



Charity Finance Group

Backing charities to deliver a better society

Autumn Budget 2017

Use this Autumn Budget to help charities deliver a better society

In our previous [Autumn Statement 2016 submission](#) we outlined why government needed to support the sector.

We believe that there are clear fiscal, economic, moral and efficiency reasons why supporting charities through the tax system is the right thing to do. From saving government billions to driving employment, charities are too big to ignore.

These reasons have been reinforced by the need for Britain to need to adapt in order to succeed after leaving the European Union. As the Prime Minister said today in Florence, we must use this moment not just to change our relationship with Europe, but also the way that we do things at home.

The Prime Minister also said that one of our country's fundamental strengths is its 'indomitable spirit'. The charitable impulse, the desire to help others, is core to that indomitable spirit. The government needs to support it and nurture it over the next few years if the UK is going to make a success of Brexit.

The charity sector, like the rest of the economy, faces risks with Brexit. We have outlined some of these risks in our report [A Brexit that works for everyone](#). In particular, it is likely that charities are going to need to do more to support beneficiaries, despite increased cost pressures.

However, there are also significant opportunities. One of the clearest areas is in charity tax. Irrecoverable VAT drains huge levels of resource from the frontline, due to rules that were created decades ago without a thought for the modern charity sector and continued government inaction.

Now is a chance for the government to lay the foundation for a stronger charity sector which can help people and communities. As we have said in our joint-submission on behalf of charities, voluntary organisations and social enterprises, the government needs every part of our economy and society working effectively to make the best of Brexit.

One of the biggest steps forward the government can take in preparing for Brexit is to support hundreds of thousands of charities across the country. Our submission contains three proposals which the government can action immediately to support the sector:

- **Create a joint government-charity sector working party to consider how irrecoverable VAT can be eliminated post-Brexit in a way that is fair and fiscally deliverable.**
- **Commit to eliminating Insurance Premium Tax for charities either immediately or through stages via a special rate.**
- **Increase business rate relief for charities, with the goal of creating 100% relief for charities by the end of the decade.**

We urge the government to engage with charities ahead of the Autumn Budget to discuss how the tax system can be made to better serve society and the charity sector.

Our proposals

- 1) Create a joint government-charity sector working party to consider how irrecoverable VAT can be eliminated for charities post-Brexit in a way which is and fiscally deliverable.

Policy option: Reduce irrecoverable VAT for charities				
Estimated Costs per year (£m) between 2017-18 and 2021-2022				
2018/19	2019/20	2020/21	2021/22	2022/23
?	?	?	?	?
What is the problem under consideration?				
<p>The latest available estimate for the cost of irrecoverable VAT for charities is £1.5bn per annum according to the Charity Tax Group.</p> <p>Irrecoverable VAT is the gap between what the sector pays out in VAT and the amount it receives in VAT. The direct impact of irrecoverable VAT is significant and is equivalent to £9,204 for every charity in the UK.</p> <p>This gap is the unforeseen circumstance of the exemptions and exceptions that charities received when VAT was created in order to ensure that they were not forced to charge beneficiaries for their services. However, this redirects charities' resources away from their beneficiaries and creates an uneven playing field for charities that wish to engage in public service delivery as public bodies already have a rebate mechanism for their irrecoverable VAT.</p> <p>The tax system should be fair to charities, and resources should not be wasted due to complexities within the VAT system that was not designed with the unique position of charities in mind. In Autumn Statement 2014 and Budget 2015, the government set up a rebate scheme for hospices, blood bikes and search and rescue charities, proving reform is possible without the need for European action.</p> <p>Now that we are leaving the European Union, further blocks to reform such as creating new zero rates have also been eliminated.</p>				
Overview of policy options:				
<ul style="list-style-type: none"> - <i>Phase in rebate scheme to enable all voluntary organisations to reclaim VAT incurred on non-business income over five years.</i> - <i>Convert existing 'exemptions' into 'zero-ratings' or 'options to tax' so that VAT can be recovered.</i> 				
<p>A rebate mechanism would not lead to all the irrecoverable VAT, but it would significantly reduce the burden facing providers of services in social welfare, education and health care</p>				

services. These are often areas where voluntary organisations are complimenting the services that are provided by the state.

A rebate mechanism would need to be complemented by converting current VAT exemptions into zero-ratings (or options to tax) for business activities so that the levels of irrecoverable VAT are substantially reduced for the charity sector. This can now be done in a post-Brexit environment.

Not all irrecoverable VAT would be recovered under these schemes, but if we assume that 90% can be reduced via these methods, then this would cost £1.35bn – if the latest estimate is accurate.

We appreciate that this could not be implemented overnight and there would need to be time for the rebate mechanism to be developed as well as negotiation about the exact process of covering VAT exemptions into zero-ratings/options to tax.

However it would be prudent to begin discussions now so that we can make progress ahead of any transition to leave the European Union and help the sector to cope with any additional burdens that may be placed upon it in leaving the EU.

This measure would have considerable public support. In representative national poll carried out earlier this year by ComRes - **63% of the public also said that the government should use its newfound flexibility in leaving the EU to amend the VAT system to end the burden of irrecoverable VAT.**

What are the policy objectives and intended effects?

The aim of the policy is to reduce the costs for charities so that more can be reinvested into delivering charitable activities.

It would also help the charity sector to meet demand in a post-Brexit environment.

The impact of VAT reform would be transformational to the UK charity sector, not only reducing the amount of time spent focused on structuring activities in such a way to avoid large VAT bills and paying for advice, but also in freeing up hundreds of millions of pounds to be spent on helping advance good causes.

Given that a large amount of the charity sector's expenditure goes on employing staff, it would also have positive impacts on employment and local communities. Unlike private businesses, charities are not by law allowed to grow „cash piles“ and can only hold reserves for specific purposes.

2) Commit to eliminating Insurance Premium Tax for charities either immediately or through stages via a special rate.

Policy option: Exempt charities from the Insurance Premium Tax				
Estimated Costs per year (£m) between 2017-18 and 2021-2022				
2018/19	2019/20	2020/21	2021/22	2022/23
-50	-50	-50	-50	-50
Policy option: Create a special rate for registered charities for Insurance Premium Tax as a pathway towards eliminate it completely				
2018/19	2019/20	2020/21	2021/22	2022/23
-10	-20	-30	-40	-50
What is the problem under consideration?				
<p>Like other organisations, charities regularly have to take out insurance in order to carry out their activities, reducing the risks of their organisation and safeguarding the charity’s assets. Moreover, they also need to “gold plate” their insurance coverage because of guidance from the Charity Commission to protect their assets and the needs to protect (in many cases) assets which cannot be easily replaced.</p> <p>Insurance is also critical in providing the ability for charities to support volunteering. Increasing tax on insurance is likely to strict the ability of charities to bring on more volunteers or leave them vulnerable to not having the comprehensive insurance that they need to protect their assets.</p> <p>According to industry data, the cost to charities through Insurance Premium Tax has increased substantially over the past three years from around £25m to £50m per year. This could rise to £83m by the end of the decade, if the Chancellor raises the Insurance Premium Tax to 20%. This would be equivalent to around 3% of the sector’s spending on charitable activities.</p> <p>It is not clear why charities, undertaking activities for public benefit and seek to safeguard these assets through taking insurance should have to pay Insurance Premium Tax. This is a historic anomaly.</p> <p>The government has referenced that insurance is not subject to VAT and that increases in IPT could be seen as bringing insurance in line with other products which are subject to VAT.</p> <p>Charitable activities are able to access a number of exemptions to VAT for their activities, such as providing welfare, education and cultural services. It is not clear why government has not provided an exemption to charities in a similar way.</p> <p>It is understandable that private companies which are undertaking activities in order to generate profit should be asked to pay tax on their activities. However it is not clear why charities, undertaking activities for public benefit and seeking to safeguard their assets through taking insurance, should have to pay Insurance Premium Tax.</p>				

Overview of policy options:

- *Exempt registered charities from paying Insurance Premium Tax*
- *Create a special rate of Insurance Premium Tax for registered charities which could be gradually reduced over several years*

The first proposal would be the quickest and most effective way to support the sector.

However, given fiscal conditions it would also be possible to create a special rate of insurance premium tax for registered charities. Speaking with insurers we believe that this would not be administratively challenging.

What are the policy objectives and intended effects?

The aim of this policy would be to save charities millions every year that could be directed towards further charitable objectives and reducing the cost for charities for supporting volunteering.

It would also help charities to undertake fundraising activities, for example, concerts or events by reducing the initial costs.

It would also ensure that charities were not penalised for being prudent in seeking to safeguard their assets which are being used to deliver public benefit.

3) Increase business rate relief for charities with the goal of creating 100% relief for charities by the end of the decade.

Policy option: Increase mandatory charitable non-domestic business rate relief to 100% by the end of the decade.

Estimated Costs per year (£m) between 2018/19 and 2019/20

2018/19	2019/20	2020/21	2021/22	2022/23
-234	-468	-468	-468	-468

What is the problem under consideration?

No other charitable relief is awarded on the basis of location, apart from mandatory business rate relief.

Consultation by Charity Finance Group and other bodies in 2015 found a number of challenges in the current system.

- The lack of clarity surrounding discretionary rate relief
- The difficulties for charities working in disadvantaged communities
- The disadvantages for charities working in multiple areas, on a national or international level
- The uncertainty around discretionary rate relief and implications for business planning

Many charities are concerned about the clarity of discretionary rate relief policies by local authorities. The detail, application and publication of discretionary rate relief policies vary hugely between local authority areas. This lack of consistency causes problems for charities trying to claim discretionary relief. A number of local authorities have requirements that organisations receiving business rate relief 'serve the residents' of the local authority area.

As part of the Local Government Finance Act 2012, the government introduced the Business Rates Retention Scheme (BRRS), which came into force in April 2013 in England. The aim of the scheme was to encourage local authorities to champion economic development and enable local authorities to keep half of all business rates revenue raised locally and flexibility to pool revenue with other local authorities, as well as borrow money against future growth. In order for 'risks and rewards to be shared', the scheme mandated that local authorities would have to fund 50% of any new reliefs granted, including charitable reliefs. This increased the cost of funding new discretionary rate relief granted to charities by over 300%.

Whilst some local authorities, particularly in London, have seen significant increases in business rates income between 2009/10 and 2014/15, many authorities have seen falls in business rate income. For example, Southampton saw a fall in real terms per capita income from business rates of £134 over this period. Manchester saw a fall of £143 and Tower Hamlets saw a fall of £2484 according to research by the Joseph Rowntree Foundation.

This is placing significant pressures on local authority budgets. As a consequence, discretionary rate reliefs for charities has come under additional pressure and local authorities have consulted on reducing discretionary rate relief as a direct consequence of the Business Rates Retention Scheme and pressure on local authority budgets. This is concerning as it means that charities working in deprived communities are less likely to receive discretionary rate relief than those working in affluent areas, increasing their costs

and potentially making their services uneconomical. Charities are important, not only for the economic benefits that they create but also for the social capital that they generate. This social capital is crucial for generating long term economic growth. Strong local communities underpin strong local economies and by making it more costly for charities in deprived areas to operate, the current discretionary rate relief arrangement is not supporting the interests of local communities.

A number of local authorities, in response to the cost pressures outlined above, have also outlined changes to discretionary rate relief that would restrict relief to charities that work at a local level. A number of local authorities also restrict rate relief for offices or buildings used mainly for offices or administration. Many other local authorities have similar restrictions which disadvantage charities which operate in multiple areas or work at a national or international level. This has a negative impact for a number of reasons:

1. it undermines the principle that charities should be equally treated regardless of their charitable objectives or activities. We do not believe that charities should be denied access to reliefs because they carry out certain activities. Moreover, these policies politicises charities and undermines the ability of charities to work on unpopular causes.
2. these criteria act as a barrier for charities that wish to work across local authority boundaries. Need does not stop at local authority boundaries, but the discretionary rates system encourages narrow thinking, as local authorities which benefit from services that are delivered by charities outside of their area do not have to bear the cost of business rate relief. The government said during the election that it wanted to use the 'talent and energy of charities to help people turn their lives around', and the current business rate relief rules are a direct barrier to this talent and energy being used.
3. discretionary rate relief policies focused on exclusive local area provision also inhibit efforts by charities to diversify their services and income. The policy encourages fragility by hampering the ability of charities to expand into new areas and develop new income streams.
4. excluding claims for discretionary rate relief from charities that use buildings for offices or administration ignores the impact that this has on the effectiveness of charities. All charitable funding must be used to deliver public benefit. Administration is not optional, it is essential to the achievement of charitable objectives. Excluding claims for discretionary rate relief from charities that use buildings for offices reduces the amount of resources that can be used towards achieving charitable objectives.
5. this system also increases the cost of delivery of services for central government in certain areas, if charities there do not have access to business rate relief. Whilst some local authorities provide rate relief to charities that deliver local services in order to reduce the costs of provision for local residents, many local authorities do not have similar rules for central government services. This artificially increases the costs of central government services, without a clear rationale.

Charities are operating in a volatile funding environment, and proposals for deficit reductions mean that this volatility is likely to remain over the next five years. Like any organisation, in planning for the future, charities want certainty on their income and the cost of delivering services. We have heard from a number of charities that have indicated that the current regime does not provide them certainty around the continued receipt of relief. Funding pressures for local authorities have meant that some organisations do not feel confident one year to the next on whether they will still receive discretionary rate relief. This

makes it hard to plan for future delivery and may lead to charities reducing or ending services in order to reduce risk. This is not in the interests of beneficiaries. No other charitable tax relief has the same level of instability as discretionary rate relief. Some local authorities issue warnings that they may have to reduce or remove discretionary rate relief a year before they do so, however, this is often not confirmed until shortly before the end of the financial year. This does not enable effective forward planning and can create financial difficulties for charities.

Overview of policy options:

- *Increase mandatory charitable non-domestic business rate relief to 100% over two years in increments of 10%, from the current level of 80%.*

The change could be achieved by modifying section 43(6) and 47(2) of the Local Government Finance Act 1988.

Based on HMRC's Charity Tax Statistics charitable occupation business rate relief will be £1.87bn in 2016-17, we assume that increase rate relief will cost £467m, with more charities applying for rate relief due to reduced bureaucracy and some charities not receiving any benefit due to the fact that they currently receive discretionary rate relief from their local authority.

What are the policy objectives and intended effects?

- **Fairness** – we believe that it should treat all charities equally, regardless of location and activity. This in keeping with the principle that providing charities meeting the legal criteria to be a charity that they should have equal access to charitable reliefs, regardless of where they operate in the country
- **Simplicity** – we believe that the system should be as simple as possible both for charities and for the government to implement. Applying 100% rate relief to all charities will avoid the need for local authorities to develop and operate discretionary rate relief policies. This would free up their time and reduce the cost of administration.
- **Consistency** - we believe that the rules should be consistently applied across all charities to give certainty and enable effective business planning.
- **Cutting red tape** – reducing bureaucracy for local authorities and charities

This proposal would be **fairer** as it would mean that all registered charities were treated equally and fairly. It would also mean that charities were not disadvantaged for working in certain local areas or a national or international level. We believe that this extended rate relief should cover charity shops which are important sources of revenue for the charities of all sizes.

It would also be **simple**, avoiding the need for local authorities to develop and operate discretionary rate relief policies. This would free up their time and reduce the cost of administration.

This proposal would also promote **consistency** in the application of business rate relief and would support charities in business planning.

This proposal would generate a number of additional benefits:

- It would reduce the costs of delivering services or public benefit for charities and enable more resources to be focused on delivering charitable objectives. This will particularly help small and medium sized charities, and support charities working in disadvantaged communities.
- Charities are important builders of social capital, so reductions in the costs of operating will have significant benefits for charities and for small and medium sized charities it is likely that this additional resource will be recycled through local communities having a positive multiplier effect.
- By shifting the cost from local to central government, we believe that this proposal would not disadvantage charities which are working in poorer areas. The Centre for Social Justice in *Something's Got to Give – The state of Britain's voluntary and community sector* highlighted concerns around 'charity cold spots'. We believe that this proposal could address this concern and ensure that no area lacks the positive impact that charities can bring.

It would also **reduce the costs of the delivery** of central government services through charitable organisations and ensure that central government costs are not higher than local government costs when working with charities. The removal of discretionary rate relief would also remove uncertainty and avoid the need for additional guidance to be given to local authorities on the operation of business rate relief.

Overall financial scorecard

Estimated Costs of all proposals per year					
	2018/19	2019/20	2020/21	2021/22	2022/23
Create a joint government-charity sector working party to consider how irrecoverable VAT can be eliminated post-Brexit in a way that is fair and fiscally deliverable.	-0	-0	-0	-0	-0
Increasing business rate relief to 100% by the end of the decade	-234	-467	-467	-467	-467
Exempting charities from the Insurance Premium Tax	-50	-50	-50	-50	-50
Total per year	-284	-517	-517	-517	-517