

CHARITY AND PHILANTHROPY UPDATE

This is the first of what we intend to be a regular update to our charity and philanthropy clients and contacts on the increasing number of significant developments in the charity and philanthropy field.

The past year has seen the introduction of the tainted charity donation rules and the proposed introduction of two important tax reliefs on gifts to charity. These reliefs are the proposed new regime for gifts of pre-eminent objects to the State and the reduced rate of inheritance tax where at least 10 per cent of an estate is left to charity on a person's death.

In the broader charity field a significant matter, which will affect many charities, is the approach adopted by the Charity Commission in applying the public benefit test. There has been a test case in relation to how the requirement should be applied to fee paying independent schools. We discuss the outcome of the case and its implications below. A further aspect of the public benefit test currently under discussion is whether a charity for the prevention or relief of poverty which restricts its potential beneficiaries (for example by reference to employment by a particular employer or relationship to a particular individual) can satisfy the public benefit test.

Apart from these issues there are a number of other interesting developments. We discuss the rights to be given to artists and their heirs to benefit from later sales of their works and how this might benefit charity.

We hope you will find this of interest. If you have any questions or points you would like to raise please contact me or your usual adviser at Macfarlanes. Also if there are any topics you would like to see covered in future issues please do let us know.



◀ **HELEN DARLING**
PARTNER
DD: +44 (0)20 7849 2298
helen.darling@macfarlanes.com

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INHERITANCE TAX REDUCTION WHERE 10 PER CENT OR MORE OF AN ESTATE PASSES TO CHARITY ON DEATH

The Chancellor in his Budget Statement in March 2011 announced the introduction of a new relief intended to encourage charitable giving. In broad terms where a person leaves 10 per cent or more of their estate on their death to charity the inheritance tax rate on the rest of the estate not passing to charity is reduced from 40 per cent to 36 per cent. The Government last month published the draft legislation designed to implement the new relief so we now have a good idea of how it will work.

We support the new relief as a helpful addition to the charity reliefs available to donors.

The relief will apply to persons dying on or after 6 April 2012.

So how will the new relief work?

THE BASIC RULE

The relief is calculated by reference to what is called a "baseline amount". The legacies in favour of charity must be equal to or exceed 10 per cent of this baseline amount.

So the crucial question is: how do you calculate this baseline amount? It is the gross value of the person's assets minus any exemptions (for example the exemption for assets passing to a spouse) and reliefs (for example the relief for business or agricultural property) and also minus the nil rate band (currently £325,000) so far as it is available.

Significantly for non-domiciled persons only UK situated assets which are within the scope of inheritance tax are taken into account in working out the level of the baseline amount.

Example:

Mr Smith has an estate worth £1m. He is a widower and on his death his estate will pass to his children. Mr Smith's estate comprises his house and stocks and shares which include a trading company listed on AIM worth £300,000.

What is Mr Smith's baseline amount?

Gross Estate		£1,000,000
Less:	Nil rate band	£325,000
	AIM shares	<u>£300,000</u>
		£625,000
		<u>£375,000</u>

The baseline amount is £375,000. In order to qualify for the relief Mr Smith must leave at least £37,500 to charity.

Assuming Mr Smith leaves £37,500 to charity the division of his estate will be as follows:

Charity	£37,500
HMRC	£121,500
The family	<u>£841,000</u>
Total estate	£1,000,000

Contrast the position if the legacy to charity was not made and the whole estate passed to the family

The family	£850,000
HMRC	<u>£150,000</u>
Total estate	£1,000,000

The effect of the new relief is that where 10 per cent is given to charity the cost of the gift is borne as to 24 pence in the pound by the family and as to 76 pence in the pound by HMRC. Strangely the proportionate cost shifts more to the beneficiaries the larger the percentage of the estate that is left to charity.

What is evident from the above example and the way in which the baseline amount is calculated is that the amount an individual needs to donate to charity in order to qualify for the relief (at least in the case of estates to which relief and/or exemptions are available) is considerably less than it first appears.

OTHER DETAILS

There is no restriction on the type of assets that may be left to charity. This is more generous than the rules for gift aid on gifts during lifetime where the relief is restricted to gifts of cash, quoted stocks or shares and land. Any asset will qualify. HMRC had at one stage been concerned that there might be opportunities for dumping useless assets on charities but still qualifying for the relief. Thankfully this concern was not reflected in the draft legislation and rightly so: a useless or sterile asset would have been unlikely to have a significant value and therefore would not count much towards the 10 per cent threshold.

As a result it should be possible to provide a general clause which can be used in a will to leave an amount qualifying for the relief. We have worked on such a clause and once the legislation is finalised will have this available.

It will be possible to elect that assets held in a trust which are taxed on death and the share of the deceased person in jointly held assets such as a share in a house should be included in the claim for the relief. This would be worthwhile if, for example, the amount left to charity out of one of the components by itself (say a trust) did not meet the 10 per cent test but combined with another component (say the deceased's own personal assets) where more than 10 per cent was left to charity both components together would meet that test. An election would then be worthwhile in order to ensure that the property in the trust also attracted the lower rate of tax.

WHAT SHOULD BE DONE IN RELATION TO WILLS IN THE MEANTIME?

For those wishing to amend their wills before the rules are finally passed in order to ensure the relief would be available if they died on or after 6 April, a discretionary will trust is recommended. Armed with a letter of wishes from the person making the will the trustees could make an appointment in favour of charity qualifying for the relief. This would also give flexibility in cases where there is concern that due to a change in circumstances there may not be sufficient assets left to provide for the family.

Where a will has not been changed and a death occurs on or after 6 April it will be open to the beneficiaries if they wish to alter the will for inheritance tax back to the date of death in order to qualify for the relief. This would be done by a deed of variation and may be particularly worthwhile where a will leaves say 9 per cent to charity and an extra 1 per cent given under a deed of variation will then bring the charitable legacies up to 10 per cent and hence bring the rate of inheritance tax on the remaining part of the estate down to 36 per cent.

LOOKING TO THE FUTURE

There has been significant interest in the new relief. Recently there has been the Legacy10 initiative endorsed by the Chancellor whereby a number of public figures and businessmen have pledged to leave 10 per cent of their estates to charity. It is likely that charities will soon be amending their literature on wills to suggest that the new relief is used where possible.

Of overall importance, and this should always be kept in mind, is that the family should be adequately provided for and not put at risk financially. Appropriate qualifications to a legacy to charity can be built in where necessary.

There will be more to say on this as time passes. In the meantime the Government is to be commended for promoting a helpful new relief.



◀ **OWEN CLUTTON**
CONSULTANT
DD: +44 (0)20 7849 2350
owen.clutton@macfarlanes.com



◀ **RACHEL STEEDEN**
SOLICITOR
DD: +44 (0)20 7849 2153
rachel.steeden@macfarlanes.com

NEW TAX RELIEFS FOR GIFTS OF CULTURAL OBJECTS

While the announcement in the 2011 Budget of the proposed inheritance tax relief for gifts to charity grabbed many of the headlines, also of great interest was the Chancellor's proposal for a scheme to stimulate lifetime gifts of pre-eminent objects to the nation by offering donors a reduction in their tax liability.

On 6 December 2011 the Government published its detailed proposals for this new tax relief which is expected to come into effect next year.

WHAT RELIEF IS PROPOSED?

The Government is offering tax relief for individuals or companies which donate objects which qualify under the scheme.

- ◆ For individuals, the tax relief available is 30 per cent of the value of the object(s) donated which can be deducted against the individual's income tax or capital gains tax liability for the current year or, if preferred, the tax relief can be spread over a five year period.
- ◆ For companies, the tax relief is limited to 20 per cent of the value of the object(s) donated and can be deducted against the company's corporation tax liability in its current accounting year (the relief cannot be spread over other years in the same way as for individuals).

Gifts made under the scheme would also not be subject to capital gains or corporation tax on the donation. Assuming that the object is standing at a large capital gain, this would represent a further potential tax saving of up to 28 per cent in comparison to selling the object on the open market.

WHAT OBJECTS SHOULD BE ELIGIBLE FOR THE NEW SCHEME?

The scheme will apply to objects which are "pre-eminent" or "associated with an historic building". Whether a particular object falls within these definitions will be considered by a panel of experts appointed by the Government. In practice, this will consist of an expanded version of the Government's existing panel which considers applications under the Acceptance in Lieu of Inheritance Tax scheme (the AIL Scheme).

If the panel recommend an application the final decision will rest with the relevant Minister. Broadly speaking, the Secretary of State for Culture, Olympics, Media and Sport will be responsible for objects located in England, whereas the equivalent ministers in Wales, Scotland and Northern Ireland will be responsible for objects located in those countries.

An object is "pre-eminent" if it falls into one of the following categories:

- ◆ any picture, print, book, manuscript, work of art, scientific object or other thing which the relevant Minister is satisfied is pre-eminent for its national, scientific, historic or artistic interest; or
- ◆ any collection or group of pictures, prints, books, manuscripts, works of art, scientific objects or other things if the relevant Minister is satisfied that the collection or group, taken as a whole, is pre-eminent for its national, scientific, historic or artistic interest.

An object is "associated with an historic building" if:

- ◆ the historic building in question is owned by particular prescribed public or charitable bodies (which include for example the National Trust);
- ◆ the object is or has been kept in that building; and
- ◆ the relevant Minister considers it desirable for the object to remain associated with the building.

WHO WILL RECEIVE THE OBJECT?

Although in theory the scheme applies for all donations "for the benefit of the public or the nation", in practice it will be necessary for an appropriate institution (which may be nominated by the donor) to accept ownership of the object. The institution would be required to accept certain conditions to the gift, including accepting responsibility for maintaining and insuring the object, committing to place the object on public display and not to sell or transfer the object without the prior consent of the relevant Minister.

It is likely that some institutions will themselves place conditions on their acceptance of an object under the scheme. For example, a number of major UK charities already adopt a policy under which they will only accept donated objects if this gift is accompanied by a suitable cash endowment to meet the costs of maintaining, displaying and storing the donated object.

FURTHER REFORM

HMRC has urged us to view the current proposals as a starting point, from which a more comprehensive scheme may develop over a number of years. It is likely therefore that if the scheme is successful, further reform will follow.

This is important as there are a number of significant limitations to the relief as proposed. In particular, it cannot be used for gifts of assets that are jointly owned or which are held in trust or by executors. It also differs from the AIL Scheme as it does not allow the eligible institution to which the object is transferred to fund the difference between the amount of tax reduction available and the amount of the object's agreed market value (known as "hybrid offers"). This has proven a useful tool under that scheme in cases where the relief available would exceed the estate's tax liability.

In addition, where an object is donated which is already subject to the conditional exemption from inheritance tax for heritage property, any inheritance tax deferred under that relief could become immediately payable. This could make the scheme much less appealing for such assets.

BUDGET

Potentially the most significant limitation on the success of the new scheme is that the Government has only budgeted for an additional £10m decrease in tax receipts (although the scheme will be able to share the existing allowance of the AIL Scheme, so the total budget for both is £30m). This could prove to be greatly underestimating the potential appeal of the relief, particularly given the ever increasing value of pre-eminent art. Applications under the scheme which may result in this budget being exceeded in any one year will be rejected.

COMMENT

Gifts of objects to charities do not currently benefit from the same generous tax treatment available for gifts of cash or certain qualifying investments (which include listed securities and UK property). This proposed scheme will, at least partly, address this discrepancy. The terms of the scheme are however very limited, as discussed above. The tax relief offered is also much less generous than that available for gifts of cash or qualifying investments.

For those seeking tax relief on objects which would not qualify under the new scheme (or for which the requirements of the scheme are inappropriate) the existing options of donating the asset to charity on death or claiming the conditional exemption for inheritance tax remain available. However, while both of these routes may avoid or delay tax charges on the object, they do not offer a corresponding tax deduction against the donor's tax liability. Potential donors considering how best to deal with particularly valuable art or other historical objects will view the introduction of this new relief with interest.



◀ **NICHOLAS PELL**
SOLICITOR
DD: +44 (0)20 7849 2390
nicholas.pell@macfarlanes.com

INDEPENDENT SCHOOLS COUNCIL V CHARITY COMMISSION: WHEN IS A FEE-PAYING SCHOOL OPERATING FOR THE BENEFIT OF THE PUBLIC?

With the implementation of the Charities Act 2006 came the introduction of a statutory “public benefit” requirement. A charity must have charitable purposes; charitable purposes must be provided for the “public benefit”. Since its introduction, what the public benefit requirement means in practice has caused difficulty for trustees of fee paying charities in general, and of charitable independent schools in particular.

On 13 October 2011, the Upper Tribunal (Tax and Chancery Chamber) published its decision on two separate but related proceedings, the central focus of which was the public benefit requirement as it applies to independent schools. The first case was a judicial review brought by the Independent Schools Council (ISC) calling for the Charity Commission’s guidance to be rewritten on the basis that it included errors of law in respect of the public benefit requirement and fee charging charities including independent schools. The second case was the referral of certain questions by the Attorney General to the Tribunal about the operation of charity law in relation to a hypothetical independent school.

The Tribunal concurred with the ISC that the Charity Commission’s guidance should be corrected. The parties were invited to work together to agree the relief from the judicial review aspect of the proceedings. The Charity Commission has announced that it will not be appealing against the decision of the Tribunal and will re-cast its guidance in light of the Tribunal’s conclusions; a process that it says has already begun.

So, what were the tribunal’s conclusions?

In response to the Attorney General’s questions, the Tribunal emphasised that whether an institution is operating for the public benefit is fact sensitive and difficult to answer in the abstract. The Tribunal was unable to provide “any sort of black letter test” by which charity trustees or the Charity Commission can determine whether an independent school is definitely meeting the public benefit requirement.

That said, the following main points were made:

- 1 The provision of mainstream education of the sort under consideration was for the public benefit in the sense that it is a “good thing for the community”. This is the first hurdle of the public benefit requirement.
- 2 The second public benefit hurdle is whether those who may benefit from the carrying out of the purpose represent a sufficiently numerous group or section of the public. As the Tribunal found independent schools met the first hurdle, it is this second hurdle that is in issue.
- 3 Where by its constitution, a school excludes those who are unable to pay its fees, it will not be charitable. This is a matter of principle given the underlying concept of charity. In reality it is highly unlikely that a school’s constitution would restrict access in this way.
- 4 A school which does not exclude “the poor” in the sense that more than de minimis or token provision is made for them may meet the second public benefit hurdle. Once a school has gone beyond the de minimis threshold, it is a matter of judgement for the trustees acting in the interests of the community as a whole and in the particular circumstances of the school in question to decide what further provision should be made.
- 5 The trustees have a wide range of options including:
 - 5.1 scholarships and bursaries;
 - 5.2 arrangements with local state schools to attend classes in subjects not otherwise readily available to them;
 - 5.3 sharing teachers and teaching facilities; and
 - 5.4 opening up sports halls, swimming pools etc for local state school pupils.
- 6 Scholarships and bursaries which provide direct assistance to those unable to pay the fees must be given the most weight when considering whether a school operates for the public benefit. However, other indirect methods of assistance (those listed at 5.2 to 5.4 above) will also be taken into account.

SUMMARY

The Tribunal's decision has not produced crystal clear guidance. The Tribunal emphasised that the test is what is "proper" for the trustees to do. Once the minimum level has been met so that "the poor" are not excluded, the further level of provision and method of provision is properly a matter for trustees, not the Charity Commission or a court.

The Tribunal's decision was extremely unlikely to produce a black and white test making life prescriptive but simple for charity trustees. There is no one size fits all test that could be laid down to cover the wide ranging circumstances in which independent schools find themselves for example as to the nature of the local community or the level of the school's endowment. Therefore and with this expectation managed, the Tribunal's decision will be welcome news to many trustees of charitable independent schools who have not been restricted by the Charity Commission or the Tribunal as to how they should behave. In fact, the range of options open to them has been considerably widened. The ISC's general counsel described the ruling as liberating schools to "innovate and be creative in their charitable provisions". How they will do so and whether this will satisfy the Charity Commission's redrafted guidance remains to be seen.

In the meantime the Tribunal will be considering a further set of questions referred by the Attorney General in January 2011, this time in relation to the public benefit requirement as it applies to charities for the relief of poverty. The questions address the uncertainty as to the extent to which trusts for the relief of poverty can restrict the class of potential beneficiaries (e.g. by reference to relatives of a particular individual or by reference to a particular employer) and still be capable of being charitable under section 2, Charities Act 2006.



◀ **EMMA KNIGHT**
SOLICITOR
DD: +44 (0)20 7849 2287
emma.knight@macfarlanes.com

NEW RULES ON ARTIST'S RESALE RIGHTS TO STIMULATE CHARITABLE GIVING

New rules came into force from January 2012 which grant the owners of the copyright of an artist who died in the last 70 years the right to benefit from a percentage of the revenue every time one of the artist's works is resold. These rules include particular provisions designed to encourage the assignment of these rights to charities.

OVERVIEW

For over 80 years Great Ormond Street has famously benefited from the gift from JM Barrie of the copyright to the Peter Pan works. This gave the charity control of the rights to these works and entitled it to royalties from any performance or publication of the play.

The gift to charity by an artist of the copyright to their works has traditionally been a less financially lucrative affair because these rights are less valuable and can be difficult to enforce. Generally, the main value of a work of art remains with the original piece of art itself. Once this is sold there is rarely any further prospect for the artist or their assigns to benefit.

In 2006 the law began to change to redress this position. The Artist's Resale Right Regulations 2006 created a new right (in addition to any rights under copyright laws) which entitled living artists to a royalty fee whenever their art is resold. The right applies to any work of art by an EEA national which is sold in the EEA. The royalty fee is payable on the sale of all qualifying works which are sold via a commercial dealer or auctioneer for over €1,000. It is calculated using a sliding scale of percentages of the sale price, subject to a maximum of €12,500 per work of art.

Until recently, this right was limited as it did not apply to sales of art by recently deceased artists (even if copyright would still have applied). With effect from 1 January 2012, these rules have changed and now owners of a work's copyright will, until 70 years after the artist's death, be able to benefit from a royalty fee whenever the art is sold.

HOW CAN CHARITIES BENEFIT?

On an artist's death, they may via their will transfer their resale rights to individual successors or to charity. If no provision is made under the artist's will, the rights will pass under the normal intestacy rules.¹ Transitional rules apply in relation to artists who have died within the last 70 years.

Charities should therefore be considering whether they may already own the resale rights of any artist who has died within the last 70 years and who may have benefited the charity under their will. If on the artist's death they passed the copyright in a work or (if they did not own the copyright at the time) the work itself to charity, the charity may now benefit from resale rights in respect of the work. Alternatively, the resale rights may have passed to the residuary beneficiary under the artist's will.

However, the most interesting aspect of the 2006 Regulations for charities is that the capacity for artists to assign the resale rights to their works during their lifetimes is very limited. Resale rights may only be assigned to a charity, and to no one else. The British art market generated £6.8bn last year, so there is a clear incentive for charities to consider how best to encourage benefactors to leave them these resale rights during their lifetime, rather than waiting for the rights to pass on their deaths.

Any owner of a resale right should ensure that their rights are registered with a collecting society such as the Design and Artists Copyright Society (DACS) or the Artists' Collecting Society (ACS). Beneficiaries of resale rights who are not registered with a collecting society risk never being aware that their art has been resold and that resale fees are payable.

COMMENT

Despite the advantage to charities of receiving such royalties, the final implementation of the Artist's Resale Right Regulations has been met with a mixed reaction. While a number of prominent artists, such as Damien Hirst, have come out in favour of the rules, other commentators have called the rules an "industry killer" due to concerns that the additional sales levy will encourage works of art to be sold outside of London where the rules do not apply, such as in China or America. These concerns are probably overstated given that the sales levy is currently limited to €12,500, which would be dwarfed by the far greater costs associated with selling works of art.



◀ **NICHOLAS PELL**
SOLICITOR
DD: +44 (0)20 7849 2390
nicholas.pell@macfarlanes.com

¹ See our practice note "An introduction to life without a will - intestacy rules, ok"

MACFARLANES LLP
20 CURSITOR STREET LONDON EC4A 1LT

T: +44 (0)20 7831 9222 F: +44 (0)20 7831 9607 DX 138 Chancery Lane www.macfarlanes.com

This note is intended to provide general information about some recent and anticipated developments which may be of interest. It is not intended to be comprehensive nor to provide any specific legal advice and should not be acted or relied upon as doing so. Professional advice appropriate to the specific situation should always be obtained.

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