

Irish Charities Tax Reform Group

Pre-Budget Submission on VAT Compensation, 2007

Incentivise charities to fundraise independently!

Executive Summary:

Budget 2007 offers the potential for the Minister for Finance to significantly incentivise independent fundraising by the charity sector. Such an initiative would bring government policy in relation to charities into line

- with the commitment to encouraging philanthropic giving in '2016' and
- with recognition at EU level and increasingly at EU member state level that VAT compensation is the most appropriate method to correct anomalies in taxation affecting charities specifically.

The pending passing into law of the Charity Bill 2007 will provide an additional framework and regulatory guarantees regarding the operation of charities in Ireland.

- Introduce a VAT Compensation scheme for charities based on their independently fundraised income.
- Recent research suggests that charities currently obtain over 40% of their income by independent fundraising.
- The EU commission have approved introduction of such a scheme at member state level and such a scheme is operating in Denmark since 2007.
- Such a scheme would incentivise charities to fundraise independently and promote philanthropic giving.
- As shown by the examples from Denmark it will be administratively simple from the perspective of both the state and individual charities.
- The ICTRG estimates, based on independent research, that the cost to the Exchequer for full Compensation would be approximately €18m.
- The scheme should be implemented in consultations between the charity sector and Department of Finance.

- The minimum donation threshold for tax relief purposes should be reduced from €250 to €100.
- Research carried out in 2005 reveals that only 13% of charities currently avail of the scheme. Reducing the threshold would spread the benefit to 45% of charities.
- The maximum cost to the Exchequer is estimated at €31m.

- Tax relief on charitable donations (S848A) should not be included in Schedule 25B of the 2006 finance Act subject to the new Section 485C limiting the use of tax relief schemes by high earners.
- S848A should be removed from Schedule 25B as there is no other benefit to the donor in charitable donations other than the tax relief. In fact S848A specifically states that there can be no additional benefit to the donor.

Background:

“ 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.”

- page. 72, ‘Towards 2016’

The Irish Charities Tax Reform Group (ICTRG) is seeking the introduction of a VAT Compensation scheme for Irish charities, based on measures allowable in EU law, similar to a scheme announced by the Danish government for charities there in 2006 and in keeping with the spirit of incentivising independent fundraising and philanthropy, in line with government policy as stated in the recent ‘Towards 2016’ Partnership Agreement.

The VAT compensation would apply to the **voluntary fundraised income** of charities.

Unlike the business sector, charities cannot reclaim VAT on expenditure. This situation is an anomaly. It exists because, under EU law, charities are treated as exempt from VAT under the Sixth EU VAT Directive. As a consequence, while charities pay VAT they cannot recover the VAT they pay on inputs.

This significantly limits the work of charities with those most in need, both at home and abroad.

It impacts negatively on independent fundraising.

It promotes and encourages a culture of dependency on state grants.

It militates against the development of philanthropy.

It has a very human cost.

The ICTRG believes that the factors outlined in this submission make it both appropriate and practical to rectify this anomaly now by the introduction of a VAT Compensation scheme for charities.

SECTION 1: VAT COMPENSATION:

There is no EU or Irish VAT law impediment:

- In 2005 EU Commissioner Laszlo Kovacs stated *“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.”* (Full relevant text included in Appendix). This statement clarified initial uncertainty at Dept. of Finance level on whether a Compensation scheme would contravene the 6th EU VAT Directive.
- A similar understanding by the Minister for Finance was clarified on Dec. 5th, 2006, in reply to Dail Question no. 225, when he stated: *“while charities cannot be refunded through the VAT system, there is nothing to prevent national Governments paying charities a subsidy to compensate them for the irrecoverable VAT which they have incurred, provided that State Aid rules are observed”*.
- In November 2006 a VAT Compensation scheme was announced for charities in Denmark following discussions there between the Departments of Finance and Taxation with ISOBRO, the Danish equivalent of the ICTRG. The scheme came into operation in June 2007. A translation of the relevant application form and guidelines is attached for information. (See Appendix I A and B).
- This Danish scheme was introduced following a consultation process involving the Danish charities and government. While the level of the compensation is limited, at least initially, it confirms the practical nature of similar proposals by the ICTRG.

Allaying fears on Cost:

- Independent research carried out by Ernst and Young in 2001 calculated the annual VAT bill of Irish charities at approximately €18million.
- Approximately half of this sum (52%) was paid for out of publicly fundraised income, the category on which VAT Compensation would apply. The cost of VAT Compensation to the Exchequer, therefore, would be in the order of €9 million annually in 2001 figures.
- Factors such as inflation and increased fundraising by charities will have increased the level somewhat in the meantime. This study, however, provides an independent and objective indicator of the likely exposure of the Exchequer to a full VAT compensation scheme related to charities voluntary fundraised activity. (The ICTRG estimates current Exchequer exposure, using Ernst and Young data as a baseline, at approximately €13 million in 2007).

Incentivisation:

If business was denied access to VAT refunds on essential expenditure, the consequence for sustainability would be significant. The absence of VAT Compensation for charities that fundraise independently is equally a disincentive and limits their effectiveness to a significant extent.

According to *A Report on the Practice and Scale of Charitable Fundraising from the Public in Ireland*, by The Centre for Non-Profit Management, School of Business, Trinity College, Dublin (2007), (Table 3.11 page 12), Irish charities currently receive 59.4% of their income from the state.

These figures indicate that charities are gradually becoming somewhat more reliant on state funding for their income.

The Ernst and Young Report also estimated the overall level of VAT paid by charities at €18 m in 2001. Allowing for inflation and increased activity by charities the amount is probably currently in the region of €25 - 30 million. Based on the Trinity figures above, 40.6% of this sum would qualify for consideration under a VAT Compensation scheme.

Individual charities rely to a greater or lesser extent on state funding. Some individual examples of VAT paid by charities include:

St Vincent de Paul's VAT Bill on independently fundraised income for 2006 was in the region of €2.6 million. Approximately 80% of the Society's income is obtained by independent fundraising.

RESPECT/ Daughters of Charity - Their 06 VAT was € 170,808.00. Their house building project accounts for the vast bulk of their VATable spending which is funded in a ratio of 5:7 independently / state funded. On this approximately €71,000 would be eligible for VAT Compensation

St Christopher's Services Longford, for people with intellectual disability had a 2005 VAT bill of €157,000.00. Just 20% of their income is independently fundraised, so approximately €31,000 would qualify under a VAT compensation scheme.

The Irish Cancer Society's VAT Bill of €300,000 would be almost entirely eligible for VAT compensation as their income is almost entirely independently fundraised.

Concern's VAT Bill of in excess of €1m is based on approximately 50% independently fundraised, so they would qualify for VAT compensation of approximately half their VAT bill.

This VAT is effectively a levy on the independently fundraised portion of charities' income.

The ICTRG believes that a VAT Compensation scheme, which would remove this levy, will promote more intensive independent fundraising by charities and incentivise giving by donors.

Ringfencing:

In reply to a Dail Question on Tuesday, 20th March, 2007. (Ref No: 10194/07) the Minister for Finance expressed a concern that *“the introduction of any grant system in lieu of VAT paid by registered charities in Ireland would undoubtedly lead to other exempt bodies, such as schools, hospitals and sporting organisations, many of which are already registered as charities, seeking to benefit from such a system of refunds.”*

Under the scheme proposed by ICTRG only independently fundraised monies will qualify for compensation. The proportion of money independently raised by schools, hospitals, etc will be very small. In addition the Charities Bill 2007 provides further ringfencing by definition, in particular requiring ‘public benefit’ and ‘charitable purposes’ activity

This matter can be addressed by recourse to the many existing precedents where ring-fencing applies in regard to specific legislation, for example, tax relief on donations. Any decision on qualification for refund will be a matter for the Department of Finance / Revenue Commissioners.

Regarding VAT specifically, there are already legislative precedents where some equipment used by people with disability can be purchased on a VAT refund basis. It is only necessary to *expand* on this benefit to ease the VAT burden that exists on charities.

The government has, in fact, accepted the principle of ‘ringfenced’ VAT Compensation in one specific instance.

On November 10th, 2004, Mr Conor Lenihan, TD, then Minister of State for Development Cooperation and Human Rights, announced that *“ the Government will be able to provide a grant to the Band Aid Trust, equivalent to the amount collected in VAT on the sales of the Live Aid DVD released earlier this week.”*

The Administrative ‘Burden’:

In the same Dail reply, Tuesday, 20th March, 2007. (Ref No: 10194/07), the Minister for Finance also expressed concern on the potential scope of and administrative work associated with VAT compensation, stating that *“over 1,900 organisations have to date been approved under the Irish donations relief scheme.”*

In its *“Budget 2006: Review of Tax Schemes, Volume III: Internal Review of Certain Tax Schemes,”* (Feb. 2006), page B15, the Department of Finance confirms, however, that just 587 charities actually benefited under the heading ‘PAYE refunds under Section 848A made by Revenue in the 2004 in respect of donations received in 2003’.

This represents a more realistic assessment of percentage uptake on VAT compensation also.

In its review the Department concludes: *“Uptake of the schemes, while increasing, could be increased further. Charities and approved bodies should promote the scheme more widely to make donors more aware of it.”* (6.6 Promotion of scheme, page B46.)

Charities are, however, fully aware of this scheme and promote it where appropriate. The explanation for ‘low’ uptake lies rather in the fact that very many charities receive the bulk of funding from government sources (**not** covered by the Section 848A refunds and which will **not** come under a VAT compensation scheme). Many other charities operate either on a small scale financially or mainly on volunteer activity and do not rely primarily on fundraising to sustain their programmes.

To confirm this further, the report states that the ICTRG which represents approximately 150 charities, *“it is understood, represents 80% of the activity in the charity sector,”* - ‘Budget 2006: Review of Tax Schemes, Volume III: Internal Review of Certain Tax Schemes,’ (Feb. 2006), page B16.

In addition the system of application and verification introduced in Denmark is administratively simple – for government departments and charities alike - (*see Appendix 1B*).

In reply to a Dail Question on 20th March, 2007. (Ref No: 10194/07)
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The Department of Finance has argued (Reply to a Dail Question on 20th March, 2007. Ref No: 10194/07) that grants to charities effectively provide ‘compensation’ *“Given that Exchequer funding is made available to very many charitable organisations this is in effect already happening... the tax code currently provides exemption for charities from Income Tax, Corporation Tax, Capital Gains Tax, Deposit Interest Retention Tax, Capital Acquisitions Tax, Stamp Duty, Probate Tax and Dividend Withholding Tax.”*

This ignores the fact that the current VAT situation is a levy on independently fundraised activity as well as the fact that the business sector while receiving a range of incentives, many not available to charities, is also entitled to reclaim VAT on essential expenditure.

Regulatory Control:

The Charities Regulation Bill 2007, which the ICTRG has actively supported and on which it has worked with the government department responsible to assist in its delivery, was published earlier this year. When introduced into law it will provide comprehensive guarantees on the legitimate operation of charitable organisations. The Bill is currently before the Dail and is expected to be enacted shortly.

Agreement on VAT Compensation exists in principle:

In advance of the recent General Election all political parties, including the three parties now in government, indicated a commitment to address the ICTRG's proposals for VAT Compensation in government. *(See Appendix 2).*

Promotion of Giving and Philanthropy:

The government has expressed its commitment to promoting Philanthropy and Philanthropic Activity in the current Partnership agreement:

“ 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.

- **page. 72, ‘Towards 2016’**

The introduction of a VAT Compensation scheme will facilitate such a development practically. It will further encourage independent fundraising by the overall charity sector and ensuring that costs associated with attracting philanthropic donations and implementing schemes supported by these donations do not incur a ‘levy’ of unrefundable VAT.

SECTION 2: SECTION 485C:

Charitable donations affected by section 485C anomaly:

Background:

The Finance Act 2006, Ch.2A, Section 485C, placed a restriction on the use of certain tax reliefs by high-income taxpayers. Individuals with income in excess of €250,000 who have specified tax reliefs available to them will be restricted in the amount of tax relief they can claim to 50% of their gross income in any one tax year.

Unfortunately the list of tax reliefs to which the section applies includes S848A Donations to Eligible Charities and Approved Bodies.

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 was to use taxation policy to actively promote the development of philanthropy in Ireland. This 2006 provision effectively introduces a cap on the scheme for high income individuals, potentially undermining the philanthropic incentive.

There are understandable reasons for 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.

Relief on Donations Anomaly:

Tax relief on donations is, however, 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.

Reform Schedule 25B:

The S848A tax relief scheme should be removed from the “List of specified reliefs and method of determining amount of specified relief used in a tax year” as laid out in Schedule 25B of the 2006 Act.

SECTION 3: MINIMUM DONATION THRESHOLD:

The ICTRG proposes that government address the current €250 threshold for tax relief purposes in line with other similar jurisdictions as summarised below, which excludes relief on many smaller donations. Ireland should aim to remove the threshold completely to bring us into line with regulations in many other countries, as outlined below:

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

We recognise, however, that there is an administrative issue around the immediate removal of the threshold. This could be overcome by a phased introduction.

In this context we request that the minimum should be reduced from €250 to €100 from January 2008 and that this be revised downward over coming years to zero to bring us in line with international norms.

Research carried out by ICTR Ltd / Dempsey 2005 validated by Ernst and Young reveals that:

- ❑ Only 13% of charities benefit from the tax relief scheme based on the €250 threshold. These charities tend to be longer established (over 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 up to 45%. This would have the effect of spreading the benefit to smaller and less established charities.
- ❑ 31% of donations to sampled charities in the research were €100 or less and 72% of donations ranged from €100 to €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 as a result. This compares to approximately €22m currently given the refunds. This is a maximum figure and would not take effect immediately.

Conclusion and Proposals:

- The Minister for Finance has the power to relieve the VAT burden by compensating charities without contravening EU law or regulations.
- The actual cost to the Exchequer of introducing a compensation scheme is miniscule in overall budgetary terms, but constitutes a very significant burden on individual charities.
- The advantage of a VAT Compensation scheme is that control remains with the Revenue Commissioners as to what organisations qualify for refunds, linked to the Charities Bill 2007
- It will encourage independent fundraising and philanthropy and reduce dependency on state funding.
- The process could best be facilitated through detailed discussions between the Department of Finance and the charity sector in Ireland to agree the terms of a VAT Compensation scheme on voluntary fundraised income.
- Remove S848A Donations to Approved Bodies from the list of tax relief schemes subject to the Section 485C restriction to end an anomaly affecting donations to the charity sector.
- Reduce 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 to €100, to take effect from the 1st January 2008.

Appendix 1 A

Suggested Application Process

Based on the Form for Application for Part Compensation of VAT for foundations and organisation as approved in 2007 for Danish charities.

Applicant Name and address of the organisation

Charity Registration No. _____

E-mail address

Name and address of accountant

E-mail address

Telephone

We apply for compensation for the following calculated VAT amount
(Amount is calculated on the basis of the following information: $(B - A) \times C$)

A	Paid input VAT for the base year 2004 (calendar year)	Euro	_____
B	Paid input VAT for the calendar year _____	Euro	_____
C	Self-financing ratio for the year stated under B	%	_____

The above information must be confirmed by a state-authorised or registered public accountant.

Date and signature

Date and signature

For the foundation/organisation State-authorised or registered public accountant.

Appendix 1 B

(NOTE: this is an unofficial translation)

Ministerial Order on compensation for VAT to charitable organisations etc.

Pursuant to s. 9 of the Financial Act [state budget] for the fiscal year 2007, note no. 107 re 09.21.10: Part refund of input tax to not-for-profit organisations, see Document no. 88 of 22 March 2007 on compensation for the expenses incurred by not-for-profit organisations towards an obligatory reporting scheme, the following is provided:

Part 1

Part refund of VAT

1. Not-for-profit and charitable organisations etc. approved in accordance with s. 8A and s. 12(3) of the Tax Assessment Act can apply for part compensation for VAT paid on purchases (input VAT) related to their VAT-exempt not-for-profit activities. Compensation will be granted for the increase in input VAT in a specific calendar year over the base year 2004 by a ratio corresponding to the organisation's self-financing ratio, but see (3). The organisation's self-financing ratio is the share of the organisation's own income out of its total income, see (2). No compensation will be granted for input VAT that has already been refunded, see s. 45 of the VAT Act.

(2) Own income includes e.g. income from collections and appeals as well as from sales of various items, provided the transaction is not registered as a VAT taxable activity, income from donations, bequests, members' fees, subscriptions and other privately raised funds. Any contributions, grants or similar donated by other private organisations are deducted from the statement of the donor organisation and included in the statement of the receiving organisation. The value of payment in kind and labour is not included in the statement. Own income does not include funds received from central or regional government administrations, public institutions, public foundations, or from the EU or other international organisations. Profit shares from lotteries etc. on Danish television stations (Danmarks Radio, TV2 etc.) cannot be included, either.

(3) The compensation granted in 2007 for VAT paid on expenses incurred in 2006 will, however, not quite match the self-financing ratio, as an amount of DKK 10 million out of the total grant allocated in the Financial Act 2007, plus an additional supplementary grant, if relevant, towards VAT compensation, will be allocated in advance to organisations as compensation for their initial expenses related to setting up the obligatory reporting scheme provided in s. 8Æ of the Tax Control Act, see (2). When the total amount of compensation applied for has been added up, the Customs and Tax Administration will set up a fraction to calculate a proportional allocation of the VAT compensation funds to the applicants. The fraction will consist of the total amount applied for in the denominator and the allocated funds plus any supplementary grant, less DKK 10 million, in the numerator.

(4) In the case of organisations that are not able to prepare a statement of their input VAT expenses in the base year 2004, either because they had not been established in 2004, were established in the course of the year, or had not been approved in accordance with s. 8A or s. 12(3) of the Tax Assessment Act, the Customs and Tax Administration will determine a basis of comparison as the average of the percentage of increase in VAT input amounts of all the applicant organisations from the base year 2004 to the relevant calendar year.

Part 2

Part compensation for expenses incurred towards an obligatory reporting scheme

2. Not-for-profit and charitable organisations etc. approved in accordance with s. 8A and s. 12(3) of the Tax Assessment Act can, for the fiscal year 2007, apply for part compensation for expenses incurred towards preparations for the obligatory reporting scheme, see s. 8Æ of the Tax Control Act and Document no. 88 of 22 March 2007.

(2) The amount of compensation awarded to each organisation is composed of a fixed amount of DKK 1,500 and a proportional amount determined on the basis of the sum of the organisation's total donations according to s. 8A and s. 12(3) of the Tax Assessment Act received in 2006, compared to the size of the total donations according to the above provisions in the Tax Assessment Act of all applicant organisations. In total, the applicant organisations cannot demand any compensation exceeding the allocated DKK 10 million, see 1(3).

Part 3

Application deadline etc.

3. Compensation can be applied for once a year, no later than 1 July of the year following the calendar year for which compensation is applied for. Applications may be submitted for the first time no later than 1 July 2007 for VAT paid on purchases in 2006.

(2) Applications for compensation for expenses incurred towards the obligatory reporting scheme must be submitted no later than 1 July 2007.

(3) Applications, see (1), must include the following information:

- 1) the amount for which compensation is applied for;
- 2) the organisation's expenses towards input VAT, excluding any input VAT already refunded in accordance with s. 45 of the VAT Act; for the base year 2004 see, however, 1(4);
- 3) the organisation's expenses towards input VAT, excluding any input VAT already refunded in accordance with s. 45 of the VAT Act, for the calendar year for which compensation is applied for; and
- 4) the organisation's self-financing ratio for the calendar year for which compensation is applied for.

(4) The information listed in (3), items 2-4, must be provided on the basis of an auditor's statement made by a registered or state-authorized public accountant.

(5) In the event of any changes occurring after the submission of the application in the expenses towards input VAT that have been applied for, the organisation must inform the Customs and Tax Administration accordingly without delay to allow the amount of compensation to be adjusted in accordance with the new information, and any already paid compensation to be repaid.

(6) Application for compensation of expenses incurred towards the obligatory reporting scheme, see (2), must include information about the total amount of donations for the year 2006 made to the organisation under s. 8A and s. 12(3) of the Tax Assessment Act, see forms 03.012 and 03.013. The information must be provided on the basis of an auditor's statement made by a registered or state-authorized public accountant. It is, however, also possible for the organisation to make a solemn declaration.

4. Applications for compensation under the provisions of the present order should be addressed to Skattecenter [Tax Centre] Bornholm, Munch Petersens Vej 8, 3700 Rønne, which will also decide whether compensation will be granted. Applications according to s. 3(1) may be submitted electronically via the tax authorities' website to the extent this is possible.

(2) It is a prerequisite for the payment of compensation that the organisation has a VAT registration number and a corresponding bank account into which the compensation amount can be paid.

(3) The decision of Skattecenter Bornholm can be appealed to the National Tax Tribunal, see s. 11 of the Tax Administration Act.

5. The Customs and Tax Administration is entitled to examine the material that serves as the basis for compensation grants. The organisation must upon request submit or forward the relevant material to the Customs and Tax Administration. The general control provisions laid down in ss. 74-76 and s. 6 of the Tax Control Act apply to this type of control.

6. The present Order will enter into force on 1 June 2007.

The Ministry of Taxation, 2 May 2007

Kristian Jensen

/Lene Skov Henningsen

Appendix 2

EU Commission position on VAT Compensation:

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.”

Appendix 3:

Positions of political parties who all have indicated support for positively addressing the issue of VAT Compensation for charities

In response to contacts from the ICTRG **Fianna Fail** stated:

“If re-elected Fianna Fáil in government will consider VAT paid by charities in the context of a budgetary framework.”

In response to contacts from ICTRG **Fine Gael** stated it:

“supports in principle a VAT compensation scheme for charities. If elected to Government, we will work with stakeholders to implement such a scheme in the context of putting the charity sector on a proper regulatory footing.”

In its election documentation the **Green Party** stated it:

“will give charities a refund on VAT paid on donations in order to support their positive contribution to Irish society.”

The Party Manifesto specifies a figure of €32m to be allocated in this regard.

In response to contacts from the ICTRG the **Labour Party** stated:

“In our manifesto “The Fair Society” we are committed to introducing a comprehensive regulation of charities as a priority. We hope to engage in Government with the various Groups to see how we can then address the broader issue.”

The **Progressive Democrats**, in their General Election Manifesto, pledged to:

“legislate to regulate the charity sector and examine how VAT is levied on charitable organisations.”