

Irish Charities Tax Reform Group

Pre-Budget 2006/7 Submission

Introduction

In framing the Budget Statement and Finance Bill for 2006/7 ICTRG would like to see Minister Cowen introduce further reform of the taxation system as it applies to charities and approved bodies as follows.

In this year's Budget and subsequent Finance Act, ICTRG would like to see the Minister build on previous tax reforms introduced to benefit eligible charities and approved bodies (2001, Minister McCreevy and in 2005, Minister Cowen) by:

- Introducing a VAT compensation scheme for charities allowing them to reclaim VAT. Recent research puts the annual VAT bill of Irish charities at a minimum of €18million of which 52% is paid for out of publicly fund-raised income so that a compensation scheme would cost the exchequer €9.4million (see report as submitted with our submission in 2005 for details). The EU Commission confirms that it is within the powers of the Minister for Finance to introduce a VAT compensation scheme without contravening the Sixth EU VAT Directive. Letters from the Department of Finance, Ms Breda Rafter of 17 February 2006 and Paul Moloney of 14 September 2006, dispute the view of an EU Commissioner on this important matter – and in this context we ask the Minister to review the current official position. (see attached Comments from EU Commissioner's Lazlo Kovacs and Frits Bolkestein - Appendix One)
- Reducing the minimum donation threshold for tax relief purposes from €250 to €100 to take effect from January 2007. Research carried out last year reveals that only 13% of charities currently avail of the scheme at the €250 threshold but reducing it to €100 would spread the benefit to 45% of charities i.e. a further 32% would benefit. The research suggests that the maximum additional cost to the Exchequer of making this change would be €31m. (Research report submitted with ICTRG submission in 2005)
- Extending the definition of "relevant donation" currently confined to gifts of **money, shares and securities** to eligible charities or approved bodies, to cover **gifts of assets, such as property and other investments**, to such organisations. (The most welcome amendment of the legislation last year has included shares and securities in the definition)
- Removing Section 848A, tax relief scheme on donation to charities, from the list of restrictions placed on high income earners under Section 485C of the 2006 Finance Act.

ICTRG makes these proposals in the light of research and experience with the tax relief schemes to date and on the basis that such extended relief's already apply in those

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jurisdictions including the U.S., the U.K., Canada, and Australia which share with Ireland a similar legal understanding of ‘charitable purpose’ and ‘charitable activity’.

VAT Compensation Mechanism for Charities & Approved Bodies

*Charities are treated as exempt from VAT under the Sixth EU VAT Directive, which means that they cannot recover the Vat they pay on inputs. This places a significant tax burden on charities which was never the intention of EU VAT law and has the effect of reducing the level of services that charities can provide to the homeless, people with a disability, children, older people, and the amount that can be devoted to medical research etc **There is no restriction on the Minister either at National or EU level dealing with the VAT issue for charities as set out by ICTRG.** This can be done by way of amendment at any time.*

Irish Charities pay out more than €18m in irrecoverable VAT each year according to a report from tax experts Ernst and Young. The comprehensive report was prepared for Irish Charities’ Tax Research Ltd and is based on the first detailed survey of the VAT burden imposed on the Irish charitable sector.

- The report demonstrates that VAT is a significant burden on Irish Charities costing the sampled charities €18million in 2001
- The VAT burden can be relieved by way of a Ministerial Order under Irish VAT law without contravening EU law. This has been confirmed by the EU Commissioner (see Kovacs and Bolkstein comments - Appendix One)
- The actual cost to the Exchequer of introducing a compensation mechanism is 52% of the total VAT bill since the remainder is paid for from public funding - in the case of the sampled charities a VAT compensation scheme would cost the exchequer €9.4m
- The advantage of a VAT compensation scheme is that control remains with the Revenue Commissioners as to what organisations qualify for refunds

The Minister has the power under sections 6(2), 11(8)a and 20 of the VAT Act 1972 to introduce a compensation scheme without falling foul of EU law. (See Kovacs - Appendix One)

As the Minister is aware there is significant public support for refunding VAT to charities as witnessed by the number of people who signed up to our web-based petition in 2002 (12,867) and who directly lobbied their local candidates in the run up to the 2002 general election and the recent local and European elections - sending almost 30,000 emails on the issue. ICTRG has also launched a campaign on this issue recently and we have a very positive initial response.

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Tax Effective Donations

ICTRG is on record (both publicly and privately) as warmly welcoming the Scheme of Tax Relief for donations to Eligible Charities and Approved Bodies under the terms of Section 45, Finance Act 2001. The Group gives full credit to the Government for introducing major tax reform in this area, which has dramatically changed the landscape for Irish charities in terms of tax-efficient giving. The scheme has a number of very important features, which are of great benefit to the charities sector:

1. The scheme applies to all eligible charities and approved bodies in Ireland in contrast to previous schemes, which had limited application.
2. The removal of the upper limit on donations for tax relief purposes is a major development.
3. The fact that the tax reliefs are applied at the taxpayer's marginal rate of tax is of significant benefit to both donors and charities.
4. The scheme streamlines and simplifies the operation of the tax relief's compared to the previous plethora of schemes.
5. Donations made by instalments (e.g. standing orders) also qualify.

At ICTRG's 10th Annual Conference (Sept. 2001) where a previous Finance Minister delivered the keynote address we were interested to hear that the Minister looked to the US model in framing the new legislation and we were encouraged by the fact that **he did not see the current minimum of €250 as written in stone**, rather that it was initially set at this level for administrative reasons. The Minister is on the record in the Oireachtas (during the debate on the Finance Bill 2002) **as not having a principled objection to reducing the figure** further and of being willing to look at this issue again.

In the context of Minister Cowen's recent review of the tax relief scheme and in light of the findings from new research carried out by Irish Charities Tax Research Ltd with independent validation by Ernst & Young, we believe that the case for reducing the donation threshold from €250 to €100 in 2006/7 is a compelling one.

Reduction of the Minimum donation threshold to €100

ICTRG proposes that ultimately there should be no minimum donation threshold for tax relief purposes in line with other similar jurisdictions as summarised below:

Country	Lower Limit
United Kingdom	£0
United States	\$0
Australia	AUS\$2
Canada	\$0
New Zealand	NZ\$5

However, we recognise that there are significant administrative difficulties in introducing this immediately and that a phased introduction would be more acceptable. In this

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context we request that the minimum should be reduced from €250 to €100 from January 2007 and that this be revised downward over coming years to zero to bring us in line with international norms.

Research by, ICTR Ltd/Dempsey 2005, validated by Ernst & Young (Attached to 2005/6 submission) reveals that:

- Only 13% of charities currently benefit from the tax relief scheme based on the €250 threshold. These charities tend to be longer established (>10 years old) and larger as measured by annual income and number of employees than those charities not in a position to benefit.
- If the threshold was reduced to €100 then a further 32% of charities could potentially benefit bringing the total benefiting up to 45%. This would have the effect of spreading the benefit to smaller and less well established charities.
- 31% of donations to sampled charities in the research were €100 or less and 27% of donations ranged between €100 and €249 – all with no tax benefits.
- The estimated total annual cost to the Exchequer of extending the benefit of the tax relief scheme to 45% of charities by reducing the threshold from €250 to €100 is €44.8m taking into account the potential stimulus to fundraising effort that could be expected to result. This compares to circa €22m currently given in refunds. This is a maximum figure and would not take effect immediately.

Proposal

That the minimum donation for the purposes of the Scheme of Tax Relief for donations to Eligible Charities and Approved Bodies under the terms of Section 45, Finance Act 2001 be reduced to **€100** to take effect from the 1st January 2007.

Extension of the definition of 'relevant donation' to cover gifts of assets, such as property and other investments.

Under the existing legislation as introduced in the Finance Act 2001, in addition to meeting the €250 minimum requirement, a relevant donation for the purposes of the scheme must satisfy the following conditions:

1. **It must be in the form of money, now amended to cover shares and securities (our emphasis)**
2. It must not be repayable
3. It must not confer any benefit on the donor or any person connected with the donor
4. It must not be conditional on, or associated with, any arrangement involving the acquisition of property by the charity or the approved body.

ICTRG requests that the definition be extended to cover gifts of assets, such as property and other investments, so that these too would qualify for tax relief in the same way as

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gifts of money, shares and securities - and subject to the same provisos as set out in points 2-4 above

Proposal

Extend the definition of “relevant donation”, currently confined to gifts of **money, shares and securities** to eligible charities or approved bodies, to cover **gifts of assets, such as property and other investments**, to such organisations.

Amendment to Section 485c, Finance Bill 2006

The inclusion of Section 848A in the list of restriction under section 485c of the Finance Bill 2006 runs totally contrary to the content and spirit of **Towards 2016** – where it is stated on page 72 that:

“The Government recognises the valuable work being carried out by organisations which promote philanthropy in Ireland and will continue to explore ways to facilitate philanthropic work, strengthen and deepen a culture of philanthropy in Ireland, and maximise the contribution of philanthropy to the common good”

The following explanation of the provision was included in the Ernst & Young/Sunday Business Post commentary on Budget 2006:

“From the 1st January 2007, individuals with income in excess of €250,000 who have specified tax relief’s available to them will be restricted in the amount of tax relief they can claim each year. The specified reliefs that a person will be able to apply against their taxable income will be restricted to 50% of their gross income in any one tax year. Any excess relief’s will however be available for “carry-forward” to the following and subsequent years, subject to the 50% income cap.” (p. 9 Budget 2006, Ernst & Young/Sunday Business Post Dec. 2006)

The tax relief scheme on donations as originally conceived places no upper limit on the amount that a donor can give to charity tax effectively in any year. The reason for this was to use taxation policy to actively promote the development of philanthropy in Ireland. This new provision effectively introduces a cap on the scheme for high-income individuals thus potentially undermining the philanthropic incentive.

We understand the reasons that the Minister has introduced this provision in relation to tax relief schemes where there is a direct benefit to the investor in addition to the tax relief i.e. they have the benefit of the investment in an asset which will generate a return as well as the tax relief.

However the tax relief scheme on donations is fundamentally different to other tax relief schemes specified in the schedule in that there can be no benefit to the donor other than the tax relief. The donation must be given at arms length with no strings attached. Therefore we believe that the S848A tax relief scheme should be removed from the “List of specified relief’s and method of determining amount of specified relief used in a tax year” in Schedule 25B of the Bill.

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Proposal

Minister amend and accordingly remove Section 848A (Donations to Approved Bodies) from the list of tax relief schemes subject to the Section 485C restriction.

Conclusion

ICTRG urges the Minister to relieve the VAT burden on charitable activity by:

- The introduction of a VAT Compensation Scheme for Charities by means of a Ministerial Refund Order as provided for under the VAT Act 1972.

ICTRG recognises the value of the Scheme of Tax Relief for donations to Eligible Charities and Approved Bodies introduced under the terms of Section 45, Finance Act 2001 to the sector and commends the previous Minister for its introduction and its extension last year by Minister Cowen in relation to shares and securities. However, we believe that the scheme would be greatly improved by;

- The reduction of the minimum donation threshold to €100, which would extend the current benefits to the majority of individual donors and their charities as appropriate (PAYE / Self-assessed) rather than restricting it to the more well off.
- The further extension of the definition of ‘relevant donation’ to cover donations of assets, such as property and other investments, to eligible charities and approved bodies.
- Removing Section 848A, tax relief scheme on donation to charities, from the list of restrictions placed on high income earners under Section 485c of the 2006 Finance Bill.

These changes would bring Ireland more into line with international practice and would provide an increased stimulus for philanthropy in this country.

Appendix One

Comments from EU Commissioners on VAT

In 2005, EU Commissioner for Taxation and Customs, **Mr Laszlo Kovacs** said, “The Commission has always considered that any scheme designed to relieve the VAT burden for charitable activities can be regarded as compatible with EU legislation if it is clearly separated from the VAT system (since under this system VAT can only be refunded if it is connected with taxable supplies) and does not affect the own resources of the Community. The essential difference is that, under such a scheme the tax is collected in the first place and then the Government chooses to allocate it back to the bodies from, which it has been collected. This is a subtle but important distinction.

I have to underline that the decision to set up such a refund mechanism **is strictly a national budgetary issue** over which the Commission has no say or influence”

In 2003, after a meeting between ICTRG members and EU **Commissioner Bolkestein** he stated in writing:

“During that meeting, the question of the Commission’s attitude to a possible scheme whereby the Irish Government would give a subsidy to Irish charities of an amount equivalent to the non-deductible VAT that they had incurred was raised. In particular, the delegation was concerned to know whether any such scheme would be at odds with the provisions of Community VAT law as contained in the 6th VAT Directive.

I wish to confirm to you that the Commission’s view, the granting of Government subsidies – irrespective of the beneficiaries – is in itself not contrary to European Union VAT law. In this regard, it has also been noted that, provided the State Aid rules are observed. Community law in general does not prescribe how Member States should spend their revenue”