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Section 344: definition of "charity" restricted to UK charities

One of the most pointless provisions in the Finance (No.2) Act 2023 (F(No.2)A 2023) is section 344 which purports to restrict the definition of "charity" for various tax purposes to UK charities.[1] This reverses a change in the law made in 2010 and required by EU law, which can now be reversed as one of the "benefits" of Brexit. The impact assessment published at the time of the draft legislation[2] estimates that the Exchequer impact would be a saving of £10 million in a full year, which hardly justifies the waste of parliamentary time in enacting this measure. This saving is said to arise from an estimated 2,000 individuals who claimed higher rate relief on donations to non-UK charities, including some 20 EU/EEA charities, 10 of which claimed Gift Aid totalling less than £500,000 a year.[3] Other than that, the measure is expected to have a negligible impact. In reality, this estimate of tax saving is suspect: assuming the same donors will still make similar charitable donations, there is no saving of Gift Aid. In some cases, the donors will simply make their gifts to the "British friends of…" the overseas charity, so the same purpose will be achieved and the same tax relief will be claimed.

However, the impact assessment possibly underestimates the consequential impact not in terms of tax relief but on those donors who wish to benefit charities established outside the UK. For reasons explained below, it is also not clear that the measure has achieved its purpose

[1] There is a parallel provision for community amateur sports clubs in Finance (No.2) Act 2023 (F(No.2)A 2023) s.345, which is not discussed further here.

[2] See HMRC, Policy Paper, *Restriction of charitable reliefs to UK Charities* (15 March 2023), *https://www.gov.uk/government/publications/restriction-of-charitable-reliefs-to-uk-charities-and-community-amateur-sports-clubs/restriction-of-charitable-reliefs-to-uk-charities#:~:text=For%20non-UK%20charities%20and,claim%20UK%20charitable%20tax%20reliefs* [Accessed 26 September 2023].

[3] See: HMRC, *Restriction of Charitable Reliefs to UK Charities* (2023).

(assuming that its purpose was to limit all charitable tax reliefs only to charities and charitable purposes under the jurisdiction of the courts of the UK).

Charitable exemptions have been part of UK tax law since at least Addington's Act in 1799.[4] Section 5 of the 1799 Act provided:

> "Provided also, and be it further enacted, That no Corporation, Fraternity, or Society of Persons established for charitable Purposes only, shall be chargeable under this Act, in respect of the Income of the Corporation, Fraternity, or Society."[5]

In 1955 in *Camille and Henry Dreyfus Foundation Inc v IRC* (*Dreyfus*),[6] the House of Lords had to consider whether a foundation incorporated under the law of New York was entitled to exemption from income tax in respect of royalties received from a company in the UK. The charitable exemption in that case was found in section 37 of the Income Tax Act 1918 (ITA 1918) which provided as follows:

> "Exemption shall be granted-…from tax under Schedule D, in respect of any yearly interest or other annual payment forming part of the income of *any body of persons or trust established for charitable purposes only*, or which, according to the rules or regulations established by Act of Parliament, charter, decree, deed of trust, or will, are applicable to charitable purposes only, and so far as the same are applied to charitable purposes only…."[7] (Emphasis added.)

The principal issue in the case was whether the wording "any body of persons…*established* for charitable purposes only" included the US-incorporated foundation, or was limited to bodies established in the UK. The decision of the House of Lords is quite brief; the Law Lords unanimously concluded that it was.

It might be noted that the exemption was not limited to the income of any body of persons or trusts, but also had a second limb: "any yearly interest or other annual payment…which…are applicable to charitable purposes only". This is a point that this note will return to.

The judgment of the Court of Appeal in the *Dreyfus* case is much fuller (and was referred to with approval by the House of Lords). The members of the Court of Appeal noted that the phrase "any body of persons…established for charitable purposes only" was not explicitly limited to bodies of persons established in the UK. However, the court concluded from various ancillary aids to interpretation that the phrase was implicitly so limited.[8] First, the context of the legislation gave some indication that the intention was to limit the exemption to bodies of persons established in the UK. The subsequent sections of the legislation referred to the British Museum and to cathedrals and colleges (which were thought to be limited to those in the UK, though not explicitly so limited). Secondly, there would be administrative difficulties for the Inland Revenue in applying the exemption if it covered bodies of persons established outside the UK (remembering

[4] See the historical references in the decision of the Court of Appeal in *Camille and Henry Dreyfus Foundation Inc v IRC* (*Dreyfus*) (1954) 36 T.C. 126; [1956] A.C. 39.
[5] Addington's Act 1799 s.5.
[6] *Dreyfus* (1954) 36 T.C. 126.
[7] Income Tax Act 1918 (ITA 1918) s.37.
[8] The three judgments in the Court of Appeal are not identical in their reasoning, but this summarises the views expressed.

that at the time the legislation was enacted in 1918, and also at the time of the decision in 1955, the UK had few arrangements for exchange of information with other countries or territories). Finally, and somewhat decisive (particularly in the House of Lords), there was legislation in 1923, 1924 and 1925[9] which dealt with the application of the charitable exemptions to charities established in the Irish Free State: this was legislation enacted subsequent to the 1918 Act, but it contained at least some indication that, on one view, when parliament enacted the exemptions in 1918, it thought that the exemptions only applied to bodies of persons established in the UK (hence the need to clarify the position with regard to the Irish Free State after it achieved independence). There was some doubt, however, how far one could interpret 1918 legislation by reference to legislation later in time, how far that later legislation was simply included out of the abundance of caution and whether it perhaps reflected an incorrect understanding of the law at the time that the legislation was enacted by parliament.

A secondary issue in the *Dreyfus* case was the question of whether the New York-incorporated foundation was established for charitable purposes. The foundation was established for the advancement of science. It was conceded that the question of the meaning of charitable purpose was to be determined according to the law of England and Wales. The House of Lords confirmed that the purposes of the foundation were charitable according to that law.

For income tax purposes, therefore, *Dreyfus* established that (a) "charitable purposes" should be determined according to the law of any part of the UK; and (b) "body of persons" and "trust" in the charitable exemption should be limited to those established in the UK and under the jurisdiction of the courts of a part of the UK.

More recently, in *Routier v HMRC* (*Routier*)[10] the Supreme Court has referred to the *Dreyfus* case as placing a gloss on the statutory language in stating that the phrase a "trust established for charitable purposes only"[11] was limited to trusts governed by the law of some part of the UK and subject to the jurisdiction of the courts of the UK.

When capital transfer tax was introduced in 1975 (and subsequently became inheritance tax in 1986) it was originally provided that "'charity' and 'charitable' have the same meanings as in the Income Tax Acts".[12] The *Dreyfus* gloss accordingly applied also to inheritance tax.

Then, on 1 January 1973, the UK joined the European Economic Community.

In *Persche v Finanzamt Lüdenscheid*[13] in 2009 the Grand Chamber of the European Court of Justice concluded that the free movement of capital in article 56 of the EC Treaty precluded legislation of an EU Member State by which the benefit of a deduction for tax purposes was allowed only in respect of donations made to bodies established in that Member State, without the possibility of a taxpayer showing that a donation to a body established in another Member State satisfied the requirements of the legislation for the tax exemption. In retrospect, it is amazing that it took until 2009 before it was recognised that a rule that restricted tax exemptions to

[9] Finance Act 1923 s.21, Finance Act 1924 s.32, and Finance Act 1925 s.21.
[10] *Routier v HMRC* (*Routier (SC)*) [2019] UKSC 43; [2019] S.T.C. 2182.
[11] ITA 1918 s.37.
[12] See the Finance Act 1975 s.51(1), subsequently the Inheritance Tax Act 1984 (IHTA) s.272. This definition was deleted by the Finance Act 2010 (FA 2010) when the new definition of "charity" was inserted for, inter alia, purposes of inheritance tax.
[13] *Persche v Finanzamt Lüdenscheid* (C-318/07) EU:C:2009:33; [2009] S.T.C. 586 ECJ (Grand Chamber).

charitable bodies established in a single Member State was an interference with the free movement of capital.

The response in the UK was to enact, in Schedule 6 to the Finance Act 2010 (FA 2010), a definition of "charity", "charitable company" and "charitable trust" for the purposes of enactments relating to all the major UK taxes (this included income tax, capital gains tax, corporation tax, value added tax, inheritance tax, stamp duty, stamp duty land tax, stamp duty reserve tax and has subsequently also been extended to the annual tax on enveloped dwellings and diverted profit tax). Paragraph 1 of Schedule 6, as originally enacted, provided as follows:

"Definition of 'charity' etc

1. (1) For the purposes of the enactments to which this Part applies 'charity' means a body of persons or trust that—
   (a) is established for charitable purposes only,
   (b) meets the jurisdiction condition (see paragraph 2),
   (c) meets the registration condition (see paragraph 3), and
   (d) meets the management condition (see paragraph 4).
   (2) For the purposes of the enactments to which this Part applies—
   'charitable company' means a charity that is a body of persons;
   'charitable trust' means a charity that is a trust.
   (3) Sub-paragraphs (1) and (2) are subject to any express provision to the contrary.
   (4) For the meaning of 'charitable purpose', see section 2 of the Charities Act 2006 (which—
   (a) applies regardless of where the body of persons or trust in question is established, and
   (b) for this purpose forms part of the law of each part of the United Kingdom (see section 80(3) to (6) of that Act))."[14]

At the time of the enactment of Schedule 6 FA 2010, the definition of "charitable purpose" was that found in section 2 of the Charities Act 2006. This was subsequently replaced by reference to section 2 of the Charities Act 2011.

The obvious point may be made that a body of persons or a trust might be established for charitable purposes only (as defined), but yet not meet the jurisdiction condition or the registration condition or the management condition. As paragraph 1(4) confirms; it might be established anywhere in the world, and still be for charitable purposes.

The jurisdiction condition,[15] as originally enacted in 2010, was provided for in paragraph 2 of Schedule 6 and was as follows:

[14] FA 2010 Sch.6 para.1.

[15] There is an unresolved issue in relation to the jurisdiction condition, which is whether "a relevant UK Court in the exercise of its jurisdiction with respect to charities" refers to the inherent jurisdiction of the English High Court, for example, to supervise charities or to jurisdiction granted by the relevant instrument. If a trust instrument or the document constituting a body of persons gives exclusive (or even non-exclusive) jurisdiction to the English High Court to resolve disputes, does that satisfy the jurisdiction condition in FA 2010 Sch.6 para.2?

"Jurisdiction condition

2. (1) A body of persons or trust meets the jurisdiction condition if it falls to be subject to the control of—
   (a) a relevant UK court in the exercise of its jurisdiction with respect to charities, or
   (b) any other court in the exercise of a corresponding jurisdiction under the law of a relevant territory.
   (2) In sub-paragraph (1)(a) 'a relevant UK court' means—
   (a) the High Court,
   (b) the Court of Session, or
   (c) the High Court in Northern Ireland.
   (3) In sub-paragraph (1)(b) 'a relevant territory' means—
   (a) a member State other than the United Kingdom, or
   (b) a territory specified in regulations made by the Commissioners for Her Majesty's Revenue and Customs.
   (4) Regulations under this paragraph are to be made by statutory instrument.
   (5) A statutory instrument containing regulations under this paragraph is subject to annulment in pursuance of a resolution of the House of Commons."[16]

Thus, when the FA 2010 was originally enacted, the jurisdiction condition could be met if the body of persons or the trust was subject to the control of a "relevant UK court" in the exercise of its jurisdiction with respect to charities, or "any other court in the exercise of a corresponding jurisdiction under the laws of a relevant territory". A "relevant territory" meant a Member State of the EU, or any other territory specified in regulations made by HMRC. This included all EU and EEA states. Thus, the UK ensured compliance with EU law by including within the definition of "charity" a body of persons or trust established for charitable purposes only (as defined in the Charities Act 2006 and subsequently 2011) and which met the jurisdiction condition, including if it was subject to the control of a court in the exercise of a jurisdiction corresponding to the jurisdiction of a UK court with respect to charities in an EU or EEA Member State.

Before turning to the changes made in the F(No.2)A 2023, something further should be said about the Supreme Court and Court of Appeal judgments in *Routier*.[17] The issue in that case concerned the estate of a lady who died domiciled and resident in Jersey, leaving her residuary estate to a trust with Jersey trustees and Jersey proper law but for purposes which were agreed to be exclusively charitable under English law. The trust had been registered as a charity under the law of England and Wales. The question was the application to assets situated in the UK of the exemption from inheritance tax in section 23 of the Inheritance Tax Act 1984 (IHTA), which provided as follows:

[16] FA 2010 Sch.6 para.2.
[17] *Routier (SC)* [2019] S.T.C. 2182. The relevant Court of Appeal judgment is at *Routier v HMRC* (*Routier (CA)*) [2016] EWCA Civ 938; [2016] S.T.C. 2218.

> "23 **Gifts to charities**
>
> (1) Transfers of value are exempt to the extent that the values transferred by them are attributable to property which is given to charities.
>
> …
>
> (6) For the purposes of this section property is given to charities if it becomes the property of charities *or is held on trust for charitable purposes only*, and 'donor' shall be construed accordingly."[18] (Emphasis added.)

The argument of HMRC was that the exemption did not apply because the trust was established in and governed by Jersey law. The argument on behalf of the executors was that such a restriction was contrary to the free movement of capital under article 56 of the EC treaty.

Before the High Court and Court of Appeal[19] the executors argued that section 23 contained two limbs: reading section 23(1) and (6) together, transfers of value were exempt to the extent that property "(a) becomes the property of a body of persons or trust established for charitable purposes only, or (b) is held on trust for charitable purposes only".[20] These were referred to as *the two limbs* of section 23(6).[21] The executors argued that the *Dreyfus* decision applied only to the first limb as the House of Lords in that case had focused on the requirement for the body of persons to be *established* for charitable purposes only. The second limb—assets "held on trust for charitable purposes only"—was not so limited. Both Rose J in the High Court and the Court of Appeal rejected this argument of the executors, and concluded that the House of Lords decision in *Dreyfus* applied to both limbs.

The primary issue before the Supreme Court was whether Jersey formed part of the UK for the purposes of article 56. A secondary question was whether the refusal of relief under section 23 IHTA was contrary to EU law.

On the first issue—which took up most of the judgment of the Supreme Court—the conclusion was that Jersey was to be considered as a third country for the purposes of the free movement of capital. So far as section 23 was concerned it was accepted that it constituted a restriction on the free movement of capital, but the question was whether it was justifiable. On its face, the Jersey trust would appear to qualify for relief. However, the *Dreyfus* case had added the gloss that trusts were to be governed by the law of some part of the UK to qualify for the income tax exemption, which also applied to inheritance tax. The Supreme Court concluded that the only reason why the exemption from inheritance tax in section 23 was incompatible with European law was because of the judicial gloss to the legislation in *Dreyfus*. By disapplying that gloss, section 23 could be brought into conformity with the free movement of capital. The Supreme Court did not have to decide whether the *Dreyfus* gloss applied to both limbs of section 23(6). It remains an open question, therefore, whether the *Dreyfus* gloss applied only to the first limb of section 23(6)—a body or trust established for charitable purposes only—or whether it also applied to property held on trust for charitable purposes only.

[18] IHTA s.23.
[19] At its first hearing. The issues were divided between two separate hearings of the Court of Appeal; the subsequent hearing—reported at *Routier v HMRC* [2017] EWCA Civ 1584; [2018] S.T.C. 910—primarily dealt with the EU law related issues.
[20] IHTA s.23.
[21] Which harks back to ITA 1918 and the two limbs mentioned there too.

There is a further question whether the *Dreyfus* case remains good law. The Supreme Court in *Routier* found that the infringement of the free movement of capital could be avoided by disapplying the judicial gloss in *Dreyfus*. That is not the same as overruling *Dreyfus*. However, the current legislation is no longer the same as that considered in 1955 (and now expressly recognises that a trust may be established anywhere in the world for charitable purposes only) and much of the reasoning of the Court of Appeal and House of Lords in *Dreyfus* is no longer applicable. The reasoning in *Dreyfus* was always somewhat weak, and it is doubtful if that case can stand any longer as an interpretation of the new legislation.

Turning finally to the 2023 legislation (in the light of the historical development of the charitable exemptions from income tax and inheritance tax at least), all that this legislation did was to cut down the scope of the jurisdiction condition in paragraph 2 of Schedule 6 FA 2010. After the amendments made by section 344 F(No.2)A 2023, the jurisdiction condition now reads as follows:

"Jurisdiction condition

2. (1) A body of persons or trust meets the jurisdiction condition if it falls to be subject to the control of—
   (a) a relevant UK court in the exercise of its jurisdiction with respect to charities[.]
   […]
   (2) In sub-paragraph (1)(a) 'a relevant UK court' means—
   (a) the High Court,
   (b) the Court of Session, or
   (c) the High Court in Northern Ireland
   (and, for enactments relating to value added tax, includes the High Court of the Isle of Man)."[22]

(The remaining parts of paragraph 2 are deleted.)

None of the other elements of the definition of charity were impacted. The change to the jurisdiction condition only removed references to courts other than a relevant UK court. The explanatory documentation suggested that the government intended this to limit tax exemptions only to charities established in the UK.[23] However, it is far from clear that that has actually been achieved.

First, it is now clear from paragraph 1 of Schedule 6 that a body of persons or a trust may be established for charitable purposes even if the body of persons or trust does not meet the jurisdiction condition. It is also explicit in the current legislation that a body of persons or trust may be established anywhere in the world for exclusively charitable purposes.

Secondly, there is the "second limb" of section 23 IHTA (as identified in *Routier*) where "property…is held on trust for charitable purposes only". Schedule 6 FA 2010 (as amended in 2023) defines a "charity" and requires, in addition to charitable purpose, the jurisdiction condition,

[22] FA 2010 Sch.6 para.2.
[23] See HMRC, *Restriction of charitable reliefs to UK Charities* (2023).

the registration condition and the management condition. There is no obvious reason why the second limb requires these three additional conditions.

Thirdly, there is now uncertainty whether *Dreyfus* remains good law. As explained, that case was focused on the meaning of "a body of persons…established for charitable purposes" in the Finance Act 1918 (FA 2018). What was said in relation to trusts was, strictly speaking, obiter. It was not focused, as such, on the "second limb" of the tax exemption in section 23(1) and (6) IHTA (even though there was also a form of second limb in 1918). The case also reflected its own era, particularly with its references to the administrative difficulties for the Inland Revenue in checking information with regard to foreign trusts and bodies of persons. Now that the UK has an extensive network of double taxation conventions, and is a party to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters,[24] the administrative difficulties argument is no longer a valid one. The legislation that contains the exemptions is no longer found in FA 1918 (to which the legislation in 1923, 1924 and 1925 might have provided clarification), but rather the provisions of the IHTA and of Schedule 6 FA 2010 (discussed above).

Putting this all together, it is arguable that the amendment in F(No.2)A 2023 has misfired. All it has done is amend the jurisdiction condition. On the face of the legislation, a body of persons or a trust may be established anywhere in the world for charitable purposes only, those purposes being defined in section 2 of the Charities Act 2011. It is explicit from paragraph 1(4) of Schedule 6 FA 2010 that the meaning of "charitable purpose" applies "regardless of where the body of persons or trust in question is established". That wording was not changed in 2023.

Section 344 is a mealy-mouthed change which is unlikely to save any tax revenue. Instead of making charitable donations direct to charities established in other countries, including the EU, UK taxpayers will have to make donations to "the UK Friends of the Louvre Museum", or other similar organisation. The Gift Aid relief will still apply, but there will be additional administrative costs falling on the charities or the donors. The writer of this note has personal experience of a donation from a body elsewhere in the EU to a museum in the UK being tax-exempt in the other country only because the writer provided an opinion that an equivalent donation in reverse to a charity in the other European country would benefit from UK tax exemptions. Such donations would not be possible after the change in the law, if the effect of the change has been to limit charitable exemptions exclusively to those established in the UK and under the jurisdiction of a UK court. However, for reasons explained above, it is far from clear that the legislation has achieved its purpose.

For reasons best known to themselves, the government appears to have an aversion to recognising that overseas trusts and bodies of persons, even if established exclusively for purposes that are charitable according to the law of a part of the UK, and even if they are clearly for public benefit, should enjoy tax exemptions. That position is unreasonable in a world where there is

[24] The OECD/Council of Europe Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

full access to information from other countries. Even if it has achieved its objective—which is doubtful—this amendment to the law was a pointless and worthless exercise.

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