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Charity Investment

Briefing Note

All charities are able to invest and investments can be a major source of funding for them. When charities invest in approved charitable investments, they are entitled to certain tax reliefs. Sections 558-560 Income Tax Act 2007 give details of the approved charitable investments.

However, HMRC have confirmed that they do not class investment bonds as an approved investment, but as non-charitable expenditure. This restriction covers both life assurance and capital redemption contracts.

Charities considering investments which are treated as non-charitable expenditure also need to be able to satisfy HMRC that the investments are:

- made for the benefit of the charity and
- not for the avoidance of tax, whether by the charity or by any other person

If an investment is treated as non-charitable expenditure, the charity will lose its tax exemption on income equal to the amount invested. For example, if the charity invested £100,000 into an investment bond, it loses tax exemption on £100,000 of income, meaning that it has a tax liability of £20,000 (£100,000 x 20%).

The tax treatment of chargeable gains under an investment bond differs depending on whether the charity holding the investment bond is a company or a trust.

Corporate Charity

If the charity is a company, the investment bond is taxed within the loan relationship rules, meaning that the 5% tax-deferred allowance is not available. Taxation of the charity depends upon the accounting basis used by the corporate charity. If the corporate charity is taxed under 'fair value', they would pay corporation tax on any increase in the value of the bond from one year to the next.

But if the corporate charity is taxed under 'historic cost', the corporate charity would continue to benefit from the tax deferral in respect of the growth on the investment bond until it is cashed in or matures and a profit has arisen.

Under the historic cost basis the original value of the bond is shown each year on the balance sheet. Whereas with the fair value basis the surrender value of the bond is shown each year on their balance sheet, meaning that there are corporation tax consequences in the movement of the value (gain or loss).

More details regarding historic cost and fair value bases can be found in our briefing note on corporate investments.

Charitable Trust

A charitable trust must be dedicated to charitable goals and not profit making. Like all trusts, charitable trusts are administrated by trustees who are governed by a trust deed. This trust deed will set out what the charity can and cannot invest in.

For chargeable events on or after 9 April 2003, charitable trustees are liable to tax on the gains they make from insurance policies at the basic rate of tax (20%). So, if the gain is from an onshore investment bond, where 20% is deemed to have been suffered within the life fund, there is no further tax liability.

However, if the gain is from an offshore investment bond, the charitable trust will be liable to pay tax at 20%.

This document is based on Canada Life's understandings of applicable legislation, law and current HM Revenue & Customs practice as at December 2023. It is provided solely for general consideration. The information regarding taxation is based on our understanding of current legislation, which may be altered and depends upon the individual financial circumstances of the investor. We recommend that investors take their own professional tax advice.

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