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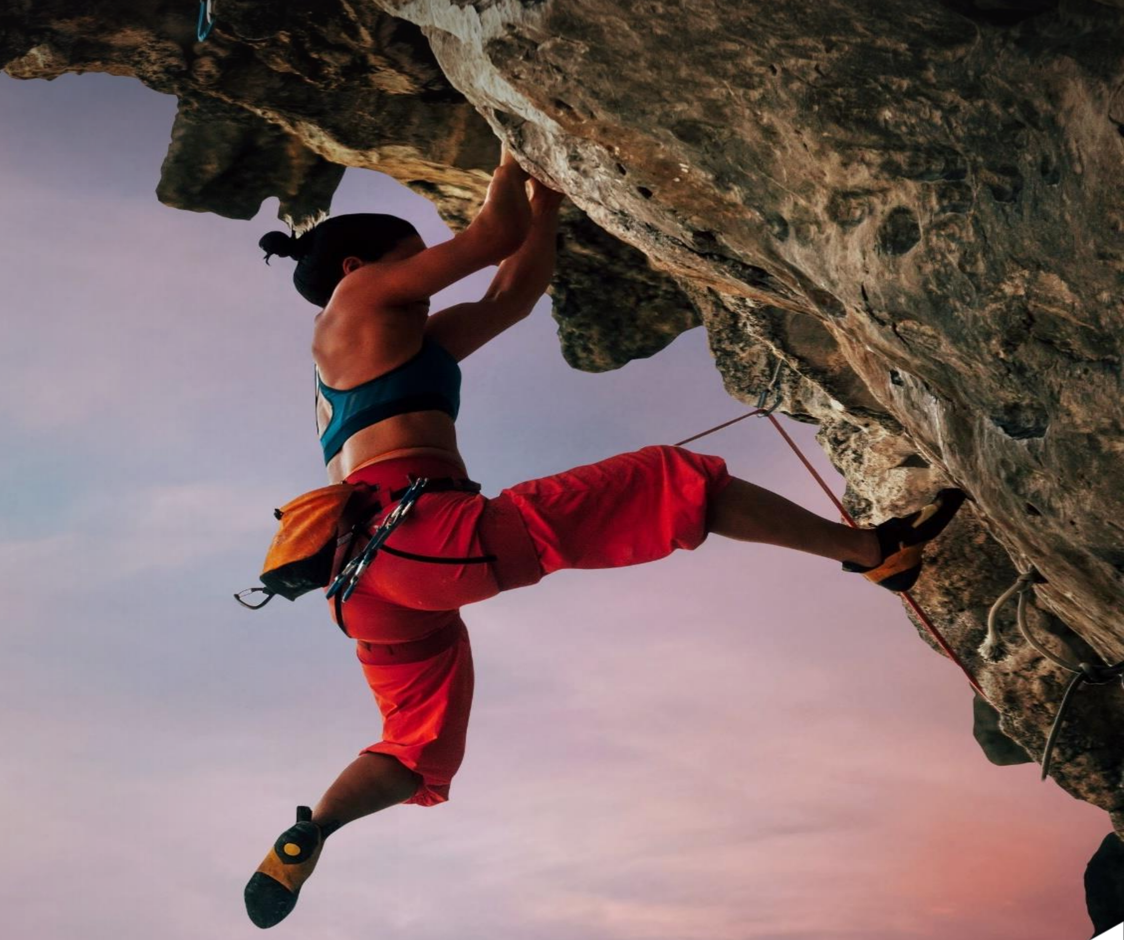
CTG Expert Insight Session

Approved Charitable Investments

8 April 2025



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Introduction and purpose of session

An overview of Approved Charitable Investments (“ACI”)

This session is intended to give an overview of Approved Charitable Investments and to cover some common pitfalls. This session will cover the following:

- The 12 types of charitable investment
- Particular emphasis on “Type 12” charitable investments which typically involve more complex analysis
- Loans to and investments in subsidiaries
- External loans and investments
- How to evidence whether a particular loan or investment is qualifying and why it matters

This is an area that is easy to overlook; whilst loan and investment assets are disclosed in the CT600E (and confirmation is required that the loans and investments are qualifying – or not, as the case may be!) particularly where charities are on periodic review (i.e. not filing a corporation tax return every year) loans and investments may not be given the required attention from a tax perspective.

The 12 types of ACI

Set out in CTA2010 s511 & s512

Type 1 (described in s511 as governed by s512 which lists investments as follows):

- Any investment in securities issued or guaranteed by the government of an EU member state.
- Any investment in securities issued or guaranteed by the government or governmental body of any territory or part of a territory.
- Any investment in securities issued by an international entity listed in the EC directive on taxation of interest payments.
- Any investment in securities issued by an entity meeting the four criteria set out at the end of that directive.
- Any investment in securities issued by a building society.
- Any investment in securities issued by a credit institution which operates on mutual principles and which is authorised by an appropriate government body in the territory in which the securities are issued.
- Any investment in securities issued by an open-ended investment company.
- Any investment in securities issued by a company and listed on a recognised stock exchange,
- Any investment in securities issued by a company but not listed on a recognised stock exchange.

Types 2-11

Type	Description
2 & 4	Any investment in a common investment fund as defined in tax legislation or any similar fund established for the exclusive benefit of charities. Broadly, these are the funds which hold and manage properties which were transferred to them from the charities or on behalf of the charities for which the charities are entitled to the capital and income of the fund.
3	Any investment in common deposit fund as defined in tax legislation or any similar fund established for the exclusive benefit of charities. Broadly these are the funds which hold and manage sums which were transferred to them from the charities or on behalf of the charities for which the charities are entitled to repayment of the sums deposited and to interest thereon.
5	Any interest in land except for in an interest in land which is held as a security for debt.
6	Any bills, Certificates of Tax Deposit, Savings Certificates and Tax Reserve Certificates issued by the UK government.
7	Any Northern Ireland Treasury Bills.
8	Shares/units in a collective investment scheme under which the property is held on trust for the participants.
9	Bank deposits that accrue interest income at a commercial rate but not when the deposits made relate to a loan arrangement under which a loan is made to some other person.
10	Any deposits with the National Savings Bank, a building society or a credit institution which operates on mutual principles and which is authorised by an appropriate government body in the territory in which the deposit is taken.
11	Certificates of deposits as defined in tax legislation.

The 12th type of ACI

Less prescriptive, more evidence and analysis

And finally, we have Type 12 which is described in legislation as:

"A loan or other investment as to which an officer of Revenue and Customs is satisfied, on a claim, that it is made for the benefit of the charitable company and not for the avoidance of tax (whether by the company or any other person)."

- Clearly, types 1-11 are extremely prescriptive; i.e. you either hold an investment of the type described, or you don't.
- Type 12 is deliberately much more open ended to give a charity more power over their investment decisions. However, this comes with a higher burden of proof and evidence that such investments should qualify for charitable exemptions.
- The two hurdles here are "for the benefit of the charitable company" and "not for the avoidance of tax".
- HMRC have helpfully published guidance regarding the terms above which can be accessed here and does a good job of explaining their approach: Annex iii: approved charitable investments and loans - GOV.UK
- Broadly, there are three ways of satisfying the benefit test:

  1. direct charitable benefit as part of the charitable objects of the charity; or
  2. financial benefit as an investment of the charity's funds.
  3. A combination of the two i.e. "a social investment"

The three types of Type 12 ACI

Charitable, Financial, Social

Charitable benefit

- HMRC guidance on charitable benefit states that it is something that directly advances the charity's charitable objects. This means that the loan or other investment is made with such conditions that it must be used in a charitable way.
- It should be noted that HMRC consider it unlikely that a loan or other investment in a non-charitable subsidiary would meet the charitable benefit test. As such an investment or loan to a non-charitable subsidiary will generally need to satisfy the financial benefit test below.

Financial benefit

- Where a loan or other investment will not fall within the charitable benefit test, the charity will need to consider whether the financial benefit test can be met.
- For a loan or other investment to be of financial benefit to the charity it must deliver a suitable return for the charity commensurate to the level of risk involved.
- The charity must be able to demonstrate that, at the time the investment decision was made, the proposed loan or other investment was suitable in the context of the charity's other investments and that the return is appropriate for the risks undertaken

Social investments

- Broadly these are investments that are:
  - Programme-related investments, being those investments made mainly to achieve charitable purposes and may not offer any realistic prospect of a commercial return.
  - Mixed motive investments, being those investments made on terms that deliver insufficient charitable benefit and insufficient financial benefit to qualify as an ACI under either of the categories when considered in isolation. However, the combined charitable and financial benefits provide sufficient benefit to the charity for it to be classified as being beneficial to the charity overall.

Evidence of decision making

Proving to HMRC that the decision has been taken with proper consideration

HMRC would expect to see evidence of the charity's trustees having made a properly considered investment decision. This would include:

- taking properly qualified, and preferably independent, advice as necessary
- seeking a commercial rate of return in relation to risk
- securing loans where possible and making proper enquiries into the credit worthiness of the borrower
- considering available alternatives
- taking reasonable steps to limit the charity's overall exposure to risk which may include a combination of the above

- The guidance goes on to say that there is no one test of commercial soundness and each case must be viewed on its own facts, and HMRC will look at the arrangement in the round.
- Where the loan is an investment loan, HMRC will normally accept it's for the financial benefit of the charity where it:
  - carries a commercial rate of interest which is paid and actively pursued;
  - is adequately secured; and
  - is made under a formal written agreement which includes reasonable repayment terms.

Documentation

Proving to HMRC that the decision has been taken with proper consideration

The charity will need to document its decision making process and retain contemporaneous documentation to support its conclusions. The following list provides some examples of the sort of documentation HMRC are likely to expect by reference to the above criteria:

- Profit/cash flow projections/business plans relating to the proposed investment.
- Copies of the professional advice taken, including internal documentation as to how that advice was implemented.
- In the case of a loan, the loan should have the same level of formal documentation that would be expected in lending to an unconnected third party.
- Any loan should be secured in the same way as would be expected in lending to a third party. This would generally be covered in formal loan agreements.

- Our recommendation would be to hold all of this evidence on file for the lifetime of the loan or investment should HMRC ever require evidence.
- Best practice is of course to take advice and to document before the loan or investment is made. It is much more difficult to prove a loan or investment qualifies without documentation!

What about subsidiaries?

Loans to and investments in non-charitable subsidiaries are still permissible

- We have discussed a number of types of investment so far but have not covered investments in and loans to subsidiary companies.
- This scenario, although very common, is not covered in legislation.
- The “usual” evidence covered on the previous slide is less likely to be available; whilst for example a commercial rate of return may be sought on a loan to a charitable subsidiary, it is equally likely that the return takes the form of gift aid payments made by the subsidiary to the parent charity.
- It will also be less likely that security can be obtained over the investment.
- It is also far less likely that this will either be a charitable or social investment given that subsidiaries are used to carry out non charitable activities (e.g. running of a café or gift shop).
- Therefore, the loan or investment must infer some sort of financial benefit (e.g. gift aid payments/dividends received, or loan interest earned).
- HMRC would expect to see evidence of the decision to invest such as:
  - Business plans
  - Cash flow forecasts
  - Board minutes documenting the decision

What if my loan or investment does not qualify?

A restriction in charitable reliefs (and likely tax to pay!)

- Unapproved charitable investments are caught by CTA2010 s496. This section of legislation deals with non-charitable expenditure, which an unapproved investment is treated as.
- Where there is non-charitable expenditure in a charity, the charity will lose tax relief on its income and gains, starting with the year in which it incurs the expenditure, carrying back any excess against income and gains for a period of six years.
- In the example shown, the charity has exempt income and gains of £20,000; these are restricted by £12,000, being the non charitable investment value.
- This results in an extra £3,000 of tax payable (in addition to the income and gains on which tax is already payable).

Worked Example		
Relievable income and gains	£20,000	
Taxable income	£5,000	
Non-taxable donations received	£8,000	
Tax payable on above		£1,250
Non charitable investment value	£12,000	
Restricted income and gains	£8,000	
Taxable income	£17,000	
Tax payable on above		£4,250

Pitfalls

Issues to watch out for

Lack of documentation

- This is a fairly obvious issue mentioned in a previous slide
- However, it is important to ensure sufficient documentation is held!

Impairing loans or investments with subsidiaries

- Documentation should be prepared & advice taken re why the impairment is necessary
- Does it bring into question how robust plans/forecasts were?

“Topping up” investments in subsidiaries

- Documentation should be prepared each time an investment is topped up / cash flows and forecasts should be updated

Subsidiary unable to trade

- Where a subsidiary cannot trade for a period of time (e.g. onsite shops in COVID) what is the rationale for continuing to invest?

External loan/investment being written off

- Questions may arise as to whether this investment was too risky – what advice was taken at the time and can it be evidenced?

Lack of oversight of when investments are made

- Are the right people within your organisation aware of what lending/investing is taking place, when and why?

Key takeaways

A high-level overview of the key points

- There are a number of types of charitable investment; Type 12 investments are the most flexible but require the most documentation and process
- Type 12 investments can be made for a financial or charitable benefit, or a mix of both
- Evidence of the rationale for making the investment needs to be documented and filed
- This includes investments made in non-charitable subsidiaries (although the documentation may be slightly different)
- If loans or investments do not qualify as approved, this could result in a corporation tax liability

Contact us

We are happy to discuss any of the issues covered today

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Helen is a Director in the North West Tax department and leads the provision of tax services to the Not for Profit sector in the North for BDO.

Helen has worked within the Not for Profit sector for the last 20 years. However, over the years her portfolio of clients has remained varied dealing with small owner-managed businesses, large corporate groups and a variety of organisations in the Not for Profit sector.

This experience enables her to bring a wider commercial understanding in terms of dealing with the tax affairs of her clients. Helen also works closely with BDO's corporate finance team in relation to the tax structuring of corporate acquisitions and disposals.

Helen is fully aware of the challenges faced within the sector, and uses this knowledge throughout the completion of the annual tax compliance cycle.

Nathan has over 8 years' experience across multiple taxes and during that time has worked with an extensive not-for-profit client base. Nathan is an ICAEW chartered accountant (ACA) and a Chartered Tax Adviser (CTA).

Nathan has worked within BDO (and by the extension, BDO's Not-For-Profit team) for the last 3 years. Nathan has extensive experience in advising clients across the sector including Universities, Housing Associations and Membership Organisations on a range of complex issues, including Approved Charitable Investments in a variety of scenarios.

Nathan has a strong track record of delivering high quality tax projects that include advice across all taxes, as well as projects where BDO work in tandem with internal finance teams, legal advisers and auditors.

Q&A responses

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If you were to waive/write off a subsidiary loan, what documentation should you have in place? Response: There will be certain necessary legal aspects around a loan waiver/write off. The documentation should ideally also explain the circumstances around this; however it is crucial that documentation is held which explains the rationale for making the original loan (ideally from the point at which the loan was made).

Do we need to submit all this evidence to HMRC while filing the CT600E? Or is it just a question of keeping these things on record. Response: The key is documentation; on the return the only disclosure will be confirming that loans and investments are charitable on the CT600E.

Rather than putting in the money as a loan, could it be put in as share capital so that there is no expectation that it will be paid back? Response: Yes, but this is still an investment and subject to the same rules.

What would HMRC consider as tax avoidance. For example if expenditure was carried out in the charity and the VAT recoverable was say £40,000, but if you an investment was carried out through the subsidiary and it spent the money and the VAT recovery was up £100,000, would this be considered avoidance of tax?

What if a charity makes a loan to a subsidiary to undertake activities to benefit from vat planning but it is beneficial to the charity Response: This will depend heavily on the precise facts and circumstances. There are accepted methods of planning that can achieve higher VAT recovery, but it is important to note that one of the key conditions of a qualifying charitable loan/investment is that it is not made for the avoidance of tax.

Could you please explain whether there is a need to inform HMRC if you re-classify a financial investment as a social investment? Response: When submitting a tax return, you would not specify why a particular investment was qualifying, only the fact that it was. You should however update your internal documentation to cover what has changed in the event that HMRC ask.

Is there any news on when HMRC will publish further details of the reforms to the Type 1 to 11 Approved Charitable Investment rules? Response: Draft legislation is expected in summer 2025.

If a charity invests in the share capital of a subsidiary, is it possible to invest in preference shares? Response: This may depend on the articles/investment policies of the charity and the subsidiary. In any case, the same conditions as any other investment would apply.

Does HMRC have a view on the length of loan term to a trading subsidiary? Response: There is no published view, but clearly loans that can be clearly demonstrated to be providing a return / that are being recovered are easier to evidence from a financial benefit perspective.

Q&A responses

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I have in the back of my mind that states that the loan under number 12 is only approved if it has been sanctioned by HMRC. I think on CTG website it says that HMRC will not approve the loans in advance but does it only become approve charitable investment when it has been approved by HMRC? Has my memory failed me?

The fact that s.511 CTA 2010 specifies an HMRC officer being satisfied "on a claim" - do we ever see HMRC raise the argument that a claim has not been made and an investment therefore does not qualify under Type 12 (e.g. where we are subsequently outside of normal time limits for claims and/or submitting irregular CT returns)

Response: HMRC's guidance states that where a charity is satisfied that they have loans and investments that are Type 12 they have several options.

If a notice to file a tax return was received, they can either:

- Tick box E26 and make a formal claim if desired
- Tick box E26 and make a formal claim if HMRC request them to do so

If no notice has been received, a formal claim can be made at any time (either because the charity wishes to make one or because HMRC have requested it) See section 10 of the detailed guidance: Annex iii: approved charitable investments and loans - GOV.UK

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