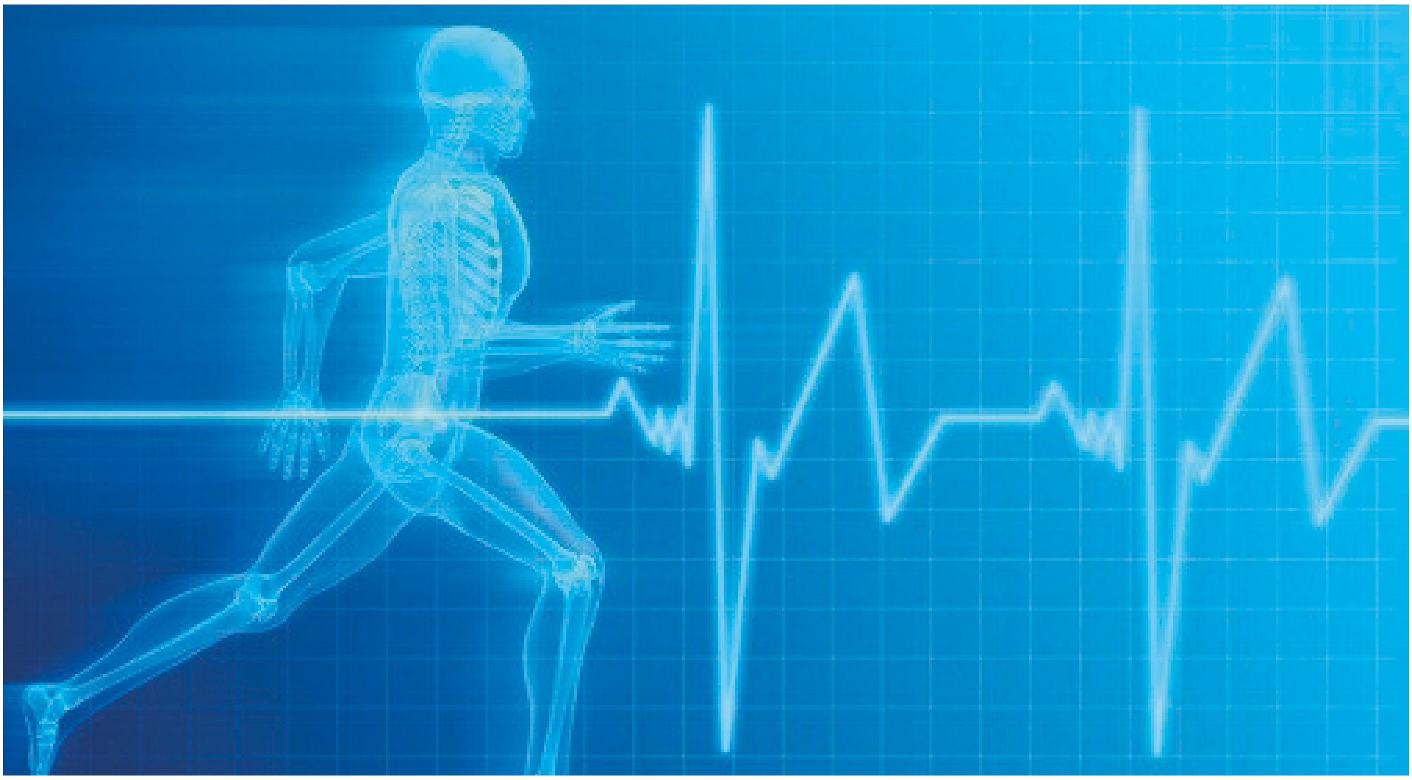


Pulse

Deloitte's Charities and Not for Profit Group Newsletter

Welcome to the autumn edition of PULSE.

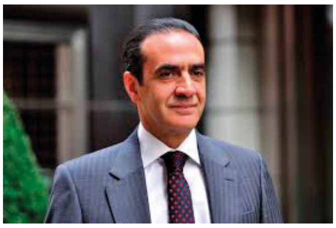
The summer is over and we expect further activities and developments in the sector.

Reporting Matters of Material Significance to the Charity Commission is now high on the agenda of both charities and the profession and it will be interesting to see how this develops over the coming months.

Recently, there have been significant developments in the tax regime which we will explore in more detail.

Thanks for reading!

Reza Motazedi



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Please note that the views expressed in this publication are those of the authors and not of Deloitte. In the complicated environment in which we all operate, always seek professional advice specifically and don't rely on contents of articles that have been written for general guidance only.

Tax Governance

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The way that HM Revenue & Customs is seeking to interact with charities and other businesses is evolving and charities should ensure that they are keeping up to date with new rules and approaches to tax management.

Self-assessment

Under the self-assessment system, charities are required to consider their tax position and make filings to HMRC reflecting this. HMRC can then review the various returns, for corporation tax, VAT, Gift Aid and other matters, and then has an opportunity to enquire into any points of interest. Some charities may also have had an ongoing relationship with a Customer Compliance Manager (CCM) at HMRC, although this is typically limited to the largest charities with the most complex tax positions and the number of charities with named CCMs appears to have decreased over time.

Over the last few years, in addition to this traditional approach to assessing a charity's tax position, there has been an increasing focus from HMRC on measures which seek to understand the charity's tax governance structures and processes.

As a result of these changes, charities should examine their tax management processes to ensure that these remain fit for purpose and implement new procedures where these are required.

Application of the changes to the charity sector

Many new tax governance requirements have been introduced with a focus on the largest private sector organisations. While many charities will not have a technical obligation to implement these rules, there are important lessons to be learned about HMRC's expectations of tax payer behaviour which should be considered and implemented by charities as part of effective tax governance processes.

There is an increasing public focus on organisations' responsibility to manage tax appropriately. Charities can use the principles underpinning HMRC's evolving approach as a framework to demonstrate a responsible approach to managing tax. Larger charities will often have the most complex tax positions, and may benefit from implementing the processes in full. While smaller charities may have simpler tax positions, they will still benefit from some level of tax governance, although this may be proportionate to the size and complexity of the organisation.

In addition, while there are many tax exemptions available to charities such that many will pay little or no corporation tax, some elements of the tax position can be particularly complicated. The position in relation to VAT and employment taxes can be at least as complex as for a private sector organisation. These rules provide a risk, through the penalties for failure to comply, but also represent an opportunity for charities, to enhance the value of income by efficient use of tax reliefs.

Pulse | Deloitte's Charities and Not for Profit Group Newsletter

Key requirements of tax governance

Some of the key changes to the tax governance environment in recent years are described below:

Tax strategy

The largest organisations (with turnover of more than £200m per year) are required to publish their tax strategy on an annual basis.

While most charities will not fall within these formal requirements, the thinking behind the development and implementation of an effective tax strategy will benefit all large organisations and HMRC may ask about the group's strategy even where there is no formal requirement to publish it.

A documented tax strategy enables decision makers within the charity to make decisions based on a common set of principles.

Senior Accounting Officer

The SAO rules only apply to the largest groups (with turnover of more than £200m per year). However, they are worth considering here because of the way that they introduce an expectation that a key individual within the organisation has ultimate responsibility for ensuring that the organisation has appropriate tax management processes.

Corporate Criminal Offence

The CCO rules look at the processes that a charity has in place to prevent the facilitation of tax evasion by individuals associated with the charity.

A charity will be automatically deemed liable for the facilitation of tax evasion by an 'associate', unless they can prove that they had 'reasonable procedures' to prevent such facilitation. In addition to the risk of reputational damage, significant penalties accompany this legislation, including unlimited financial penalties, confiscation orders and serious crime prevention orders.

Digital Tax Data

There is a trend towards a requirement for submissions to be made to HMRC electronically and for the underlying data to be held digitally. In recent years this has included the introduction of online filing of Gift Aid claims, iXBRL filing of corporation tax returns and the introduction of Making Tax Digital for VAT.

Stephen Gucciardi's article in the last issue of Pulse dealt with how these requirements may apply for VAT. Overall, these provisions are about ensuring that the source data is held appropriately and reduces the risk of error, while allowing HMRC to test the data submitted digitally.

Common themes across governance requirements

The various measures introduced over recent years cover a variety of tax situations. However, they include a number of common themes which can be used to understand how HMRC will seek to interact with organisations. These include:

Senior strategic engagement

One of the key features of each of these measures is the requirement for increased strategic engagement on tax and, in particular, for input, guidance and oversight at Board or Senior Executive level.

Charities should consider whether existing tax decision making is subject to appropriate oversight and how this is documented.

Communication throughout the business

A key element of these measures is that successful implementation of tax management process cannot be isolated to a single individual or team. Instead, the importance of tax management must be communicated to the organisation and appropriate training must be made available. This links with the need for senior management time, as effective lines of communication must be established both to and from the Board.

One area where we see this as of particular relevance to the charity sector is on Gift Aid, where many different teams may be involved in a single claim including fundraising, supporter services, marketing, database managers, finance etc. Charities should be able to provide evidence that the processes extend across all the teams with Gift Aid responsibilities correctly.

A focus on processes not transactions

This approach requires a charity to think more widely about how it operates. In the past, the key focus may have been around whether the treatment of a particular income stream was correct for VAT purposes, for example. Moving forward, there will be increased scrutiny of how a particular conclusion was reached, what factors affected this decision and who has responsibility for the outcome. Appropriate documentation of decision making is key to providing evidence of this.

Impact of failure to comply

In some cases the requirement to implement the rules is formal, with penalties for both the organisation and key individuals for non-compliance. In all cases, engagement at appropriate levels will be an important factor in mitigating the risk of HMRC challenge in future.

The potential impact of failure to manage tax effectively, including reputational damage, public profile and tax costs and penalties mean that this is an area which charities cannot afford to ignore and the principles established by the various programmes can provide a useful guide to how to manage tax.

Case study – HMRC working with charities on Retail Gift Aid

An example of the way that HMRC is seeking to engage with the sector to manage risk is the recent work on Retail Gift Aid. HMRC had formed a view that some charities were not operating Retail Gift Aid schemes effectively which may have meant Gift Aid was being over claimed by the sector.

One approach would have been for HMRC to open enquiries into a number of charities. In practice, HMRC's approach was to engage with the sector over the concerns and develop processes which aim to reduce the risk of invalid claims. In this case, this involved revising the HMRC guidance on Retail Gift Aid schemes with a key addition being the requirement for charities to deliver, and be able to provide evidence of, training to shop staff and volunteers. HMRC then worked with charities to develop a training package that can be used to deliver this training.

This approach demonstrates how HMRC are focussing on charities getting the processes right to reduce risk of non-compliance.

Key points to consider

Each charity should review its approach to tax management. Some useful questions to use as a starting point include:

- Does your charity have a clearly defined tax strategy which is understood at all levels throughout the organisation?
- Does the Board have sufficient oversight of how the tax strategy is being implemented?
- Are tax processes clearly understood throughout the organisation?
- Is appropriate training provided to staff and volunteers to ensure that they understand the processes and the importance of following them? Can you demonstrate that this training has been provided and participants have understood the critical messages?
- How is performance against the tax strategy monitored and reported back to stakeholders?

The only way is ethics

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Charities have a legal obligation to provide a pension scheme for their employees due to auto enrolment, but can pension scheme investments be based on ethical and not financial factors?

Some charities will have a trust based occupational pension scheme; while others will have established a contract based workplace pension scheme with an insurance company or master trust provider. The primary purpose of a pension scheme is to help an employee save for retirement. This means financial considerations such as value for money and good investment returns are paramount. However, some charities are starting to ask whether the pension funds their employees invest in can or should be aligned with their charitable interests for ethical and commercial reasons. This article considers some of the issues around this.

ESG and SII in a pensions context

Any decision about suitable investment funds for a pension scheme must take into account financial factors. Where ethical or social factors are aligned with competitive market returns, investment fund selection is simplified. It is clear that environmental, social and governance (ESG) factors such as a company's environmental record (E), its working conditions (S) or its policies on bribery or diversity (G), can impact directly on its financial performance and so are material considerations for a pension fund in deciding whether to invest. However, in some cases such as social impact investing (SII) i.e. investments with a positive social impact or that avoid a negative impact, it is more likely that wider non-financial matters such as ethical and social considerations will be taken into account in a way that is not aligned with the best financial return. This is an area of greater risk for charities looking to offer investment choices that reflect their charitable outlook and for pension trustees of a charity's occupational scheme.

Occupational pension schemes

Trustees of occupational pension schemes are responsible for making investment decisions. They must consult with the charity sponsoring the pension scheme but do not need the charity's agreement to their investment choices. If a charity wants to influence pension trustee investments the starting point is to seek investment funds where ESG or SII factors are aligned with competitive market returns.

Where this is not possible or if pension trustees are being asked to take prioritise non-financial matters (such as animal testing, health or social equality) when making investment decisions, they can only do so if they can meet an established two stage test under English case law: (i) the pension trustees must have good reason to think the scheme members hold the relevant concern; and (ii) the decision should not involve significant financial detriment. If either of these tests is not met there is a risk of a breach of trust claim from the scheme members. Ultimately the charity would be liable for this as scheme sponsor.

Whose choice?

To meet this test the charity and pension trustees would need to engage directly with the pension members to establish if they share the ethical concern. Charities must use charitable funds to further their objectives so underwriting a costly employee engagement exercise may not be warranted. A stepped approach is likely to be more suitable: perhaps carrying out a preliminary questionnaire to gauge member engagement and if there is significant interest, consideration could be given to running workshops or presentations to give employees an opportunity to discuss proposals and even setting up focus groups or forums. However, pension trustee approval and engagement is necessary at every stage as any investment choice must ultimately be approved by the pension trustees.

In certain circumstances it may be possible to avoid an employee engagement exercise: (i) if the issue is reflective of broader public opinion, for example, if the UK has ratified an international convention it may give pensions trustees reason to believe most people would support a particular investment stance; (ii) if the charity pursues a particular aim, such as cancer research, it is likely that conclusions can be drawn about investments that should be avoided. However, it should be borne in mind that different categories of scheme members (active, deferred and pensioner) may have a diversity of views and there will always be gradations of opinion. As such, pension trustees will need to be convinced of the merits of these arguments.

Where there are differences of opinion, only near unanimity is likely to be acceptable for trustees of defined benefit occupational schemes. This is because pension scheme funds are held for the benefit of all members and so ESG and SII issues impact on all members. It is likely to be a rare set of circumstances that permit defined benefit pension trustees to prioritise non-financial factors when setting investment strategy.

My choice?

For defined contribution schemes there will be greater latitude. This is because members of defined contribution schemes will commonly be able to choose between a number of different funds in which to invest their money and may choose to favour non-financial factors over financial concerns. The individual member ordinarily bears the risk in this circumstance, not the membership as a whole.

However, offering defined contribution members the opportunity to select a fund which prioritises a social impact agenda is qualitatively different from taking non-financial factors into account when choosing a default fund for members. Particularly as a charity and pension trustees should be aware that the majority of members do not exercise a choice once put into a default fund. If a charity wanted to use a default fund that prioritised non-financial over financial factors, again, near unanimity of member approval would be required to proceed safely.

Contract based workplace pension schemes

These are increasingly used by many charities, particularly as a way to meet the automatic enrolment duty. Charities setting up a pension scheme that meets the auto enrolment requirements will need to ensure that the product provides value for money for the employees and that the provider is financially robust and is providing access to suitable investment funds. At this point, if ESG or SII investment products are available from the pension provider then these could be added as an option. Again, prioritising these factors over financial matters in choosing the default fund for employees is qualitatively different to providing them as an option.

Reviewing the options?

However, once a workplace scheme is established, a charity has no direct obligation under pensions law to ensure investment funds are suitable and indeed need to be careful that they are not seen to be giving investment advice or carrying out financial promotion as they are not authorised to do so (except potentially at the point of establishing the scheme). This makes a subsequent decision to try to seek an ESG or SII investment fund with the insurance company a more risky proposition because if things go wrong and an employee makes a claim to recover poor investment returns in years to come, the charity needs to be careful that it has not strayed into giving financial advice. Of course, this does not prevent a good employer from regularly carrying out a governance review of its pension schemes but this will ordinarily be concerned with, financial performance, value for money and the service provided to employees.

If as part of the process a charity chose to offer employees access to a fund that prioritises non-financial matters, the charity should be absolutely clear with employees the basis on which the fund was chosen. If there is a risk of significant financial detriment (when compared to 'ordinary' investment funds) in any given investment fund under a workplace pension scheme, then this should be communicated to employees and the charity will be well advised to keep a clear paper trail. Charities are not ordinarily authorised to give financial advice or carry out financial promotion and so any communications should make clear that financial advice is not being given. Charities could also consider seeking some form of disclaimer from employees who enter into the funds to reduce the risk of future liability.

Because tax matters – delivering One Million Futures within Tax

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Matt Ellis, Deloitte UK's Head of Tax and Legal, launched 'Because Tax Matters' in 2017 as part of our One Million Futures social impact strategy. Our One Million Futures goal is to support a million people to get to where they want to be; whether it's in the classroom, the workplace or the boardroom. Our focus is on what matters most to us in society – raising aspirations, improving skills and developing leaders.

Value from volunteering

Because Tax Matters gives our tax professionals the opportunity to use their professional skills and experience to give something back to society. The programme focuses on providing advice to those in need, improving tax and financial education and awareness, and providing pro bono advice to charities.

Pro-bono support for charities

Our most valued asset is our people – we have over 3,000 tax professionals in the UK with a huge range of expertise, skills and experience. Through Because Tax Matters, charities can access pro bono support from our network of experienced tax professionals. We target our support where we can add value on projects and charities that are aligned with our One Million Futures goal.

We work closely with our pro bono teams in other service lines as some projects require the input of experts from different fields, such as impact assessments.

A day in the lab

We have developed a programme of tax labs for charities, where we work with the charities in a creative environment to help set their vision and strategy, and to identify key operational priorities, enablers and blockers.

We launched this programme in October 2017 with a global mobility tax lab for a large multinational charity; helping the team set their mobility strategy, focus their limited budget on key countries, and identify and target key risk areas. We have recently launched a multi-charity lab format allowing charities to share ideas and best practice with each other as well as working with our experts.

Helping those in need of advice

We work with two major tax charities in the UK: TaxAid and Tax Help for Older People, which provide free tax advice for people on low-incomes who need professional support but can't afford to pay for it. Our pilot team of 18 TaxAid volunteers worked on around 100 individual cases in FY18, helping vulnerable and low-income taxpayers to resolve their tax problems. Our teams in Newcastle and Leeds meet taxpayers in person, with a wider UK team providing advice by telephone. Many of the taxpayers we have helped have small underpayments of tax caused by errors in their tax code, and this can escalate into large debts due to penalties and interest. Others have simply fallen behind on their tax return compliance due to ill health or other problems. Just a couple of hours of support from an experienced volunteer can help resolve what seems like an insurmountable problem for a vulnerable taxpayer.

The charities estimate that between 60,000 and 300,000 individuals on low incomes could be in need of their services each year – a figure our own research supports. Yet TaxAid can only open its helplines for two hours per day, dealing with around 8,000 cases a year. It currently has around 60 volunteers supporting the full time charity employees. So we've been helping the charities document their current case allocation and workflow management process, and understand how improved technology could increase efficiencies and scale up the volunteering programme to keep the helplines open for longer.

We used our Lab format to work with the tax charities on their vision for the future - bringing together key stakeholders, including trustees, senior management, office managers and volunteers, with a cross-business line Deloitte team on hand to make the day a success. The lab incorporated our research on the market for the charities' services, user experience design work by Deloitte Digital to understand how the charities interact with their clients and volunteers, and the expertise of our Greenhouse trained facilitators to deliver a creative brainstorming day. During the lab, we explored the charities' strategy, the target population for their services, priorities, as well as barriers to change. Stephen Banyard, the Chair of Trustees for TaxAid said "Many thanks for laying on such a good day… It was very well thought out and designed – and your people did a first class job in delivering an event which fired our teams up and got the best out of them."

We're continuing to work with the charities to help them turn their vision into a reality.

Educating the next generation

Many students leave school without the tools and knowledge they need to successfully navigate the tax and financial systems. We're working with our Deloitte Access schools to help students better understand their finances, budgeting, pay slips and digital tax accounts. We explain how tax will affect them and how to deal with common pitfalls as well as equipping them to manage their finances effectively and plan for the future.

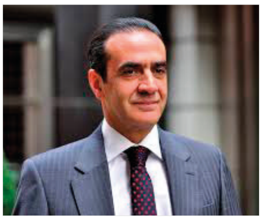
This autumn, we're running our first Fantasy Budget Competition giving students the opportunity to develop their economic, business and tax awareness skills, by stepping into the shoes of the Chancellor of the Exchequer and proposing decisions on government spending and taxes for 2019. We've had a great response from our schools and we're looking forward to hearing the students' ideas!

What does the future hold?

Our goal is for Because Tax Matters to be seen as the leading corporate social responsibility programme for the tax profession in the UK, with opportunities for everyone at every level of Deloitte's UK tax practice to participate. We want Because Tax Matters to become embedded in our culture so we can make an impact that matters in society.

The team has made significant progress to date, with much more in the pipeline. Please do get in touch if you are aware of any charities that would benefit from our services.

Charities and Not for Profit contacts



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