HMRC guidance on approved charitable investments and loans

James Maloney | April 2013

HMRC has, at long last, published its updated guidance on approved charitable investments and loans following publication of the revised Charity Commission guidance *Charities and Investment Matters: A guide for trustees (CC14)* in October 2011.

Sections 511 and 514 of the Corporation Tax Act 2010 (for charitable companies) and sections 558 and 561 of the Income Tax Act 2007 (for charitable trusts) describe the types of investments and loans that are "approved charitable investments" and "approved charitable loans". An investment or loan which is not accepted as falling within one of the permitted categories will be regarded as non-qualifying expenditure, and may be liable to tax.

The approved categories can be summarised as follows:

- any investment in a charity common investment fund, common deposit fund or similar scheme;
- any interest in land (unless it is held as a security or a guarantee for a debt);
- shares or securities of companies listed on a recognised stock exchange;
- units etc. in a Unit Trust Scheme;
- shares in an Open-Ended Investment Company incorporated in the United Kingdom;
- bank deposits – other than deposits made as part of an arrangement under which the bank makes a loan to somebody else (e.g. back to back loans);
- certificates of deposit;
- any loan or other investment made for the benefit of the charity and not for the avoidance of tax (whether by the charity or any other person).

In relation to the last of these categories, HMRC's interpretation of "for the benefit of the charity" is crucial.

HMRC has traditionally held the view that an investment or loan must be either for financial benefit or for charitable benefit. However the new guidance recognises that charity trustees need greater flexibility in making investment decisions, and that a rigid distinction is no longer necessarily appropriate. It also accepts that, in considering whether an investment or loan has been made for the benefit of the charity, trustees may take a broad view as to how the charity benefits.

These specific considerations only arise in relation to the final category of "approved charitable investments" and "approved charitable loans" listed above (i.e. those made for the benefit of the charity and not for the avoidance of tax). The same is true of comments the guidance makes about specific ways to invest, which are as follows:

- HMRC acknowledges that the Charity Commission's guidance identifies a distinction between "financial investments" and "programme related investments" and also recognises the concept of "mixed motive investments".

- The guidance states that investments recognised by the Commission as financial investments should be investments in the strict sense – funds invested to generate a flow of income or gains to enable the charity to carry out its objects. Where an investment is a financial investment HMRC would expect trustees to be able to demonstrate that the investment was made "for the financial benefit of the charity".

- Ethical investments – HMRC notes that "while these are still financial investments and must be demonstrably made for the financial benefit of the charity" they are "likely to be made in accordance with the charity's values and ethos and may yield a lower return than the best performing commercial alternatives". The guidance goes on to state that "Trustees may be able to demonstrate benefit to the charity, despite this lower performance, by reference to the positive effect on the charity's objects, the avoidance of conflict with those objects or the impact of the investment decision on supporter perceptions."

- Programme related investments – HMRC states that these "are not investments in the strict sense… they are not made with a view to generating a flow of income or gains to carry out the charity's objects" and "may not offer any realistic prospect of a commercial investment return". The guidance states that "these investments are properly viewed as application of funds to further the purposes of the charity. Where the trustees are able to demonstrate that proper consideration has been given to such an investment and how it is expected to further the charity's objects HMRC is likely to accept that it has been made for the benefit of the charity."

- Mixed motive investments – HMRC states that "some charity investments will be made on terms that deliver insufficient financial return for them to be accepted as financial investments. At the same time they deliver insufficient charitable benefit to be accepted as being programme related investments. However, trustees may be able to demonstrate that, taken together, the combination of financial return and carrying out of charitable objectives is sufficient for the investment to be made for the benefit of the charity."

- In relation to MMI, the guidance gives the example of an overseas development charity investing in a fair trade tea production and marketing venture with a lower rate of return than would be expected from a "conventional investment" (2% as against 5%). However, the trustees are able to demonstrate that "the social benefits in the target population are such as would have justified an application of charitable funds to the value of £15,000". Taking account of this, "a 2% return on the amount invested looks more reasonable and HMRC would be likely to accept this as being for the benefit of the charity".

The new guidance broadly endorses the Charity Commission's CC14 guidance. HMRC's recognition of mixed motive investments is particularly significant, as the absence of guidance on this point had been a disincentive for investments of this kind.

It is important to note that trustees will still need to be able to justify any investment and loan making decision and demonstrate how the arrangement benefits the charity. HMRC may ask to see evidence of the trustees' decision-making process and what information they considered as part of that process.

You can see the new HMRC guidance here http://www.hmrc.gov.uk/charities/guidance-notes/annex3/annex_iii.htm. The Charity Commission's guidance is available here: http://www.charitycommission.gov.uk/publications/cc14.aspx

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