment risks associated with income drawdown and individuals should therefore seek independent financial advice before making a decision.

It is not necessary to put 100% of a pension fund into Income Drawdown, individuals can designate an amount or percentage of their pension fund to be put into Income Drawdown. However, not all pension arrangements will allow this mainly due to the additional complexity of the administration.

In April 2006 changes were made to how an Income Drawdown pension fund could be paid out upon death - including the introduction of the Charity Lump Sum Death Benefit. In addition, the requirement to purchase a pension by age 75 was removed.

Once a member of a pension scheme whose fund is in Income Drawdown passes age 75, the only options for payment of the fund upon death if there are no surviving dependants is to leave the pension fund to a beneficiary, or pay the value of the pension fund to a charity as a Charity Lump Sum Death Benefit.

If the fund is left to a beneficiary it becomes part of the member's estate and can be subject to an effective tax rate of up to 82% (see example on next page). The fund remains in the pension arrangement for the benefit of the beneficiary and cannot be accessed until the beneficiary reaches age 50, the minimum retirement age (changing to age 55 from 6 April 2010).

- If the fund is paid to a charity as a Charity Lump Sum Death Benefit within 6 months of the member's death, the payment is tax-free.

Who might be interested in donating to charity through a Charity Lump Sum Death Benefit?

- Individuals who are already in Income Drawdown, or have the option to go into Income Drawdown in the future.
- Individuals who already have plans to make a donation to charity in their will from another source of funds may find it more tax efficient to leave their pension fund to charity, and use the funds originally designated as a donation for another purpose.
- Those who were not planning to leave a donation to charity but would like to do this to take advantage of the tax-free status of a Charity Lump Sum Death Benefit.

Any individual wishing to leave their pension fund to charity in the event of their death with no dependants after age 75 can nominate the charity that should benefit from the payment. This nomination can be made to the administrator of the pension arrangement, and can also be set out in the individual's will. In the event that the individual has a dependant when they die they can also nominate in advance that any funds remaining after the death of their dependant should be paid to their nominated charity.

What is the scope for this as a fundraising idea for charities?

The number of people who currently meet the conditions for payment of a Charity Lump Sum Death Benefit is relatively small but growing. Income Drawdown is becoming more widespread with most insurance companies offering this option to individuals with private pensions.

Most work-based money purchase pension schemes do not currently offer an Income Drawdown option at the moment. The Occupational Pension Schemes Survey 2007 indicated that only 7% of active members were in a work-based money purchase pension scheme which offered Income Drawdown. However it is possible for Trustees to introduce the Income Drawdown option to most work-based money purchase pension schemes by amending the scheme's Rules.

Many people who may be able to leave their pension fund to charity tax free upon death will not be aware of that option, as it was not generally publicised when it was introduced in April 2006. Charities may therefore wish to take steps to raise awareness of this option among their supporters. The cost of any fundraising activity in this area could be recouped by just one person deciding to leave their pension fund to charity.

What to do next

We can help you raise awareness of this option among your members and supporters by producing tailored communications to be included in newsletters or on your website. If you would like to discuss this in more detail please contact us.

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Example

Mrs A is a widow aged 77 with no dependents. She is taking Income Drawdown from her pension fund.

Mrs A dies with a pension fund worth £100,000, and an estate worth £400,000 excluding the value of the pension fund. The nil rate band for Inheritance Tax for the 2008/09 tax year is £312,000.

Has Mrs A nominated a charity to receive her pension fund upon death?

Yes

The £100,000 pension fund is paid direct to Mrs A's chosen charity **tax-free.** The value of the pension fund does not form part of her estate for Inheritance Tax purposes.

Effective tax rate 0%

No

The £100,000 pension fund is added to the value of Mrs A's estate, which totals £500,000. As the value of the estate exceeds the nil rate band, Inheritance Tax is chargeable at 40% on the amount above the nil rate band, including the £100,000 pension fund. This charge is deducted from the fund and paid by the pension scheme's administrator.

£40,000 tax

Remaining fund £60,000

The transfer of the remaining pension fund to the ownership of a beneficiary is an unauthorised payment and is subject to the unauthorised payments charge (40%) and surcharge (the surcharge of 15% does not always apply). This is a tax charge of 55% on the £60,000 fund, and is paid by the beneficiary from their own resources.

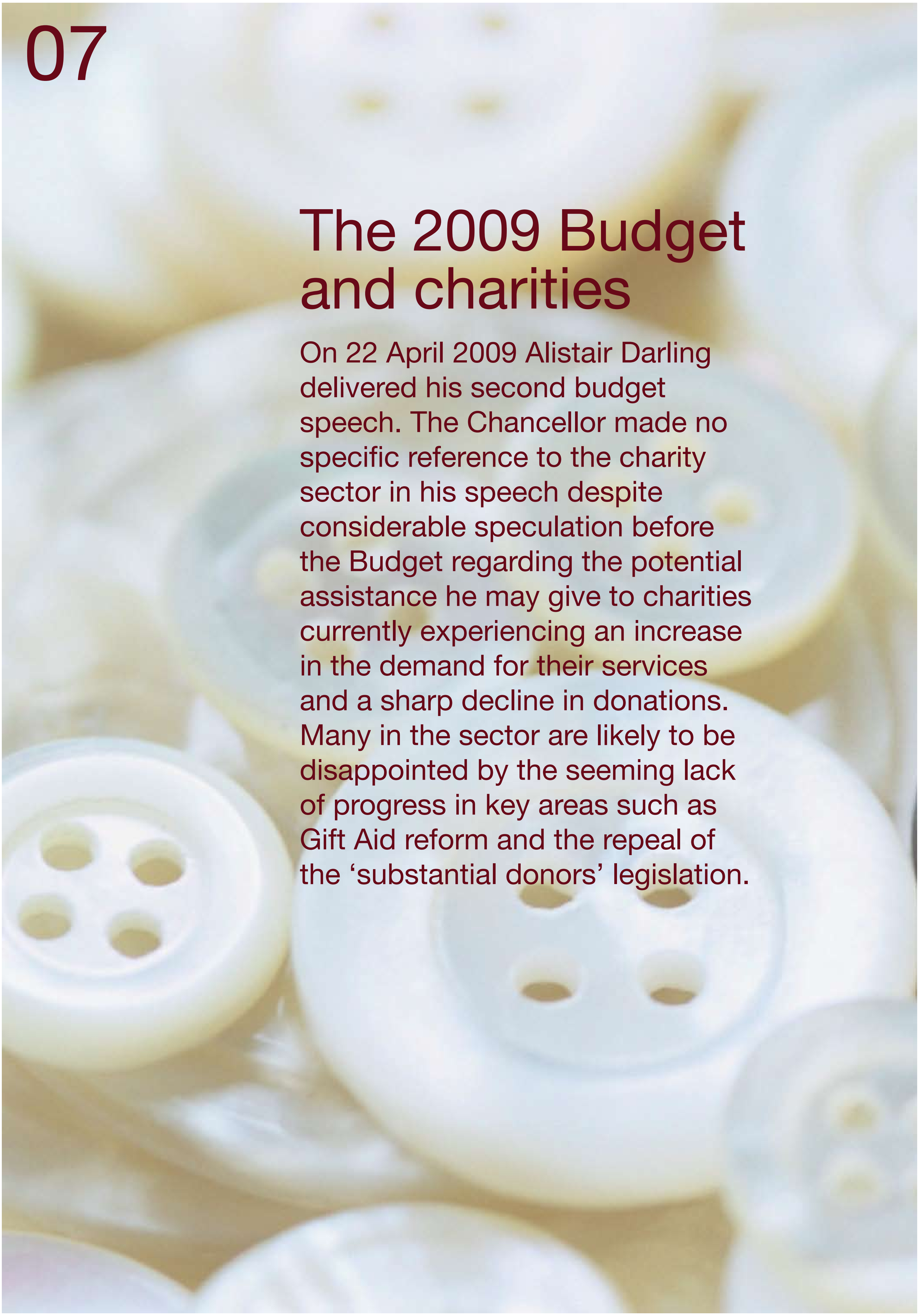
£33,000 tax

The pension arrangement or scheme is also charged a scheme sanction charge for making an unauthorised payment, which the scheme can deduct from the remaining pension fund.

If the unauthorised payments charge and surcharge above are paid by the beneficiary, the scheme sanction charge is a tax charge of 15% on the amount of the unauthorised payment i.e. the remaining £60,000 fund above.

£9,000 tax

Effective tax rate 82%



07

The 2009 Budget and charities

On 22 April 2009 Alistair Darling delivered his second budget speech. The Chancellor made no specific reference to the charity sector in his speech despite considerable speculation before the Budget regarding the potential assistance he may give to charities currently experiencing an increase in the demand for their services and a sharp decline in donations. Many in the sector are likely to be disappointed by the seeming lack of progress in key areas such as Gift Aid reform and the repeal of the ‘substantial donors’ legislation.

This article concentrates mainly on the Budget measures which are specific to income and corporation tax and how these impact on the charity sector. In addition the Chancellor also announced the following measures to help the charity sector:

- Launch of a new £20m Hardship Fund to provide support to third sector organisations delivering front-line services to the most vulnerable and disadvantaged in society who have been affected by the recession.
- Plans to consult on the development of a Social Investment Wholesale Bank.
- Plans to consult on the regulation of Common Investment Funds and Common Deposit Funds by the FSA.
- Various initiatives and funding to support the unemployed and others disadvantaged by the current economic downturn.

Gift Aid

The budget material states that the Government continues to explore ideas to improve Gift Aid, and has commissioned research into the effect of redirecting higher-rate relief from donors to charities. However, no further announcements were made in the Budget to help simplify the Gift Aid scheme.

It is intended changes should be made to the remittance basis provisions to ensure that any amounts paid by way of the £30,000 remittance basis charge by non-domiciled tax payers will be regarded for Gift Aid purposes as tax paid, enabling the donee charity to make a tax claim under the Gift Aid provisions.

Increased income tax rates

In a bid to generate increased tax revenues the Chancellor has escalated measures announced in the Pre-Budget Report 2008 ("PBR 2008") to increase income tax levied on those with higher incomes. The new tax rates will be both higher than previously indicated and commence one year earlier from 6 April 2010.

New 50% rate of income tax

From 6 April 2010, there will be three main rates of income tax, with a higher rate of 50% being introduced for individuals with taxable income over £150,000. This has been increased from the 45% originally indicated in the PBR 2008. Dividend income in excess of this new limit will be taxed at 42.5%. At the same time, individuals with adjusted income over £100,000 will see their personal allowance restricted by £1 for every £2 over this limit; the marginal rate of tax on incomes between £100,000 and £ 112,950 will therefore be approximately 60%.

It remains to be seen what the impact of the increase in the higher rate of income tax and the restriction of allowances will be for the charity sector. The sector will hope to see an increase in the amount of donations from those liable to the new 50% tax rate, assuming they are able to claim relief for their Gift Aid donations at this rate.

Amendments to the substantial donor legislation

It had been hoped that the Budget would include an announcement that this complex legislation would be withdrawn or substantially amended. There has been no such announcement but the Government has issued a regulation to increase the six-year donation threshold of relievable gifts which a person may make before becoming a substantial donor from £100,000 to £150,000 with effect from 23 April 2009.

The Government has also announced further consultation on the substantial donor legislation 'to develop new rules based around an effective anti-avoidance purpose test', which will take place during summer 2009, with a view to producing legislation in 2010.

Taxation of foreign profits

Very little was said about the proposed foreign profits regime and associated changes in the Budget; however, the amended legislation was published in the Finance Bill on 30 April 2009. The dividend exemption will apply to dividends and other distributions received on or after 1 July 2009, but the debt cap rules are to be deferred until accounting periods beginning on or after 1 January 2010.

The February edition of Charity News contained an article outlining the proposals for the taxation of foreign profits and interest as they might apply to charities.

Dividend exemption

All distributions (both UK and foreign) received by companies will be taxable unless they fall within one of five specified exemptions, each of which is subject to anti-avoidance provisions. However, the Finance Bill contains a specific exemption for corporate charities so that they will not be taxable on either UK or foreign dividends, except those of a capital nature. Previously charities had a specific exemption for foreign dividends only, because UK dividends were exempt from UK corporation tax under a general exemption applicable to all companies.

Originally, it was proposed that the exemptions would not be available to small companies in respect of foreign dividends received arising from shareholdings of 10% or more. However, it has now been confirmed that small and large companies will be treated alike.

Unincorporated charities are already exempt from tax on all dividends; there is no change to this.

Debt cap

Following the publication of the amended legislation in Finance Bill 2009 the basic principles behind the debt cap remain similar to those originally proposed but the mechanics of the calculations have changed substantially.

Under the debt cap rules, within a wholly owned UK group a disallowance of interest in one company should be matched by a relief in another. In the case of the payment of interest from a trading subsidiary to a charitable company the charity is already relieved from tax on the receipt of interest. Therefore the disallowance of the interest payment in the trading subsidiary would give an asymmetrical result.

On 7 April a note was issued indicating HMRC's latest thoughts on the design of the debt cap rules. The rules were never intended to apply to small or medium sized companies. The note contained the following of relevance to large corporate charities (one which, with any subsidiaries, has more than 250 employees, balance sheet assets of more the €43m and turnover of more than €50m):

'Changes have been identified that would allow incorporated charities and other exempt bodies corporate to remain within the debt cap rules while not being subject to an asymmetric disallowance simply as a consequence of their tax exemption.'

It would appear from the above note that corporate charities should not be disadvantaged by the introduction of the debt cap rules in relation to interest payments received from trading subsidiaries. Although this is not included in the first draft of Finance Bill 2009 we understand that it is intended amendments will be introduced to cover this point. Indeed a letter from the Financial Secretary to the Treasury (dated 30 April 2009 and published on HMRC's website on 1 May 2009) states that the government intends to propose an amendment making special provision for exempt financing income received by charities (and certain other bodies) during the passage of the Finance Bill. This is identified as one of the points of detail that was not included in the original Bill because of time constraints. We hope this amendment will rectify the asymmetry identified.

Trading subsidiaries and business taxation

Corporation tax small companies' rate

The rate of corporation tax for small companies (taxable profits of less than £300,000) will remain at 21% from 1 April 2009. Thus, those corporate charities or their trading subsidiaries that do pay tax will (on the assumption that they are small companies for corporation tax purposes) benefit from the hold in the previously announced rise of the rate to 22%.

Capital allowances – temporary first year allowances

The Chancellor announced a temporary 40% first year allowance, to promote investment in certain types of plant and machinery, available when qualifying expenditure is incurred in the 12 months beginning either 1 April 2009 (for corporation tax payers) or 6 April 2009 (for income tax payers).

Extension of trading loss carry back for business

An extension to the right to carry back trading losses from one year to up to three years was announced in the PBR 2008. It was announced in the Budget that the extension would now apply to trading losses made over a longer period. The amount that can be carried back to the preceding year remains unlimited but this extension will allow any additional unused trading losses, up to a maximum of £50,000 per 12 month period or tax year, to be carried back for offset against the profits arising in the earlier two years, with losses being carried back against later years first. Losses created by gift aid payments are not eligible to be carried back in this way, or indeed of course carried forward.

Tax administration

Certification of accounting systems

There is to be a new requirement for Senior Accounting Officers of large companies or large groups of companies (see below) to take reasonable steps to establish and monitor accounting systems so that they are adequate for accurate tax reporting purposes. The Officer will have to certify annually that this is the case (or specify their inadequacies to HMRC). Not only will there be penalties on the company for careless or deliberate failure to comply with these obligations, but also personal penalties of up to £5,000 will fall on the Senior Accounting Officer. Large companies are obliged to notify HMRC of the identity of that Senior Accounting Officer.

This measure was not trailed or discussed before the Budget. It follows the increasing interest taken by HMRC in systems and the risk based approach. It will apply to returns due for accounting periods commencing on or after the date of Royal Assent for Finance Bill 2009.

Large companies are those which are neither small nor medium sized as defined in the Companies Act 2006. ‘Small’ or ‘medium’ sized under that definition are those which meet two out of three of the following measures - fewer than 250 employees, turnover of less than £22.8m and balance sheet total of less than £11.4m.

Changes to penalty regime

Changes continue to be introduced as part of HMRC’s ongoing review of Powers, Deterrents and Safeguards and Tax Administration. Penalties for failing to comply with HMRC notices and for providing inaccurate information took effect in 2008 with further changes scheduled for those who pay taxes late or fail to file returns on time. The regime will be introduced over a number of years, starting with penalties for late payment of in-year PAYE from April 2010. Additional returns will be brought into the regime over time. It is intended that legislation to extend the regime to other taxes administered by HMRC will be introduced in Finance Bill 2010.

Name and shame taxpayers

There are plans to “name and shame” taxpayers across all taxes where there is a loss of tax of £25,000 or more and HMRC believe there has been deliberate misstatement or failure to notify. Those who make an unprompted disclosure or full prompted disclosure within the required time will not be affected.

HMRC Powers

Backing up the penalty regime are changes to the powers of HMRC to obtain information and inspect businesses and the introduction of a new Tribunal system.

Budget 2009 – VAT

VAT – Overview

This year's Budget was a relatively quiet one in terms of indirect tax announcements. Most of the significant developments, such as the anti-forestalling provisions regarding the change in the standard rate and the implementation of the VAT Package, were announced previously and the Budget documents contain little further information.

Other areas covered by the announcements include the conditions for automatic permission to opt to tax land and buildings for VAT purposes and, of significant importance, the personal penalties for senior accounting officers of large organisations including charities.

VAT rate returns to 17.5% on 1 January 2010

HMRC confirmed that the standard VAT rate will revert to 17.5% on 1 January 2010.

It was also announced that 'anti-forestalling' legislation will be enacted to counter 'schemes' relying on the creation of VAT tax points by the issue of an invoice or receipt of payment when the rate is 15% if the actual supply of goods or services is not to take place or be completed until after the rate has reverted to 17.5%.

This anti-forestalling legislation will, in summary, apply where the recipient is unable to recover VAT charged on a supply (or the grant of the right to receive a supply at a discount or for free) and:

1) the supplier and customer are connected parties; or

2) the supplier assists the purchaser to fund the acquisition of the goods or services (or grant of the right); or

3) a VAT invoice is issued by the supplier but payment is not due for at least six months; or

4) the value of a prepayment is £100,000 or more, unless such prepayments are 'normal commercial practice' (HMRC has indicated that property supplies and asset leasing will not be affected, but further detail is expected from HMRC, e.g. as to whether longer-term supplies such as construction could be affected).

The first three conditions were effective from 25 November 2008, the fourth from 31 March 2009.

VAT – Administration

VAT registration and deregistration turnover limits

From 1 May 2009, the taxable turnover threshold, which determines whether a charity must be registered for VAT, has been increased from £67,000 to £68,000. The taxable turnover threshold which determines whether a charity may apply for deregistration has been increased from £65,000 to £66,000.

The registration and deregistration threshold for relevant acquisitions from other EU Member States have also been increased from £67,000 to £68,000, again from 1 May 2009.

Changes in fuel scale charges

From 1 May 2009, the current table of fuel scale charges used to calculate VAT on private use of road fuel has been amended. Charities will need to use the revised fuel scale charges from the start of their next prescribed accounting period starting on or after 1 May 2009.

Personal penalties for senior accounting officers

One development which will be of considerable interest to senior accounting officers of large charities is the legislation which will be introduced in Finance Bill 2009 and which will require "senior accounting officers" of large charities to:

- take reasonable steps to establish and monitor accounting systems so that they are adequate for tax reporting purposes (tax reporting in this context being the preparation and submission of returns to HMRC and not accounting for tax figures in the financial statements); and
- certify annually that these systems are adequate or alternatively specify to HMRC the inadequacies (and additionally confirm that they are notified to the charity's auditors).

We have covered these developments in more detail in the section on direct taxation, along with information on HMRC's plans to "name and shame" taxpayers across all taxes where there is a loss of tax of £25,000.

VAT – Implementation of VAT Package 1 January 2010 changes

Summary

Legislation will be published as part of the Finance Bill and in secondary legislation to implement the 1 January 2010 'VAT Package' changes to:

- the place of supply of services and introducing the new EC Sales List for services, which businesses will have to complete for supplies of services made to VAT registered customers.
- Simplify the 8th Directive VAT refund procedure under which EU businesses can reclaim VAT incurred in Member States in which they are not established for VAT purposes.

New place of supply rules for services

From 1 January 2010, the rules for determining the place (i.e. taxation) of supplies of services will be re-written, extending the reverse charge on business to business (B2B) transactions and ensuring that most types of service will be taxed in the Member State of consumption.

Supplies of services - new reporting obligations

As a result of the changes to the place of supply of services, and to reduce the risk of VAT fraud, the current EC Sales List (ESL) system, which requires suppliers of goods to complete periodic listings of intra-EC transactions, will be extended to include intra-EC supplies of services in respect of which the recipient is required to account for VAT under the reverse charge procedure.

Simplified 8th Directive refund procedure

The simplified 8th Directive VAT refund procedure, under which businesses can obtain a refund of VAT incurred in other Member States, includes a simplified electronic procedure for the submission and processing of refund applications, and a detailed timetable for processing and paying refund applications.

Time of supply for reverse charge services

In addition to changes to the place of supply of services, the time of supply of reverse charge services will change from the time of payment to the earlier of when the service is completed, or when payment is made. In respect of continuous supplies of services, the time of supply will be the end of each billing or payment period.

For continuous supplies not subject to billing or payment periods, the time of supply will be 31 December each year unless a payment has previously been made (in which case the time of supply will be the date of payment).

Further details will be set out in a Revenue & Customs Brief which will be published at some point in May 2009.

VAT – Other Changes

Simplification of the option to tax

When an organisation has made VAT exempt supplies of land or a building and decides that it wishes to tax future supplies, it must obtain HMRC's permission to opt unless it satisfies one of four conditions for "automatic permission" which are set out in tertiary legislation published in Notice 742A "Opting to tax land and buildings".

HMRC announced that the third of the four conditions, i.e.

- the building or relevant part of the building has been unoccupied between the date of the surrender and the date the option to tax is to take effect; and
- there will be no further exempt supplies of the land or building; and
- you do not intend or expect that you will occupy the land or building other than for taxable purposes

is to be amended to reduce the number of organisations which are required to seek HMRC's permission. This simplification came into effect on 1 May 2009, but some of the current informal concessionary relaxations of the requirement to seek permission will continue to have effect until 30 April 2010.

The revised third condition was recently published by HMRC in Information Sheet 06/09.

Reduced rate on children's car seat bases

The 5% reduced rate of VAT is to be applied, with effect from 1 July 2009, to supplies of bases for children's car seats. Currently the reduced rate is only applied to supplies of the children's car seats themselves.

Charity Tax Contacts
If you would like to discuss any of the tax issues in more detail, please use your usual PricewaterhouseCoopers Direct Tax or VAT contact, or contact the following specialists:

Charity VAT Specialist

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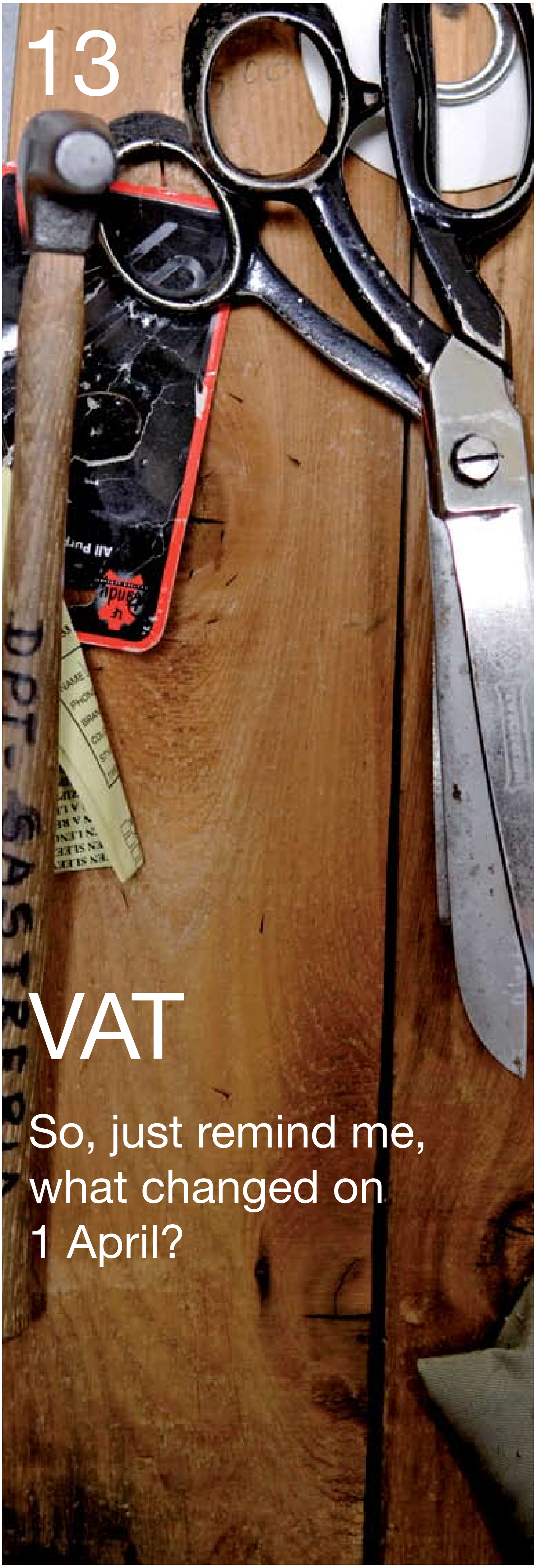

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VAT

So, just remind me, what changed on 1 April?

1 April 2009 saw a number of significant changes in VAT take effect and this is just a brief reminder, with some handy information if you need to refresh your mind.

Time limits

Time limits are extended from three years to four years for:

- incomplete VAT returns (i.e. returns where the VAT due to or from HMRC has been over or understated);
- failure to make VAT returns, including additional assessments over and above the amount of assessments automatically issued where returns have not been rendered;
- amounts of VAT which have been refunded to taxpayers and should not have been refunded;
- amounts of VAT refunded to persons who should not have been registered for VAT;
- VAT returns rendered on behalf of the taxpayer by an agent or representative;
- failure to account for acquisition tax;
- VAT due on the acquisition from another Member State of goods subject to excise duty and new means of transport; and
- VAT due from a warehousekeeper or fiscal warehousekeeper.

The time limits for assessments of penalties, interest and surcharges are also extended to four years from three, as is the time limit for assessments where the taxable person has died.

Likewise, the time limit for VAT error or mistake claims will be extended from three to four years, to retain symmetry.

Section 77(4) VAT Act 1994, which currently provides a 20-year time limit for assessments in cases of failure to notify liability to register for VAT, issue of false VAT invoices and conduct involving dishonesty and fraud, has been extended to cover other circumstances.

Charities should be aware that, from 1 April 2009, they may be able to submit VAT claims for more than three years and that, from 1 April 2010, the time limit will effectively be four years rather than three. This may have a crucial impact of the cost/benefit analysis - a claim which may not be economic on the basis of a three-year limit may well be worth submitting if the amount claimable is around a third higher (with very little additional cost). However, the changes cut both ways: businesses which may have been exposed to an assessment covering three years' worth of VAT will face a significantly larger exposure.

Partial exemption

HMRC introduced changes to the standard partial exemption method, affecting provisional input VAT recovery, the annual adjustment, input VAT recovery for start-ups, and the treatment of 'foreign' and 'specified' supplies.

'In-year' recovery based on the previous year's recovery rate

Charities operating the standard method can now use the adjusted recovery rate of the prior tax year as the basis for provisional deduction in the four quarterly / twelve monthly VAT periods of the current year, rather than carrying out the full partial exemption calculations in each period. Recovery would then be adjusted to reflect the actual figures at the end of the year as part of the annual adjustment process.

Charities need not notify use of the option to HMRC and may freely choose whether or not to use the option each tax year, but they must consistently apply the current or the new rule for the whole of any given tax year once the option has been exercised in the first period. Charities whose irrecoverable input VAT in the previous tax year was 'de minimis' and which exercise this option must apply the theoretical recovery percentage rather than simply recovering all input VAT (although this will be shortly reviewed by HMRC). Finally, the applicable recovery percentage is the percentage as determined before any application of the standard method override in the previous year.

Annual adjustment

Charities can now perform the 'annual adjustment' in the VAT return for the last period of the tax year rather than in the first VAT return of the following tax year. Again, this measure is optional rather than mandatory and HMRC states that it does not need to be notified. The changes are effective for annual adjustments in respect of tax years ending on or after 30 April 2009.

Input VAT recovery for new charities/businesses

An option allowing new partly exempt charities/businesses (i.e. taxable persons who do not have an immediately proceeding "longer period") to attribute input VAT on the basis of use (rather than using the standard turnover-based partial exemption method) has also been introduced. This change is effective for VAT periods commencing on or after 1 April 2009.

Widened scope of standard method

For VAT periods commencing on or after 1 April 2009, the scope of the standard method is widened to include all of the business's input VAT, including input VAT attributable to 'foreign' and 'specified' supplies which were formerly subject to reg 103. However, a separate use-based calculation similar to that applicable under reg 103 will be required where the taxpayer makes the following supplies:

- supplies falling within either Item 1 or Item 6 Group 5 Schedule 9 VAT Act 1994 (broadly, supplies of money or certain securities); or
- supplies made from an establishment situated outside the UK.

Unlike the other changes, this is compulsory rather than optional. It is effective for VAT periods commencing on or after 1 April 2009.

Withdrawal of the VAT staff hire concession

From 1 April 2009, employment businesses supplying staff as principal must charge VAT on the full amount received from their customers - including the element representing the wages payable to the worker. In addition to the compliance implications for employment businesses, users of temporary workers who cannot recover input VAT in full may face significant additional VAT costs. PwC has potential solutions that preserve the status quo and affected charities should take advice on the implications of this change as a matter of urgency.

Tribunals system

As from 1 April 2009, appeals and other tax disputes that would previously have been heard by the VAT and Duties Tribunal and the High Court will be heard by the newly established Tax Chambers of the First-tier Tribunal and the Upper Tribunal ('the Tax Tribunals'). Reform has not brought simplicity, however, with the relatively simple VAT Tribunal rules being replaced by a volume of legislation, practice statements and overlap with the civil procedure rules (CPR).

Several important aspects of the new system have yet to be clarified, including the important classification of what constitutes a 'complex case'. Whilst the full implications of the new rules are yet to be seen, users of the Tax Tribunals need to be aware that the new rules impact on costs recovery and awards against the taxpayer, procedure and evidence, jurisdiction and appeals.

Misdirection and misunderstanding

From 1 April 2009, extra-statutory concession 3.5, VAT: Misdirection, is withdrawn and replaced with the guidance which covers both VAT and IPT (Insurance Premium Tax). The guidance appears to embody many of the fundamental principles behind ESC 3.5/the 'Sheldon' principle, i.e. if an HMRC officer:

- with the full facts before him, has given a clear and unequivocal ruling on VAT in writing; or
- knowing the full facts, has misled a registered person; and
- that is to his detriment; then
- any assessment of VAT due will be based on the correct ruling from the date the error was brought to the registered person's attention.

The guidance brings information given by HMRC "where it takes the form of Guidance and Public Notices" within the scope of the misdirection rule.

Penalties regime

A new 'behavioural-based' penalty regime aligning penalties across taxes has now kicked in for some documents and returns to be filed on or after 1 April 2009. The new regime will initially cover errors in relation to VAT, corporation tax, income tax, capital gains tax and PAYE.

More penalties are expected because HMRC will have less discretion and because the scope of penalties has been widened with fewer defences available. Charities must consider not just the quantum of errors, but the reasons behind them, and how to be proactive and avoid being penalised.

VAT record keeping requirements

From 1 April 2009, the substantive changes are:

- clarification that HMRC will exercise its existing powers to vary the period for which records must be retained by specifying the period in writing, and the period may vary according to individual circumstances; and
- automatic permission for taxpayers to retain records by electronic means, subject to exceptions and conditions set out by HMRC in writing.

VAT Cases

In the next Charity News we will report on the ECJ's judgment in the VAT cases Vereniging Noordelijke Land- en Tuinbouw Organisatie (VNLTO) (C-515/07) and Sandra Puffer v Unabhängiger Finanzsenat, Außenstelle Linz (C-460/07) which could affect those Charities that have recovered input VAT under the 'Lennartz' principle.

In addition, we will also consider the impact on Charities of the ECJ's judgment in TNT Post UK Limited (C-357/07) which has ruled that postal services are taxable if not 'in the public interest'. In the UK, this would mean that Royal Mail services supplied on individually-negotiated terms are not exempt and instead taxable which could result in an additional irrecoverable VAT cost being incurred by Charities.

If you would like more information concerning these changes and how they could impact on your organisation, please contact your usual PricewaterhouseCoopers' VAT contact or our VAT charity specialist Keith Lawson on 020 7804 9064 or by e-mail to keith.lawson@uk.pwc.com.

Do you know how safe your investments are?

Alternative investments are a prominent feature of the global economy and charities have used them to increase diversity and returns. However, investor confidence has been shaken by poor results and recent high profile frauds.

Current alternative investment environment

Charities are suffering in the current economic climate, fund raising has proved challenging, public spending has declined and charitable donations have decreased. Charities' investments have been affected by stock market falls, market volatility and uncertainty just like everyone else's. They have seen the value of investments drop and dividend income fall away. The formerly failsafe option of cash has lost its appeal, now offering very poor returns as a result of interest rate cuts. Even government bonds are not as attractive as they once were. Fund managers point out that volatility is a function of markets and diversification is used to mitigate its effects. Many charities have embraced a diverse range of assets over the last few years, such as hedge funds, private equity and property, and others are considering doing so in the future.

Hedge fund managers are under significant pressure. The size of the industry has almost halved in the past year, with investors withdrawing approximately $150bn, nearly 10% of assets, from hedge funds in December 2008 alone. The press has been critical of the sector, highlighting issues such as secrecy, short selling and use of excessive leverage to generate returns. The collapse of Lehman's in September 2008 left many hedge fund managers with their assets frozen. The subsequent flight to liquidity by investors has resulted in many hedge funds imposing unpopular measures to limit redemptions.

Private equity has experienced substantial growth in recent years and the private equity industry is now a recognised asset class in its own right. The UK is the largest and most developed private equity centre in Europe, second only in size to the US. Today, many private equity firms labour under a mountain of debt at a time when they are keen to snap up businesses at bargain basement prices to add to their portfolio. There is growing disenchantment among investors with the industry, which has seen its returns turn sharply negative in the credit crisis. Big investors in private equity, including charities, are steering clear of new private equity funds as they lick their wounds over losses from money put into earlier funds.

Over the last ten years investors have increased their allocations to property from zero to 5% and in some cases up to 10%, bringing it into the mainstream. More ways of measuring the performance of real estate are now available e.g. indices providing historical information, which give transparency. However, real estate worldwide has suffered badly from the global economic downturn and is under attack from falling property values. Real estate funds are unlikely to recover in the near term because many face refinancing issues as debt markets continue to be closed to most. This situation could force these funds to sell properties they hold at deep discounts. The current consensus, based on a wide range of forecasts, is that capital values will continue to fall into 2010, albeit the decline is expected to be less severe.

Are alternatives still a good investment?

Charities' requirements from their investments are often different from other investors. They have to take into account not just present beneficiaries but often future recipients too and therefore need a secure and growing income stream combined with capital growth. Charity trustees have a duty to preserve the assets of their charity and in making investment decisions need to ensure that they diversify the portfolio appropriately. Unfortunately, charity investments lost 20% of their value in the past 12 months. Investments lost value in all major asset classes other than cash. UK equities are currently the most popular investment for charity trustees.

Hedge funds aim to deliver absolute returns during periods of extreme volatility. Whilst the average hedge fund across all strategies ended 2008 down 18.3%, this has to be seen against a backdrop where the FTSE 100 lost 31% and the Dow Jones 34% of their value in the same period. There were still some stellar performers in the industry who achieved double digit growth. Overall, there was much greater dispersal in the performance of funds than previously seen, making it clear that some fund managers were simply not very good. We can expect market forces to result in a Darwinian response to this situation – only the fittest can expect to survive.

Private equity investments are relatively illiquid, particularly in the early years, and are held for the long term, normally for between three and five years. So even if values fall in the short term, there is every chance prices will recover by the time it comes to exit. Traditionally, such investments are seen as high risk, and indeed they are. There is some correlation between returns on private equity and public equity and bond markets, but the correlation is not high. For many institutions, the potential higher returns over conventional asset classes justify the higher risk of such investments. As the companies are not listed on a public exchange, investors wishing to exit their private equity holding do so by selling it to another investor through a secondary market. So if an investor can build a small portfolio of unlisted investments and take a five year view, then it could be an attractive proposition.

Real estate is also a relatively illiquid asset class. However, investors like property because it is a stable way of generating inflation linked income over the long term. It is not correlated to stocks and bonds. Compared with equities, real estate looks relatively strong. Whilst many investors are not moving to boost allocations and are adopting a wait and see approach, fund managers are confident that real estate is here to stay. Most managers are planning to keep their allocations unchanged or increase them over the next year. Most are also keeping cash at the ready to deploy when the markets show signs of recovery.

Generally, investments in alternatives are still predicted to grow in the medium term. As charities continue to look for positive returns throughout market cycles the focus in the future really needs to be making sure that, if assets are invested in alternatives, they are only with managers who will provide growth whilst ensuring the underlying assets are secure.

Managing risk

Whilst performance statistics seem to suggest that hedge funds are still a good investment, recent scandals have highlighted weak governance and control in some hedge funds and funds of hedge funds. Consequently, several major charities have discovered that they were victims of fraudulent activity. Furthermore, a number of charities had millions of pounds of assets frozen in Icelandic bank accounts following the collapse of Iceland's financial sector which was riddled with bad debt.

Recent events suggest that charities need to become more sophisticated and ensure that they understand the underlying risks of strategies and the structure of the investment model in place before handing over their funds. Asset allocation is not about taking charities portfolios further up the risk spectrum. It is about spreading out investment risk across a variety of different asset classes and therefore reducing the overall risk. The Trustee Act called for more regular reviews of charity investment strategies. Effective pre-investment due diligence should identify unacceptably high risk investments. Ongoing monitoring of the operational controls of the fund manager would also confirm that the assets continue to exist.

Is there a case for more regulation?

There is a lot of debate about whether additional regulation over the alternative investment sector is required. In the UK, hedge fund managers and private equity fund managers are already regulated by the FSA.

However, the European Commission's proposals for regulating alternative investment fund managers were published in the form of a draft directive on 29 April 2009. The Alternative Investment Fund Managers Directive proposes regulation of managers of hedge funds, private equity and real estate funds with a portfolio of more than EUR 100m. This will apply to roughly 30% of hedge fund managers, managing 90% of assets of EU domiciled funds, although it is estimated that the majority of assets run by EU managers are domiciled outside the EU. There is a higher threshold of EUR 500m for managers not using leverage and having a 5 year lock-in period for investors. All investment managers will be required to be authorised and subject to harmonised regulatory standards. This draft legislation is currently very contentious and even if adopted is unlikely to come into effect before 2012.

Additional reliance on regulators may bring with it a belief that regulation can fix everything in markets. In fact, it could provide false comfort - the FSA and other regulators may not be in a position to address all relevant concerns, unless regulation becomes onerous.

Amidst the rhetoric, there is also a risk that people may lose sight of the mechanisms that already exist to maintain orderly markets and drive best practice in the industry. Investors can already turn to the industry's own best practice standards, and to the SAS 70 or AAF 01/06 frameworks for guidance.

Tools available to help charity trustees

To date, we have seen charity trustees and boards being less demanding of their investment managers than other institutional investors. Traditional asset managers have been asked, primarily by the pension trustees, to provide AAF 01/06 (formerly FRAG 21) or SAS 70 controls reports as a pre-requisite to investment and as an ongoing source of information and comfort over the control environment and operational controls. These reports include information on the investment manager's control environment, together with an independent opinion on the design suitability and operational effectiveness of controls over important areas, including safeguarding of assets and valuations, from a qualified reporting accountant. Whilst hedge fund managers, private equity and real estate managers, have not prepared such reports in the past, we are seeing a sea change in attitude since the start of 2009. For example, several large London-based hedge fund managers have already produced a controls report, or are considering doing so, and some large institutions have prepared separate controls reports covering their hedge fund businesses. We are also aware that a controls report is produced for a private equity house and two real estate managers.

Charity trustees should be demanding the same standard of operational controls as other institutional investors and ask for greater transparency and independent verification that their investments are being safeguarded. In this way, the market itself will improve standards irrespective of additional regulatory intervention.

For further advice and information please contact:

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What our clients are doing

Queen Elizabeth's Foundation and "Swapping for Good"™

Ethical, eco-friendly and extremely good fun, swapping clothes has become the latest fashion craze to hit the UK and it is not uncommon for canny fashionistas to benefit by overhauling their wardrobes for free. What made our "Swapping for Good"™ event at the Rose Theatre, Kingston in February so special was that it was specifically designed to help raise money for Queen Elizabeth's Foundation (QEF).

QEF has been nurturing ability out of disability for almost 75 years. As an organisation, it has always stood for developing the very best in disabled people – identifying talents, recognising abilities and providing opportunities. The charity provides specialist centres focusing on brain injury rehabilitation, vocational training for sustainable employment, the development of basic life skills for those with complex disabilities and mobility assessments and tuition.

We are constantly striving to improve our services for disabled people and our retail business plays an important part in helping to raise additional funds to be invested back into the charity. As this recession tightens, more and more people are visiting our charity shops looking for ethical bargains but, ironically, donations of good quality, unwanted clothes are dropping. Charities are no different than commercial companies in terms of needing to find creative solutions to commercial problems and our 13 shops across Surrey needed good quality clothing for resale.

So how did it work? Ladies were asked to bring along four garments, swapping three and donating one item to be sold through QEF charity shops. The evening was a great success as over 150 women came along to exchange their unworn unwanted clothes for a new free wardrobe while, at the same time, doing a good turn for others. Indeed, many ladies generously donated more than a single item resulting in over 300 donations of clothing on the night.

Helping to make our "Swapping for Good"™ a night to remember were TV style guru Nicky Hambleton-Jones who came along to offer advice, skin experts Dermalogica who were on hand to provide a Face Mapping® skin analysis, and the fashion students from Kingston University who gave tips on how to customise fashion to suit the individual.

It was a lot of fun and everyone seemed to have a really good time. So much so, that QEF "Swapping for Good"™ nights are likely to become a regular feature of our events diary.

Queen Elizabeth's Foundation
PROMOTING EQUALITY FOR DISABLED PEOPLE

Simon Dillsworth, Head of Business Development, Queen Elizabeth's Foundation
www.swappingforgood.com / www.qef.org.uk


NORTHERN BROADSIDES AND
WEST YORKSHIRE PLAYHOUSE
Othello

PricewaterhouseCoopers

Date for your diary

Charities Accounting, Taxation and Legal Update Seminar

Monday 23rd November 2009, 16.00
PricewaterhouseCoopers LLP, 1 Embankment Place, London, WC2N6RH

This technical update will cover recent accounting, taxation and legal matters affecting the sector.

If you would like to attend this event, please contact:

Lorraine Sackey lorraine.e.sackey@uk.pwc.com 020 7804 1301

PwC's Charity News is going green

Many of you will have received this edition of Charity News in electronic format; thank you for helping us to reduce our impact on the environment. We hope that more of our readers will switch to receiving an electronic copy in the future. We will, however, continue to mail printed copies to those of you who prefer this format.

If you would like to receive Charity News electronically, please send your email address to:

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