

when a charity's income is not its income!

**Errors and pitfalls in
handling donations**

September 2006

stewardship[®]

PO Box 99, Loughton, Essex, IG10 3QJ

t: 08452 26 26 27

e: enquiries@stewardship.org.uk

w: www.stewardship.org.uk

CONTACT DETAILS

Stewardship

PO Box 99, Loughton, Essex IG10 3QJ

t 08452 26 26 27

f 020 8502 5333

e enquiries@stewardship.org.uk

w www.stewardship.org.uk

Stewardship is the operating name of Stewardship Services (UKET) Limited, a registered charity no. 234714, and a company limited by guarantee no. 90305, registered in England

© Copyright Stewardship 2006

DISCLAIMER

Whilst every care has been taken in the preparation of this material, Stewardship cannot be responsible for action taken or refrained from in reliance thereon. It is recommended that appropriate professional advice be sought in each relevant individual circumstance.

table of contents

	Page
Summary	2
1 Introduction	3
2 Gift aid: overview	3
3 Basic gift aid principles	3
3.1 Payment to charity and subsequent ownership	4
3.2 Gift by the donor	5
3.3 Receiving something in return	5
3.4 Applied for charitable purposes	6
4 Acting as Principal or Agent: overview	7
4.1 Acting as Principal	7
4.2 Donations for purposes outside of the charity's objects	7
4.3 Acting as Agent (or as a conduit)	7
4.4 Agency and gift aid	8
4.5 Agency and objects / powers	8
4.6 Money laundering risks	8
4.7 Principal v Agent: the boundaries	8
5 Gifts destined to benefit non-charities	8
6 Gifts overseas	9
7 Practical examples	9
8 Gift Aid - conclusion	12
9 Accounting considerations	13
9.1 Charities complying with SORP	13
9.2 Charity accounts on the receipts and payments basis	13
10 Further help from Stewardship	13
Appendix 1: Glossary	14
Appendix 2: HMRC Guidance	16
Appendix 3: Extract from Statement of Recommended Practice 2005: Accounting and Reporting by Charities	17

Summary

Whilst Gift Aid is simple in concept, aspects of its application give rise to plenty of opportunities for pitfalls for the unwary.

“When a Charity’s income is not its income” covers a difficult gift aid issue – that of ‘conduit funding’. For some churches and charities this could potentially be a significant banana skin because it is possible to undertake conduit funding without realising it. But the gift aid and other consequences of blissful ignorance can be significant and, at the extreme, critical.

Conduit funding risks arise when a charity accepts donations with an instruction, in some form, that the donation is passed to another charity or cause. It is certainly not always the case that such an arrangement will amount to conduit funding but in between clear cases at either extreme, there can be some unclear ground.

This Paper sets out to equip trustees and treasurers to understand the legal and tax principles involved in order that they can be aware of danger areas and either apply the principles to their own situation, or seek further advice where it is needed.

Essential to understanding the issues involved is an appreciation of basic gift aid principles. These are covered in Sections 2 and 3.

When a donor makes a gift for a specific purpose, that gift may legally fall into a restricted fund (sometimes known as an earmarked fund). But, it is also possible in some circumstances that the amount received is not a gift which will actually belong to the charity at all!

Distinguishing between these two cases is a crucial question for gift aid purposes that all too often is glossed over or not addressed at all.

If the donor sets conditions against a donation that are expressed in very tight terms, or the donor or a close relative receives a benefit as a result of the gift, the Revenue may attempt to argue (a) that there is no gift at all (on the basis that a gift with strings attached is not a gift) or (b) that the ‘benefit rules’ are breached. The consequence of either case is that the income is not eligible for gift aid tax recovery.

Section 4 deals with the fundamental question of whether a charity, in receiving a gift that is to be passed on to someone else, acts on their own behalf (i.e. as principal) or merely acts for the ultimate recipient (i.e. as agent).

This section explains the responsibilities the trustees have, in that a charity can only claim gift aid tax relief where it acts as principal, and also highlights the significant money laundering risk that charity trustees can take when acting as agent.

Sections 5 and 6 cover special situations: where a charity is asked to pass on funds to a non-charitable cause and where gifts are being made overseas.

Section 7 contains 8 examples illustrating the theory in practical situations common to churches and Christian charities.

Section 9 covers accounting for conduit funds.

1 Introduction

It is not uncommon for churches and Christian charities to receive donations that are ultimately intended to benefit another organisation or individual, such as a mission organisation or Christian worker.

Whilst a church or receiving charity may assume that it can always reclaim tax under gift aid on donations like these, the right to make that claim should be determined by legal principles based on the facts of the case. It may be that it is the organisation that ultimately benefits from the gift that should make the claim.

If the church or charity is merely acting as a conduit (or agent) in passing the funds onto the ultimate recipient, then gift aid should not be claimed. This is the province of the final recipient (and then, only if they are a UK charity).

As the issue of conduit funding is not readily understood, this Briefing Paper has been prepared in a bid to unravel this complex subject. It has been written with a particular focus on churches and Christian charities but the term 'charity' has been used throughout to refer to both.

The main focus is on the tax issues that arise for charities although a separate section also touches on accounting considerations.

A number of special meanings attach to words or phrases used in this document. Where this is the case, the particular word or phrase is presented in *Capitalised Bold Italics* and a definition is given in the Glossary (Appendix 1).

2 Gift aid: overview

Gift Aid provides tax relief on eligible gifts to charity in two parts:

- a) For the recipient charity by regarding the gift as coming from income that has borne tax at the "standard rate". This is currently 22%. So, for example, a gift of £78 is regarded as £100 less £22 tax and this tax can be reclaimed by the charity receiving the gift.
- b) Where the donor pays tax at the higher rate, currently 40%, s/he can obtain higher rate relief by reduction of her/his personal tax liability.

So in theory Gift Aid is very simple but in practice the detail gives rise to many issues. This paper focuses on some of the key issues that arise for charities in connection with gifts and other payments that they make.

3 Basic gift aid principles

There are several principles underlying Gift Aid that we need to consider. These are:

1. There must be a *Payment* of a sum of money to charity with the result that the funds given then *belong* to the charity;
2. The payment must constitute a *gift* by the donor;
3. There must be no benefit received by the donor, *or any 'person connected'¹ with them*, in consequence of the gift made;
4. The funds gifted must be used by the recipient charity in pursuance of its own *Charitable Objects*.

¹ Tax legislation defines what a 'connected person' is. Broadly this will include close relatives and business partners and associates

3.1 Payment to charity and subsequent ownership

In order for a charity to make a valid gift aid claim, the donation on which the claim is based must be a *Payment* of a sum of money to charity (section 25 Finance Act 1990). An attempt at a non-technical commentary, based on law, is made in the Glossary (Page 14).

A key issue is not just that the donation is a *Payment* but that, as a result, the funds then *belong* to the charity.

Restricted Income v Conduit Giving

A key principle in answering the question of just who can claim gift aid relief, the charity originally receiving the funds or the ultimate recipient, is an understanding the difference between restricted funds and conduit funds. Restricted funds belong to the charity, conduit funds do not, they merely pass through the charity.

This is very much a live issue. HM Revenue and Customs (HMRC) have raised enquiries into several charities on this point. Getting it wrong could prove costly both for the charities involved and, potentially, their trustees.

A donor may stipulate that the gift be used for a specific purpose. This is known as restricted income and is a well-established feature of charity finance. When a donor's restrictions are such as to prevent ownership by the charity the result is known as 'conduit' giving.

A *Payment* is broadly a transfer of ownership from payer to recipient (although that is not a legal definition!). If the donor gives on the basis of conditions that deny the charity any of the benefits of ownership (for example by *dictating* what the charity must do with those funds), then the charity does not become the full owner of the funds: it merely acts as a conduit of those funds to the ultimate recipient.

In other words, the question has to be asked: Is the charity just acting as agent (or as a conduit) in passing funds on to the third party or do the funds become its own income, albeit restricted?

This question has implications for:

- Tax recoveries under Gift Aid
- Year end accounting treatment and disclosures
- The charity's own charitable activities, and potentially
- The trustees' personal liability for tax incorrectly claimed.

Example

A charity may establish a fund for a specific purpose and appeal for donations to that fund (for example the disaster appeals for the Tsunami and for Pakistan Earthquake relief). Donations subsequently received for these can qualify for Gift Aid (assuming that the other requirements of the regulations are met). This is because the charity took the initiative in establishing the fund. The same principle applies to small projects and/or support for individual workers. Where however the giving initiative originated with the donor then, unless the trustees can exercise discretion over *how* the donation is used, the gift may be regarded as 'conduit' giving and not eligible for Gift Aid. For further guidance, see the practical examples included below, starting at page 9.

3.2 Gift by the donor

Generally speaking, a **gift** is something freely given, with nothing demanded in return. God's saving grace is a clear example. He does not expect anything in return for salvation. It's free. Unconditional. So it follows that this concept may be impaired when conditions are attached to a gift or when the donor receives something in return.

In exactly the same way, if a donation is to qualify for gift aid, it must be made free of any conditions that bind the charity trustees' hands so tightly that they cannot make any decisions about the funds for themselves. A gift conditional on its being applied for a general purpose such as the relief of poverty in a particular country would be acceptable, but not if it had to be paid to specified individual beneficiaries, giving the trustees no scope for making a decision. Where the gift is made in response to an appeal or is for a specific fund or need already established or recognised by the charity, then the charity has already made decisions concerning it and there is no difficulty.

A donation cannot be made subject to conditions as to repayment. For example, if the gift is made subject to a condition that it will be repaid if something does or doesn't happen, then it is likely to be regarded as a loan and not a gift and so not available for Gift Aid.

Our view (which is shared by HM Revenue and Customs) is that where the church trustees decide to set up a fund for a particular purpose, this is exercise of discretion. So, monies received into that fund, notwithstanding that the fund may be for a fairly restricted purpose², qualify as gifts and therefore, subject to all other gift aid rules being met are capable of tax relief.

Remember that unless the donor specifies otherwise, the tax reclaimed must be used for the same purpose as the restricted donation itself.

3.3 Receiving something in return

The word 'gift' is not defined in the tax legislation and therefore takes its ordinary meaning. If a definition were attempted, options may include:

- Something given with nothing received in return;
- Something given but with only something minor received in return;
- A payment or gift of another asset, so long as the value of whatever is received in return is less than that the value of the gift;
- Something given but with an inducement to the recipient to behave in a particular way;

For gift aid purposes, the second and third options can be dismissed since they are dealt with by the 'no benefits' rules built into the gift aid legislation. Further comment is made on this below.

The fourth option, whilst it has the appeal of *potentially* qualifying as a gift, the no benefits rules could apply and, if the inducement amounts to a condition, the payment and belonging tests may not be satisfied.

For gift aid purposes, this therefore leaves us with only one safe option, namely the first one – to qualify for gift aid relief, the gift should be given with nothing received in return.

² Here we use the term restricted purpose to mean a purpose specified by the donor which is narrower than the charity's overall *Charitable Objects*.

This links in with the concept of a 'gift' adopted by gift aid legislation. In effect, Parliament is saying that, for gift aid purposes, although very small benefits will be accepted (possibly as a practical measure)³, in essence the concept of 'gift' should follow option one above.

Having said this, the practical rules governing permissible benefits are quite complex in their application!

What counts as a benefit?

Connected Persons

Subject to the very small limits,³ there should be no benefits accruing to the donor, or any person *Connected* with the donor, in consequence of the donation.

The law defines who is regarded as a *Connected* person and includes the situation where the ultimate beneficiary of a gift is a "close relative" of the donor. The donor is deemed to have received a benefit in consequence of making their gift and the gift therefore cannot qualify for Gift Aid. A "close relative" is broadly defined as an ancestor, descendant, sibling or the spouse of any of these. For further guidance, see the Table on Page 14.

This has particular relevance in Christian work as close relatives of Christian workers frequently are in full sympathy with them and support them financially. Gifts for personal support from close relatives that are passed directly to the worker cannot qualify for Gift Aid. However if the charity operates a system that pools gifts and the worker receives an allowance or salary from the pool that is not influenced by the gifts received by the charity for them, the direct link with the gift from the close relative is broken and Gift Aid may be claimed. This proscription applies only to gifts for personal support and not to expenses of the work or projects.

Readers may find HMRC published guidance on the subject of "Donations to support missionaries and other full-time workers for a charitable cause" which is reproduced in Appendix 2, helpful in this regard.

Intangible benefits

One can imagine a range of examples where a gift is given but something is received in return (for example, flag day donations). Obtaining 'something' in return need not be monetary and does not have to be of equal or similar value to the gift. It could be an intangible benefit such as influencing the trustees to act in a particular way that benefits the donor.

3.4 Applied for charitable purposes

Both for the purposes of charity law and for tax law, charity trustees are obliged to spend their funds only in pursuance of **their** charitable purposes or on activities that are reasonably incidental thereto (for example necessary administrative expenditure).

Where a charity does spend significant sums on activities outside of its *Charitable Objects*, the charity trustees not only risk action against them by the Charity Commission for breach of trust for reimbursement with interest of charity assets which they have misapplied, but they may also be exposed to personal liability for repayment of charity tax reliefs lost as a result of the misapplication.

³ Gift Aid legislation provides for very small benefits within given limits, as defined in law, to be allowed.

Trustees can unwittingly become vulnerable here where the influence over the proposed destination of funds is coming from outside of the trustees, namely the donor. A donor may be unaware of the charity's own legally defined objects. So, even if the *Conduit Funds* hurdle is overcome, the trustees must also check that the proposed payments are not only charitable according to (the relevant) UK⁴ law but are also within the charity's own, probably narrower, *Charitable Objects*.

Where the ultimate recipient is either an individual or an overseas charity, this will normally involve the trustees in taking additional reasonable steps to ensure that the funds are actually applied for charitable purposes within the charity's objects.⁵

4 Acting as Principal or Agent: overview

Before going into a detailed analysis of the consequences of a charity acting as principal on the one hand or agent on the other, it is useful to present some general principles in overview.

4.1 Acting as Principal

Where a donation is given to the charity for its own funds, to be used by the trustees in furtherance of its *Charitable Objects* according to the discretion of the trustees, it will be acting as principal. This is the most common way that a charity will handle its funds. A donor may specify that their donation is to be used for a purpose which is *narrower* than, but still within the charity's overall objects. Provided that the trustees can still exercise discretion with the funds given, the charity will be acting as principal, but of a restricted fund.

4.2 Donations for purposes outside of the charity's objects

A charity cannot normally act as principal where a gift is made by a donor for purposes outside of its *Charitable Objects*. It may be able to act as agent but, even then, it should only do so if one or more of its *Charitable Objects* are being advanced as a result.

4.3 Acting as Agent (or as a conduit)

A charity may *choose* to act as agent (in other words, as a conduit) for a variety of reasons. For example, the charity may be in a position to raise or have access to funds for a particular cause but another charity may be in a better position, perhaps because of readily available resources and practical experience, to actually carry out the charitable work with the funds 'organised' by the first charity. Rather than the first charity making grants to the second (in which case, the trustees of the first charity would be exercising discretion in making those grants and would take responsibility for ensuring that the second charity used the funds for the intended charitable purposes), the first charity may *choose* to simply pass funds on. No trustee discretion is involved and the donors may be made aware that their donation is going to be 'channelled' on to the next charity.

⁴ Principally, the Charities Act 1993 and the forthcoming Charities Act 2006 in England and Wales; The Charities and Trustee Investment (Scotland) Act 2005 in Scotland and general case law in Northern Ireland.

⁵ This is required by Section 506(3) Taxes Act 1988.

4.4 Agency and gift aid

In an agency arrangement all parties concerned need to be clear that a gift aid claim **cannot** be made by the intermediate charity that acts as agent. Only the ultimate recipient charity can make this claim, if it is eligible to do so.

4.5 Agency and objects / powers

A charity can only act as agent if, in doing so, it is furthering its objects and the charity's powers extend to its acting as agent. If the objects specifically permit a particular course of action, then there is an implied power.

4.6 Money laundering risks

Trustees should be aware that churches and charities are increasingly being targeted to launder money. This can arise from the proceeds of **any** crime, not just drug trafficking and terrorism.

It is therefore incumbent on trustees to be careful and not allow the charity to become vulnerable to a charge of being complicit in money laundering activity. Trustees should take steps to satisfy themselves that they do not have suspicions about a particular transaction or transactions. For example, suspicions may be aroused over the legitimacy of the source of the funds or the proposed destination. Trustees should always take reasonable steps to satisfy themselves over the bona fides of the ultimate recipient and that the funds will be spent for the intended charitable purposes. This is particularly so in relation to payments overseas.

If a donor wants the charity to enter into an agency arrangement, the trustees should ask themselves why? Are there dubious or inexplicable reasons pointing to a real motive such as a need to offload funds or 'park' them such as in divorce proceedings?

Clearly the risk of being used for money laundering is significantly higher where the charity is asked to, or decides to act as agent rather than principal; particularly where the relationship between the parties is more of a one off nature rather than one of building a working relationship. The safest option is for charities to refuse to act in an agency capacity.

There are specific statutory provisions relating to money-laundering with which charities must comply, the details being beyond the scope of this Briefing Paper

4.7 Principal v Agent: the boundaries

The boundary between an agency (or conduit) arrangement and one where the trustees act as principal is not always clear cut. There can be different interpretations of the facts and charities should therefore be prepared to argue their case if challenged, where it is warranted.

5 Gifts destined to benefit non-charities

The purpose of Gift Aid is to provide relief for gifts to charities: an incentive for charitable giving. Therefore the gift must be used for charitable purposes to qualify for tax relief.

So, interposing a charity cannot make something that is not charitable become eligible for gift aid relief in these circumstances. HMRC are keen to support genuine charitable activity but do not want to see claims made when charities are interposed just to 'tidy up' or take advantage of Gift Aid.

Practical Examples 7 and 8 below further illustrate the issues here.

6 Gifts overseas

One final point on tax, referred to earlier. Where a church is making gifts to overseas causes, the Taxes Acts⁴ impose a further condition if charitable tax reliefs are to apply without restriction. Here, the trustees should take reasonable steps to *ensure* that the funds remitted overseas are not only intended for use for a purpose that would, if used in the UK, qualify as a charitable purpose according to UK law, but that the funds are in fact so used.

Given that charity laws in foreign countries do not necessarily match UK law, ensuring that funds are being used by a charity registered in an overseas jurisdiction is insufficient. HMRC guidance on 'payments to overseas bodies' on the legal requirements can be found at http://www.hmrc.gov.uk/charities/guidance-notes/annex2/annex_ii.htm#ii4

7 Practical examples

The following examples are not exclusive or all-embracing. They have been selected to illustrate and, hopefully, clarify areas of difficulty and/or doubt. *In each of the examples 1 – 6 below, we have made the important assumption that the proposed gift from the charity will be within the charity's own charitable purposes.*

1. Jean B approaches the Church and says "I would like to see the Church support work in a village in Agawayo in West Africa". She explains the local needs to the Church trustees. Relief of poverty worldwide is part of the charitable objects of the Church and so they agree that this would be worthwhile use of the Church's resources and accept the donation from Jean at the same time setting up a restricted fund for that purpose.

Here, the trustees whilst not taking the original initiative have exercised their own discretion in the running and managing of the charity. The income received belongs to the Church albeit it is restricted as to use. Gift aid can be claimed and the tax repaid will also form part of that fund (unless donors specify otherwise).

2. John G approaches the Church and dictates that the £100 'donation' that he is making is to be paid onto the Agawayo Foundation in West Africa. Support for the Agawayo Foundation is not part of the Church's current activities or mission budget nor has an appeal for it been made by the Church.

Here, the position will not always be free from doubt. It may be argued that the trustees of the Church are being given no option (or discretion) as to what to do with this money. It does not relate to a fund they have established and therefore they are simply acting as a conduit (or agent) for the funds to be passed onto the ultimate recipient. It is therefore not their income and they cannot claim a repayment under gift aid. If this assertion is right, the ultimate recipient is not a UK charity and therefore cannot make a claim for Gift Aid either.

However, legal counsel has advised Stewardship that the above analysis may not necessarily be correct. In the absence of any contrary evidence or agreement, the trustees' act of receiving the money into their bank account and the passing on of the funds to Agawayo (which is within the church's objects) could be interpreted as an implicit acceptance by the trustees of a gift for their own funds. Further, one presumes for reasons already outlined, that the trustees will want to have learned more about Agawayo before making any payments. The trustees should apply thought to the gift, and document that process. This is key to reducing the risk of them being only a conduit.

3. The Church is organising a mission trip to Agawayo. Church members have to raise their *own* support, including air fares, and as long as the money is raised the individual will be allowed to go. This is effectively the 'purchase' of the 'right to go'. Monies gifted to the Church earmarked for a *particular* individual who thus obtains the right to go on the mission will **not** qualify for gift aid relief. **There are several problems:**

- **The Church has not selected the individual in order to achieve a charitable objective. The money received is not a gift to achieve that end but a purchase by the donor. The Church is obliged to apply the funds for the benefit of any individual that raises the target level of funding;**
- **If any of the support comes from relatives (or other *Connected* persons), then the donor benefit rules are likely to prevent gift aid being available.**

Here the trustees are not exercising any discretion. Their hands are tied and the gifts effectively amount to self selection by the individuals concerned, by virtue of their own fundraising efforts and the consequent instruction to the Church.

But by adopting a different approach, it may, in our view, be possible to claim gift aid relief, as in the following example. However, because self selection is removed, the personnel that go on mission may differ.

4. As 3. above but the Church selects the individuals to go (maybe, but not essentially, after an application process) and then the Church invites support.

If the Church invites donors to support a named individual who has been selected for the trip, care must be taken that no relative or person otherwise connected with the named individual gives under gift aid as this is very likely to offend the 'no benefits' gift aid rule;

The church may undertake to give preference to those that raise funds (or sufficient funds) for the trip in selecting who goes on the trip. This would still be a charitable application of funds and therefore would not prevent gift aid applying. The key is that the Church remains in control of the selection process.

If the Church invites members and friends to support a fund for all of those going (rather than named individuals) and the level of support given will not affect the personal position of any one of the trip participants, then, in our view, gift aid relief can be claimed, even where giving is from a relative or connected person, since any benefit received will not usually be "in consequence of [the relative's] donation"⁶.

5. A mission charity sets up a fund for A, who is a prospective missionary with them. They ask for A to raise his own support through friends and contacts, all of which is to be given by supporters to the mission charity direct. They say to A that they will pass on all of the funds received to A but on the strict proviso that the funds passed on will only be used for purposes a, b or c (all of which are clearly purposes within their own *Charitable Objects*).

Here, the trustees have exercised discretion in setting up the fund for the support of A and in how those funds are to be applied (purposes a, b and c). We would therefore consider that Gift Aid can be claimed on donations to the fund.

⁶ It is conceivable that in the particular circumstances of the church's finances that it could be argued that there is a benefit in consequence of a relative's donation. Therefore, the benefits point should always be borne in mind.

The trustees should nevertheless insist on A's accountability and obtain reports of how the funds are used to ensure their continuing charitable application, particularly if funds are to be applied overseas.

It may also be necessary to put a financial ceiling on one or more of the purposes. For example, if purpose a. is to clothe and feed A whilst on the mission field, this may clearly be a charitable purpose where support is £X, because it provides a basic level of living that A could not otherwise afford, but **not** where support for (or expenditure on) purpose a reached five times £X!

Again, the "close relative" rules should not be overlooked.

6. A prospective missionary B approaches a charity and says "if I am a suitable candidate and you agree that the work that I am proposing is a worthwhile way to meet your *Charitable Objectives*, I will arrange for full funding to be provided to you for these activities". The trustees make an evaluation of both B and the project that he is proposing and are very enthusiastic. They assess his funding plan and the associated risks and accept his proposal. They monitor funding levels and the expenditure as part of the payment process.

Qualifying donations can be gift aided. The charity has exercised its discretion on the project and in monitoring the expenditure. This is not a mere channelling of funds from supporters to B through the charity. Monitoring of funding levels is very important and should have regard to the local living standards of the mission territory and not simply according to UK standards of living. Our Briefing Paper 'Relief of Poverty by Charities' may provide useful further reading.

7. A church is asked if, instead of making a gift directly to a person or cause which is not a charity, the donor can make it to the church in order for a gift aid tax reclaim to be made.

This is dangerous territory and could amount to fraudulent and abusive use of the charity's status! If the donation is given subject to an instruction as to use without discretion by the trustees, the funds do not actually belong to the church (so there is no 'payment' to charity as required by gift aid law)⁷. If the funds do not belong to the church, there is no gift to charity. The gift to the third party would need to fulfil a charitable object of the church if it is to be made at all and would be a conduit payment. However, the significant risk in these circumstances that the church becomes complicit in money laundering should not be under-estimated.

8. As in 7. above but the donor expresses a *desire* that their gift is used to benefit a person or a cause which is not a charity.

The 'gift' objection is overcome and the Church is not now prevented from receiving ownership of the funds. But further consideration needs to be given. There are two potential scenarios:

Scenario 1: Are the Church's Charitable Objectives fulfilled?

If the Church is actually pursuing one or more of its own charitable purposes in paying the funds onward because, although the ultimate recipient is not a charity, *the activity* that the payment is funding is in line with the Church's *Charitable Objectives*, then gift aid can be claimed subject to the normal gift aid rules without further concerns.

⁷ *Barclays Bank Ltd v Quistclose Investments Ltd* is an example of the trust principles that apply here.

An example would be a payment to an overseas missionary to fund their purchase of Bibles, their living costs where they would otherwise be unable to maintain themselves on the mission field or funds sent to an overseas hospital to fund particular medical work amongst the poor.

Scenario 2: Proposed use not charitable or outside of the Charitable Objects.

Assuming that the donation has been made in a way that it is capable of being a gift to charity and that the funds donated now belong to the Church, the trustees are in a tricky position.

If they comply with the request and pay the funds to the cause nominated by the donor they will be in breach of trust. Although they may have legitimately claimed gift aid relief on the incoming donation, the funds will not have been applied for *their* charitable purposes. If the amounts involved are significant, the trustees could face investigation by the Charity Commission for breach of trust and misapplication of charity assets.

HM Revenue and Customs will want to ensure that payments made by the Church are all charitable. If non-charitable payments are significant, the church may find that some or all of their charitable tax reliefs are withdrawn and some or all of the tax previously reclaimed may have to be repaid.

In either circumstance there could be a claim against the trustees personally.

The trustees may be aware of their position. They have two options. The first and better course of action is for the situation to be explained to the donor and for the trustees to seek permission for the donation to be used in a way that is charitable. The second but inferior option is to repay the funds to the donor. If there is a clear error or misunderstanding on the part of the donor, or the donor and the trustees, at the time of the donation, this may well be permissible. In other circumstances, the original donation is now part of the Church's charitable funds and making a payment back to the donor is not a charitable use of the Church funds! The authorities do not always take this point but if the amounts involved are significant, advice should be taken before making any repayment.

8 Gift Aid - conclusion

From the above examples, it should be clear that much depends on the circumstances and structure of the arrangements. It is vital that the trustees exercise their discretion as trustees and that gifts received by them are not subject to unduly strict conditions. Wording on documentation can be important and should evidence, rather than contradict, the desired outcome.

9 Accounting considerations

9.1 Charities complying with SORP

Charities that are required⁸ to or voluntarily comply with the principles of the Charities Statement of Recommended Practice "Accounting and Reporting By Charities" (2005) ("SORP") should consult Paragraphs 112-113⁹ and 319-320 of that document.

As expected funds received under conduit funding arrangements should not be shown as the charity's own income in the Statement of Financial Activities.

Equally, the asset (for example, cash) received and the obligation (liability) to pay this over to the third party should **not** be shown in the charity's balance sheet. **Instead, it should be separately identified in the notes to the accounts**, with sufficient detail so that the reader of the accounts will understand the nature of the transaction and the relationship with the donor and ultimate recipient.

Where the arrangements are such that the funds do belong to the charity, normal charity accounting principles apply.

9.2 Charity accounts on the receipts and payments basis

Where a charity is permitted to prepare its accounts on the receipts and payments basis, SORP only has the status of guidance.

The charity should not account for conduit funds as a receipt or a payment unless a separate receipts and payments account is prepared with appropriate explanation of the nature of the transactions therein and the relationships with the other parties (as set out above for charities complying with SORP).

In all cases, the Statement of Assets and Liabilities should separately identify the assets held (for example, cash donated) and the liability to pay over the funds to the ultimate recipient, again with appropriate narrative description to enable the reader of the accounts to understand the nature of the transactions and relationships involved.

10 Further help from Stewardship

Further help and assistance can be obtained from:

Stewardship
PO Box 99, Loughton IG10 3QJ
tel: 08452 26 26 27
e-mail: enquiries@stewardship.org.uk
web: www.stewardship.org.uk

contacts: Kevin Russell or Stephen Mathews

⁸ Broadly, unincorporated charities with a gross income of over £100,000 and all charities that are either limited company charities or are preparing accounts on the accruals basis are legally required to comply with SORP.

⁹ A paraphrased extract is given in Appendix 3.

Appendix 1: Glossary

Charitable Objects

The charitable objects of a charity are normally set out in its Governing Document (commonly, the Trust Deed or Memorandum and Articles of Association) and usually cannot be changed. The charitable objects are not therefore the same as the mission statement, the short to medium term goals, the strategies or the day to day activities, but each of these must be consistent with the charity's objects.

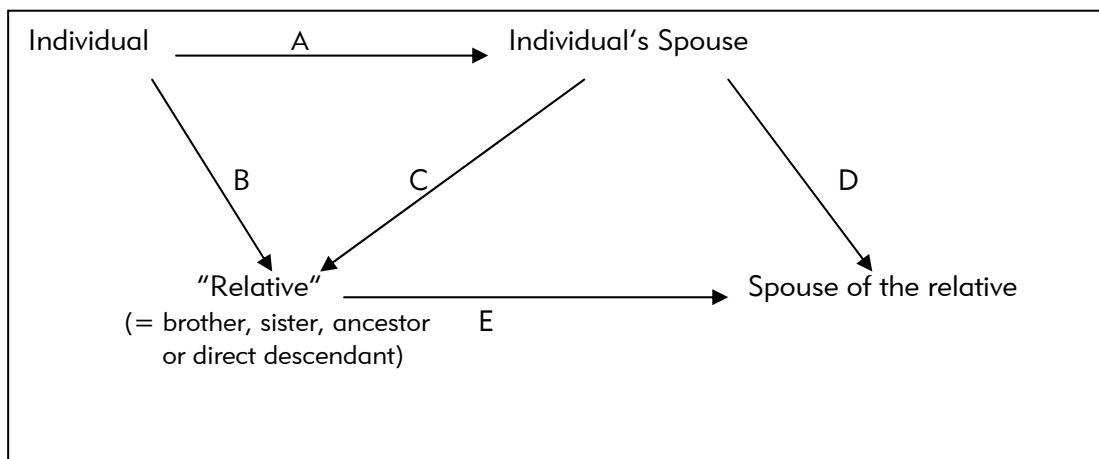
The objects express what the charity was originally set up to do, in other words its purposes. In law, they are the basis (or trusts) on which donations are received. Typically, charities are established to do things that are narrower than the full range of activities that would be considered charitable in law. This means that a particular charity may not be empowered to undertake many forms of charitable activity because to do so would be outside the bounds of its Governing Document and would therefore amount to a breach of trust.

Objects (the purpose that we intend to achieve) can also be contrasted with 'powers' (what we are allowed to do in pursuance of those purposes). These are in most cases defined in the charity's governing document, although there are some powers available by virtue of statute (eg the Trustee Act 2000 or the Companies Acts) and some powers may be implied..

For gift aid purposes, objects must be charitable according to UK charity law. This can be very different from what may be regarded as 'charitable' in overseas countries.

Connected Persons

The term 'Connected Persons' is defined in tax legislation in fairly complex terms. In order to present a more simplified analysis, the following diagram illustrates persons that are connected with "an individual" (who would normally be the donor). There is a connection for these purposes if you can follow through a family connection from the Individual to any other person via the arrows or a series of arrows.



1. Is a donor "connected with" his step-daughter, who is a missionary?

In the diagram above, the Individual (donor) is connected with his/her Spouse (A). The Spouse is connected with her/his Daughter, who is a direct (lineal) descendant (C). Therefore the donor is connected with his Step daughter (route AC).

2. What about the donor giving to the Step daughter's husband who is also a missionary?

They are still connected because of the spouse of the relative rule in the table above (route ACE).

Payment

A donation must be a payment **of a sum of money**. Therefore, it does not include waiving the right to repayment of a loan previously made to the charity or by otherwise converting a debt or loan.

A 'payment' can be made by cash, cheque, direct debit, credit card, debit card, postal order, standing order or telegraphic transfer, in sterling or in foreign currency.

Donations by cheque are only valid pending clearance of the cheque. If the cheque is not honoured a payment has not been made. Although it is a promise to pay money to charity, payment does not strictly take place until the promise is fulfilled. However, it seems that so long as a cheque is paid in the normal way, HMRC are content to treat this as a valid donation once the charity is in possession of the cheque.

Payments by banker's standing order may be claimed according to the due date provided that payment is subsequently received.

Gifts in kind (goods or services or property) are not payments within the gift aid scheme. Note however that there are separate tax reliefs for gifts of quoted shares and land and buildings to charity.

Appendix 2: HMRC Guidance

The following is extracted from Chapter 3 of HMRC Detailed Guidance Notes for Charities. Additional emphasis has been added.

Donations to support missionaries and other full-time workers for a charitable cause

Gift Aid only applies to **unfettered gifts** to a charity for its charitable purposes. Donors earmarking money for the support of relatives are, in principle, no different from those generally making payments to support other relatives, for whatever reason. These are not tax relieved. Once a Gift Aid payment has been received it is for the charity to show that its income has been applied for charitable purposes only. Gifts given on **condition**, rather than hope or expectation, that they will be used to feed and clothe a relative **are likely to breach the benefits rules for Gift Aid**.

HM Revenue & Customs takes the view that donations to cover the costs incurred by a charity such as a missionary society in supporting the relative of the donor, as a missionary, **can qualify under the Gift Aid scheme provided the missionary society is not merely channeling** a donation to the donor's relative. Where, for example, a missionary society says to its workers "It costs us £10,000 a year to support you while you carry out your charitable work. We look to you to raise at least this amount of funds **for the society** through donations from family, etc" the donations may qualify under the Gift Aid scheme. Where, on the other hand, a missionary society says to its missionaries "It is up to you to support yourself while you carry out your charitable work, with the help of your family, etc. If your family wishes to send you money they can do so via the Society" payments will **not** qualify under the Gift Aid scheme.

This situation equally applies where a church, for example, supports the charitable work of a Christian worker. The Christian worker is unlikely to be in the employment of the Church and so **the onus in demonstrating** that payments made to particular individuals are unfettered and only applied for charitable purposes **falls to the trustees** of the church.

Appendix 3: Extract from Statement of Recommended Practice 2005: Accounting and Reporting by Charities

Words in *italics* are author's clarifications rather than quoted text.

Paragraphs 112 and 113 of SORP 2005:

"Some incoming resources do not belong to the charity, for instance where it receives resources in circumstances where the trustees, acting as agents ... are legally bound to pay them over to a third party and have no responsibility for their ultimate application. In these circumstances the transaction is legally a transfer from the original party ... to the specified third party. If the original payer [*e.g. a person paying into a church/charity*] retains the legal responsibility for ensuring the charitable application of the funds, the intermediary charity should not recognise the resources..."

"However, in some cases an intermediary charity may control the use of the resources prior to their transfer to a third party and its trustees will act as principal and have responsibility for their charitable application..."

The key issue shown here is in the responsibility taken by the church/charity to ensure the funds are used for their proper charitable purpose.