

# relief of poverty by charities – the tax issues

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## 1 Introduction

Responding to disastrous or calamitous situations and to very real and pressing needs can provoke an instinctive and immediate reaction 'from the heart'. The Tsunami was a clear example. Poverty in all its guises is another.

When we act instinctively to situations we can often disregard other considerations, things that we would have taken into account if we had some time to examine them in calmer and more rational times. That is not to say that we would deny help where needed but that we may avoid making some wrong assumptions. For example, there may be charity law and tax consequences arising from our actions. If these crop up and surprise us years after such a humane act, they can leave more than a bad taste. It is therefore worth being aware of the issues. This is particularly important for church leaders and trustees who have responsibilities and obligations to the authorities as much as to beneficiaries.

## 2 Why is relief of poverty a tax an issue?

There are several aspects to consider:

- Should the charity support this particular cause? (an *internal* decision)
- Is the charity empowered to give this particular support? (a *regulatory* decision)
- Following on from this, what are the Gift Aid and other tax consequences?

The first is a subjective consideration. The other two can lead to very unwelcome outcomes if charity leaders get it wrong.

Describing or defining the word 'poverty' is like trying to describe an elephant. It is not easy to give a robust definition and it means different things to different people. It is also very subjective. Like an elephant, in most cases, we are pretty sure when we see it.

Both churches and individuals can react to poverty with the heart. Poverty is not only evident in the third world; it is on our doorsteps - the homeless, aged and infirm, those caught up in a cycle of drugs, alcohol etc. It is difficult for most to turn away and ignore issues like this when they stare one in the face. For Christians, this is arguably a more acute issue.

## 3 Should the charity support the particular cause?

As noted above, this is an internal policy decision. The answer will depend on the goals and objectives that the trustees have set for the short and medium term, the priorities and the expected impact that their involvement will have in the particular circumstances.

In some cases, the charity's involvement could be quite crucial and have major impact, for example where a church identifies an ongoing need that others have not seen or recognised.

At the other extreme, it may be that other charities or relief bodies are already doing an excellent job and the benefits of your charity becoming involved may be marginal.

Could those funds and resources that you would otherwise devote be used for greater impact elsewhere?

## **4 Is the charity empowered to give this particular support?**

Churches usually have the promotion and advancement of religion as the central charitable objective. Some may have a separate objective of relieving poverty. Even where this second objective does not appear in the governing documents (trust deed, memorandum and articles or similar founding document), it is often a strand of the church activity through its doctrine and tenets.

### **4.1 What is poverty?**

Strictly, this is not a tax issue. Further, tax legislation does not specify or define 'poverty'. We therefore have to turn to quotes ('judicial dicta') from judges in cases that have gone before the courts. Even here, they fall short of a definition as such.

Most parties agree that poverty is a relative term. Anyone who cannot afford the normal things in life that most people would take for granted could probably be classed as being in poverty. So it doesn't just apply to those with a recognised low quality of life, it could include a wealthy person who has fallen on hard times through a particular event such as bereavement. In these cases, there may be temporary financial hardship that would still be eligible for assistance. Trustees may consider in these circumstances that it is more appropriate to give relief by way of a loan rather than an outright gift.

Just because someone is in receipt of State Benefits does not mean that they cannot receive further support from a charity if their full needs are not met by those benefits. That said, charities should take care in case provision of support means that some of the State Benefits are thereby withdrawn for example because of means testing. If that is the case, support may not be appropriate since the charity could then effectively be relieving the State rather than the individual!

### **4.2 Justification**

It is recognised that assessing 'the normal things in life' can be difficult to assess particularly in this day and age. Inevitably there will be a subjective judgement to be made. Also, standards of living and public perception change over time. It is therefore important that church leaders and trustees are able to justify their decisions to support individual cases of poverty rather than just acting on feelings or emotions or *long established* policy.

### **4.3 Guidelines and Policy**

However, it is helpful for churches or charities that are relieving poverty on a more than casual basis to establish guidelines covering the criteria used to decide on support for identified cases. These guidelines should be regularly reviewed. Possibly the restraints of the cash available will make it a case of deciding on need first. It may be better to make an impact on a narrower group of people rather than spread resources too thinly such that impact is materially reduced.

### **4.4 Further assistance**

The Charity Commission booklet CC 4 entitled 'Charities for the Relief of Financial Hardship' provides excellent advice to guide decisions and is recommended reading. It is available for download from [www.charity-commission.gov.uk/library/publications/pdfs/cc4text.pdf](http://www.charity-commission.gov.uk/library/publications/pdfs/cc4text.pdf)

## 5 What are the gift aid and other tax consequences?

Once the decision to support someone is made it's then a matter of how.

Practical help such as support, guidance, spiritual direction etc are helpful and will generally have no tax consequences. Cash gifts on the other hand might have consequences for the recipient although this is likely to be rare since in most cases, the relief given is unlikely to be regarded as taxable income.

### 5.1 Gift Aid – general principles

However, the gifts made into the charity are subject to a number of tax considerations, especially if made under the Gift Aid Scheme.

Take for example money put into church funds using Gift Aid. In tax terms donations are income in the hands of the church and are only exempt from tax if spent on the *charitable objectives*. If the Church trustees follow the guidance above, they will have taken steps to ensure that proposed payments are charitable and therefore there should be no problem here.

A few words of caution here: the need for a charity's funds to only be used for the charitable purposes set out in its Governing Document (Trust Deed, Memorandum and Articles of Association or similar) arise in both charity law and tax law. Therefore all payments that a charity makes must pass this test. Although it is rare for there to be a material breach of this nature, it does happen from time to time, even in the church sector. For example, a church decides to spend some of its income on a new sports car for the preacher (yes, this has happened). Unless that payment can be described under one of the legal 'heads of charity', it is classed as non-charitable expenditure. Any non-charitable expenditure can attract tax at the appropriate rate. For churches this could be the prevailing company tax rate. There are some peculiar elements to the tax calculation but the principle for recovery of tax is sound.

With restraints on funding in most churches this latter point is an unlikely event. However bizarre the example may seem it reflects the underlying need for 'trustees' to demonstrate care in whatever they do.

### 5.2 Gift aid and restricted funds

It is not uncommon for funds to be given to the church for specific appeals. Although donors can **express** a use for their donation one of the principles of Gift Aid is that it is given without imposing conditions on the charity's trustees. So a donor cannot make a gift under gift aid on **strict condition** that it is used to relieve a particular case of poverty (or for that matter on a **strict condition** that it is used for any other specific purpose). Trustees must retain discretion on how their charity's funds are used.

This is different to the situation where the church (that is the church trustees) recognises a need and establishes an appeal for that cause or where a donor suggests that their donation is used for a particular purpose and the trustees exercise their discretion in agreeing to the donor's suggestion.

As a matter of trust law, donations made to an appeal in this way become restricted funds and **must** be used for that purpose. If fulfilling this purpose becomes difficult or impossible, the trustees must either obtain the donor's permission to use the funds given by them in another way, return the donation to the donor on the basis that the trust created (by the donation) has failed or seek the advice of the Charity Commission. Advice should be sought before returning a donation as the payment is unlikely to rank as charitable expenditure and it therefore important to establish that the funds can be returned as a matter of charity and trust law.

**Returning a donation will also have tax consequences** if Gift Aid relief had been claimed on the donation – the tax so claimed will need to be promptly repaid to HM Revenue and Customs by sending a payment or adjusting the next repayment claim. The HMRC Charities office will talk you through the options if these circumstances occur.

### **5.3 Gift aid and payments overseas**

The matter becomes a little more involved when dealing with matters outside of the UK and extra care is needed. Whilst the same subjective judgement of 'poverty' can be made the trustees must take additional steps. Tax law is explicit on this. Section 506 of the Income and Corporation Taxes Act 1988 demands that when making payments to a body outside of the UK "... the charity concerned ... [takes] ... such steps as may be reasonable in the circumstances to ensure that the payment will be applied for charitable purposes".

Again there is a subjective element to this but evidence of enquiring into the overseas need, reading literature, receiving a presentation from someone closely involved, getting updates, seeing evidence of the money being spent on charitable needs (according to the UK definition of what is or is not charitable) would be strong support that the purpose was charitable.

## **6 Conclusion**

Supporting those less fortunate than ourselves is very important. By embedding the steps discussed above into the charity's thinking and procedures, an unexpected tax bill that could take the shine off the good work that is done, can be avoided.

## **7 Further help**

Further help and assistance can be obtained from:

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