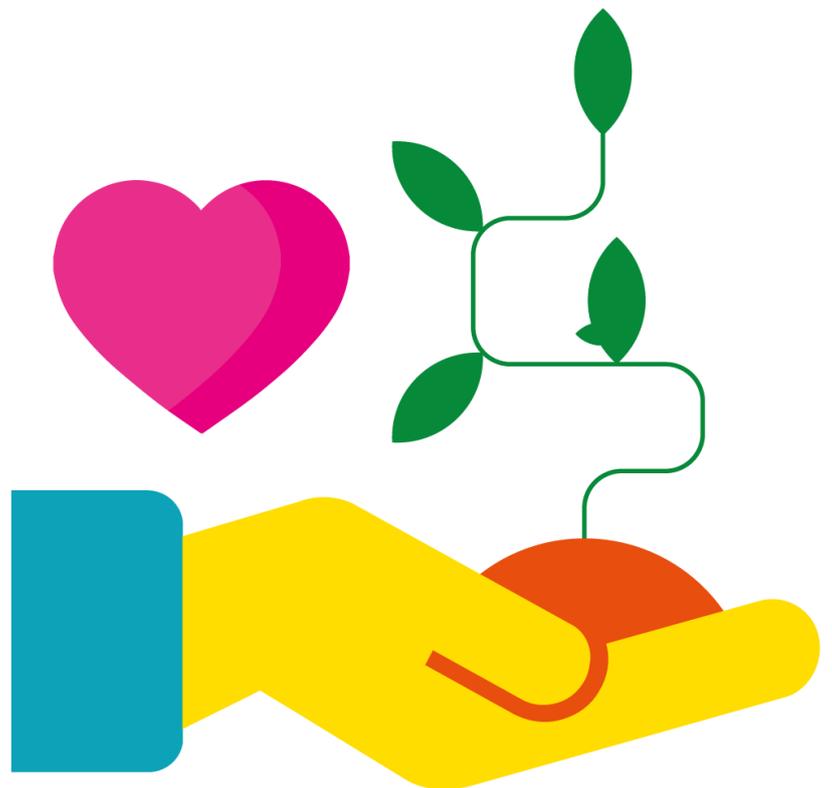


Charity legal update

Legal updates for in-house charity lawyers

September 2020



Contents

Fiduciary duties: not just for trustees.....	Page 1
CIGA: Regulations made for CIOs and Community Benefit Societies.....	Page 2
VAT: new guidance on digital advertising, and humanitarian and associated research.....	Page 3
Charity Governance Code: inclusion ahead?	Page 4
MLD5: exempt and excepted charities	Page 4
New online charity register launched by Charity Commission.....	Page 5
Revitalising trusts programme.....	Page 5
Fundraising Regulator: updated guidance on compliance with audit rules	Page 6
Advertising Standards Authority: new guidance on collection bags	Page 6
Gambling Commission: new lottery rules in force	Page 6
Status of UK fundraising: 2020 report	Page 6
Growing place-based giving: what have we learnt so far?.....	Page 7
Mutual admiration: charity, philanthropy and mutual aid post-COVID.....	Page 7
ACO reports applications for support from foundations up 122 per cent.....	Page 8
ACF: reports on investment and funding practices published.....	Page 8
Decision update.....	Page 9
Circular loan arrangement not an “approved charitable investment or loan”.....	Page 9
Parish council retains power to appoint charity trustees of allotment charities	Page 10
Application for tax return rectification unsuccessful.....	Page 11
Appointment of interim manager quashed	Page 11

Since the last edition, we have seen the return to the office (for some, at least), and several interesting legal developments in the sector, even as it continues to deal with the fallout of the pandemic.

In this update...

We set out the main points of which charities should be aware in relation to the fiduciary duties of members of charitable companies, following the recent decision in the CIFF case.

We summarise key information on the new guidance from HMRC relating to VAT and digital advertising, the latest developments for exempt and excepted charitable trusts in relation to MLD5, and the outcome of the consultation on the “refresh” of the Charity Governance Code.

We also have...

- Updated guidance from the Fundraising Regulator on compliance with the audit rules
- A consideration of the roles of place-based giving and mutual aid in civil society post-COVID
- A look at how the practices of some of the members of the Association of Charitable Organisations have changed during the pandemic

Finally, we have the usual summaries of cases decided over the last couple of months, which have included a decision that a circular loan arrangement is not an approved charitable investment, a consideration of the legal basis of the ability of a Parish Council to appoint trustees of allotment charities, the quashing of the appointment of an Interim Manager, and an unsuccessful attempt to rectify a Gift Aid claim.

We hope you find the update useful. If you have any comments or suggestions for improvement, please don't hesitate to contact us.



Neil Burton

Partner

+44(0)1223 222455

neil.burton@mills-reeve.com

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tori.spratt@mills-reeve.com

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Fiduciary duties: not just for trustees

The recent decision of the Supreme Court in the case [Lehtimaki & others v Cooper](#) may have left charity lawyers with more questions than answers in relation to the fiduciary duties of members in a charitable company.

In relation to the question of fiduciary duties, it is clear, at least, that members of a charitable company **do** have such duties.

It is also clear, however, that the extent of a member's fiduciary duties will depend on the particular circumstances, and must be worked out when they arise.

Key points from the judgment:

- A member of a charitable company owes a fiduciary duty to the charitable purposes of the charity, not the company, and that duty is “one of single minded loyalty” – although that loyalty is entirely subjective, and disputes about what loyalty means in practice may well arise.
 - The principles decided upon in the judgment apply to members of charitable companies large and small.
 - As a result of the fact that trust law allows fiduciary duties to be “diminished by an appropriate means and to an appropriate extent”, the fiduciary duties that a member owes are tailored by the Memorandum and Articles of Association of the charitable company in question – and it may be the case that the Memorandum and Articles impose restrictions which mean that a member cannot discharge their fiduciary obligations under the general law.
 - It is not possible, however, to reduce a member's fiduciary duties below an “irreducible core” of obligations, which the Court considered to have been identified in [Armitage v Nurse](#) [1998] Ch 241, 253-254 – to perform the trusts honestly and in good faith for the benefit of the beneficiaries.
- Responding to particular points raised by Counsel, the judgment also addressed:
- **Declarations of interest and conflicts of interest:** there is an obligation of disclosure on the member, and no entitlement to vote on any resolution allowing the member a benefit, even one authorised by the Memorandum and Articles of Association.
 - **Delegating the right to vote to a proxy:** There is no difficulty in a member delegating the right to vote to a general proxy if that is what the Companies Act 2006 and the Articles allow.
 - **Receipt of benefits from the charity:** There is also no objection to a member receiving an incidental benefit, provided it is authorised by the Memorandum and Articles of Association – and subject to the need for appropriate disclosure and management of conflicts of interest.
 - **Provision of information:** A member is not entitled to any further information than that to which members of a company registered under the Companies Acts are entitled by virtue of those Acts or general law – and this would seem to limit the member's ability to investigate a matter before voting on it, so that the member would not be expected to have the same level of knowledge as the trustees, for example.
 - **Limitations on how voting rights exercised:** there are limitations on how a member may use his voting rights, and the power to alter the articles must be exercised not only in the manner required by law, but also “bona fide for the benefit of the company as a whole, and it must not be exceeded”.



Questions asked but, somewhat frustratingly, not addressed by the judgment included whether a member has a duty to attend and vote at meetings, whether a member can fetter his discretion by making a voting agreement, or whether a member is entitled to be indemnified for the cost of attending a meeting of the company or for the cost of taking legal advice.

Uncertainty for CIO members too

Although this decision related to the existence and extent of fiduciary duties of members of a charitable companies, it also muddied the water a bit in relation to the duties of members of Charitable Incorporated Organisations (CIOs) by suggesting that a CIO member's duties are not fully set out in section 220 of the Charities Act 2011 – there may be more...

What next?

While there are still many grey areas following this judgment, it is now clear that members of charitable companies have fiduciary duties, and that the Court can use its inherent jurisdiction in respect of charities to order a member of a charitable company to exercise their fiduciary discretion in a particular way.

This may be of use to charity trustees needing to make a difficult decision, and considering whether to ask the Court to make the decision on their behalf, but concerned that any such decision by the Court may be effectively blocked by a subsequent vote of a reluctant membership.

In relation to the extent of a member's fiduciary duties, some charity lawyers will already be familiar with the Commission's existing [guidance](#) on membership charities, and this guidance was mentioned and given considerable weight in the judgment.

It is now to be hoped, however, that further guidance from the Charity Commission will be forthcoming on the newly emphasised fiduciary duties of members of charitable companies, to clarify some of the outstanding questions.

CIGA: Regulations made for CIOs and Community Benefit Societies

[Regulations](#) amending the Charitable Incorporated Organisations (Insolvency and Dissolution) Regulations 2012 to make the necessary modifications and substitutions so that the moratorium provisions under Part 1A of the Insolvency Act 1986, introduced by the Corporate Governance and Insolvency Act 2020 ("CIGA"), apply to CIOs came into force on 13 August.

Further [Regulations](#) making the Part 1A moratorium provisions and the Part 26A arrangements and reconstructions process for companies in financial difficulty introduced by CIGA available to most Community Benefit Societies, with some amendments and subject to certain exceptions, came into force on 18 July 2020.



New brief on digital advertising relief for VAT from HMRC

Some charities may now be able to claim back overpaid VAT on digital advertising, after HMRC has [published](#) a new brief on charity digital advertising relief from VAT confirming that only:

- advertisements sent to email addresses;
- the listing of a charity in a search engine's results (which is not considered advertising for the purposes of VAT relief); and
- social media and subscription website advertising

are now considered standard rated for VAT purposes. The categories now zero rated, in brief, are: audience targeting, behavioural targeting, channel targeting, content targeting, daypart targeting, demographic targeting, device targeting, direct placements on third party websites, location targeting, lookalike targeting, pay-per-click adverts, and retargeting.

Generally, as long as the advertisement being published qualifies for the zero rate, the copyright, design and production services will also qualify.

Charities that have overpaid VAT on digital advertising will now have 4 years, in accordance with section 80(4) of the Value Added Tax Act 1994, to reclaim any overpayment.

Previously, HMRC had ruled that VAT was due on most forms of digital advertising, and this has cost charities millions of pounds of irrecoverable VAT, and has only now changed its position in response to three years of campaigning by the Charity Tax Group.

VAT treatment of humanitarian and associated research funding clarified

The Charity Tax Group has also [obtained](#) clarification from HMRC as to the VAT treatment of humanitarian and associated research funding.

The new clarifications cover Government funding including the UK Overseas Aid Programme, DfID special arrangements, and grants from other non-UK governments and intragovernmental organisations, as well as more generally on Back-to-Back grant funding arrangements.

HMRC has indicated to the Charity Tax Group that its guidance may be updated in due course.



Charity Governance Code: inclusion ahead?

The steering group for the Charity Governance Code has [published](#) the results of its consultation which ended in February this year on the “refresh” of two of the principles of the Code – the Integrity Principle, and the Diversity Principle.

It looks like the Diversity Principle is going to be the more changed of the two when the amended Code is published – as seems appropriate given recent developments in the sector.

The consultation revealed a broad consensus in favour of a “refresh” rather than a more substantial overhaul. Of those responding, 90 per cent had either fully or partly adopted, or were working towards full adoption of the Code. However, satisfaction with the Code was markedly lower amongst the responses received from the Small Charities Coalition members, and the steering group intends to look at how the Code can be made relevant for smaller charities in the future.

There were mixed responses, on the question as to whether and how to reflect [NCVO's Charity Ethical Principles](#) in the revised Code, and in particular the “right to feel safe”, in relation to the Integrity Principle. There was, however, wide support to broaden the Diversity Principle to address aspects of inclusion and equality. Specialist consultants have now been commissioned by the steering group to provide expert input on this. A more comprehensive revision of the Code is planned for 2023.

MLD5: exempt and excepted charities

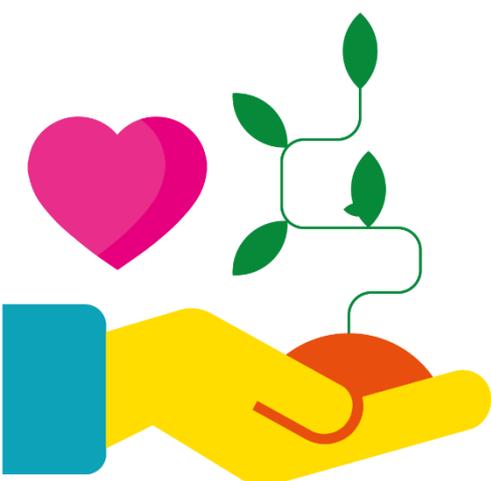
The Government has [published](#) the outcome to its consultation on the expansion of the Trust Registration Service as required to transpose the Fifth Money Laundering Directive into national law, as well as its proposed regulations. The

To address concerns raised by respondents to the consultation that only charitable trusts that were registered with the Charity Commission were removed from the scope of the legislation, and not those that were exempt or excepted, or with income of under £5,000 a year, the proposed draft regulations now provides the following definition of charitable trust:

“A trust for charitable purposes which —

- (a) in Scotland or Northern Ireland, is registered as a charity; or
- (b) in England and Wales, is registered as a charity or not required to register by virtue of section 30(2)(a) to (d) of the Charities Act 2011(c).”

This is intended to provide that **all** charitable trusts regulated in the UK will be exempt from registration with the Trust Registration Service – although the position of charities on the “deemed list” in Northern Ireland and not yet registered remains unclear, and will need to be addressed if all charitable trusts regulated in the UK are to be exempt.



Charity Commission launches new online register

This month has seen the launch of the [new online register of charities](#) by the Charity Commission.

Changes have been made to make it easier to find out:

- whether a charity is subject to regulatory action, or is of ongoing concern;
- what policies a charity has in place, such as those relating to safeguarding, conflicts of interest and so on;
- whether any trustees are remunerated for their work, and how many employees receive pay packages of £60,000 and above.

It is also now possible to search the register by constituency, so as to find all local charities registered, and to export data sets more easily in relation to searches carried out.



Revitalising Trusts Programme

The Charity Commission's annual report and accounts revealed that its [Revitalising Trusts Programme](#), which seeks to release funds from "dormant" charities and transfer them to other charitable organisations, has so far released £32 million in this way.

Charities which are that are either inactive, having had no income or expenditure over the last 5 years, or ineffective, having spent less than 30% of their total income over the last 5 years, may be approached by the Commission as part of this programme.

Initially, the Commission seeks to work with the trustees of such charities to get the charities up and running again.

Where this fails, however, it intervenes to wind up the charity and remove it from the register, with its funds being transferred either to the UK Community Foundations or another charity with similar purposes.

The Commission has [confirmed](#) that the programme will now be funded by DCMS until March 2021, and aims to "reach out" to more than 500 charities during the next year to release further funds.

Fundraising Regulator: updated guidance on compliance with audit rules

A further [review](#) of charities' compliance with the fundraising reporting rules has been published by the Fundraising Regulator.

Charities registered with the regulator and with income of over £1 million are required to include statements on their fundraising activities in their annual report, but the review of 187 charities' annual report revealed greater compliance in some areas than others.

Positively, 81 per cent of charities included a statement in their annual report as to their fundraising approach. Only 41 per cent of the reports contained a statement on third party monitoring, however, and only 40 per cent of reports included a statement on protecting vulnerable people – and in total, only 21 per cent of the reports reviewed complied with all six of the fundraising reporting requirements.

In light of this, the Fundraising Regulator has updated its [guidance](#) to help charities meet the reporting requirements, to contain more information on how to write clear and detailed statements.



ASA reminds charities to collect clothes not complaints

The ASA has published a [news item](#) highlighting to charities the need for marketers to be upfront and clear about the commercial element of the service – and that in order to do so, the charity's name and logo should not be given greater prominence than that of the company carrying out the collection, as well as the company's name appearing on both sides of the collection bag.

The ASA has previously published guidance for commercial participants in door-to-door charitable collections, in 2017, and a link to this is included in the news item.

Changes to lottery rules in force

The new rules applicable to society lotteries came into force on 29 July 2020.

The changes, set out in greater detail in the Gambling Commission's [response](#) to consultation in April this year, include an increase in the limits on the size of society lotteries, and new requirements and guidance in place to provide key information to consumers in a clear, transparent and easily accessible way.

The [Licence Conditions and Codes of Practice](#) have been updated accordingly.

Status of UK fundraising: 2020 Report

It is widely reported that many charities are suffering a fall in voluntary income, and a report from Blackbaud in partnership with the Chartered Institute of Fundraising contains some interesting insights and figures, including:

- although 27 per cent of charities surveyed have seen a decrease in voluntary income, 40 per cent reported an increase (although down from 49 per cent in 2019);
- two thirds of respondents are either fairly or very confident that their organisation will recover from the financial effects of the coronavirus; and
- during the pandemic, almost three quarters of those surveyed had used at least one virtual fundraising initiative for the first time.

The full report can be downloaded from the [Blackbaud website](#).

Growing place-based giving: what have we learned so far?

CAF has produced an interesting [blog post](#), reporting some of the perspectives and insights obtained during a recent event on the role of place-based giving in rebuilding communities after the pandemic.

Key points for the future were the need to recognise:

- the nature of place-based giving as not simply transactional;
- the need for trust-building and partnership between stakeholders;
- that ownership of the scheme needs to be flexible and accepted by the local community;

- context is all – what works in one community will not work in another; and
- the development of a strategy, and availability of early funding is of utmost importance.

In addition, the blog post contains links to two short reports setting out considerations firstly for those interested in setting up a place-based giving scheme in their area, and secondly for funders who want to support such schemes.

Mutual admiration: Charity, philanthropy and mutual aid post-COVID

Anyone wondering about whether the huge upsurge in informal civic action we have witnessed during the pandemic might point to a new army of volunteers and philanthropists in the post-COVID world may find this [blog post](#) by CAF interesting. It seeks to explain the difference between mutual aid and charity, and sets out a brief history of “mutual aid” in the UK, as well as how it came to the fore during the pandemic, before raising some very interesting questions about:

- the longevity of the upsurge in this kind of civic action;
- whether enthusiasm for mutual aid might “enlarge the pie” of civil society, or just slice it differently;
- the practical effects in terms of social capital;
- the role of technology; and
- whether there is a dark side to mutual aid.

Coronavirus hub
[Click here >](#)



ACO: 122 per cent increase in applications for support – and increase in trustee delegation...

A survey of the members of the Association of Charitable Organisations (ACO) prompted by the pandemic has revealed that respondents had experienced a 122 per cent increase in applications for support compared to applications in 2019 – with 20,745 applications received since March 2020.

They also reported that they had distributed approximately £15,395,898.91 in grants since 23 March 2020 compared to £5,560,643.15 reported over the same period in 2019 – a 176 per cent increase in the amount in grants distributed.

In response to the pandemic, 53 per cent had introduced a specific COVID-19 grant fund.

Almost 9 in ten of the charities that responded still accepted postal applications, but almost half reported changing their procedures so as to discourage postal applications.

Changes made included:

- introducing online applications;
- encouraging applications be sent by email and completed in editable PDFs;
- suspending normal grants programmes to focus more on meeting people's basic needs and helping more different households;
- allowing verbal consent as well as written consent for applications; and
- giving more decision-making capabilities to staff instead of Trustees over grants.

The survey gives a useful overview of the kind of steps being taken by charitable organisations in response to the pandemic. From a governance perspective, of course, the delegation of decision-making capabilities to employees from Trustees should be planned carefully, so that any delegation of trustees' powers are appropriately documented, and suitable policies put in place.

ACF publishes last reports from “Stronger Foundations” initiative

The ACF's “Stronger Foundations” initiative aims to help grant-making foundations identify and pursue excellent practice.

The last two reports in the series look at:

- [how foundations can align funding practices with their mission](#), consider the impact of funding practices on those who experience them, and seek to achieve a positive impact beyond a financial contribution, setting out the five characteristics of excellent practice; and
- [how foundation investments can be more closely integrated with a foundation's mission and grant-making](#), setting out the seven characteristics of excellent practice, which include prioritising mission when setting investment objectives, holding investment managers to account, and seeking to influence the investment behaviour of others.

All the previous reports have been published on the ACF website, and are well worth a read.

The [report on Diversity, Equity and Inclusion](#) (DEI) is particularly good, covering DEI in the context of knowledge, strategy, data, process, accountability, advocacy and collaboration – and so could be useful to many charities looking at DEI in respect of their operations, not just foundations.

The ACF [intends](#) next to create a toolkit for foundations to use to consider their own practices, and what steps they could take to become stronger across the areas reported upon.

Decision update

Circular loan arrangement not an approved charitable investment or loan

This decision demonstrates how important it is for charity trustees to be able to demonstrate to HMRC how their charity benefits from any investment or loan made by the charity.

The loan arrangements and the parties to those arrangements addressed in this decision will be familiar to anyone who keeps a close eye on the Charity Commission's reports of investigations, as the Reb Moische Foundation [featured](#) back in 2018.

The company, Gladstar, had made loans to the charity totalling over £2.5 million between March 2005 and March 2007. The charity, which did not need the funds immediately for its purposes, then loaned the sum of £2 million back to Gladstar.

The loan was repayable on demand or at the lender's option in the case of default, secured by a guarantee from Gladstar's parent company, and at an interest rate of 24 per cent per annum – although this subsequently lowered to 10 per cent per annum with no consideration as to the terms of the agreement.

The Commission decided that the trustees put the charity's funds at risk in entering into the loan facility, failed to take sufficient steps to protect the charity's interests or recover the charity's assets particularly since the expected return from the loan did not materialise, and failed to manage a conflict of interest on the part of one trustee between his duty as a trustee and his duty or responsibility to the company involved.

The tribunal has now [decided](#) an appeal by the charity against a decision by HMRC that the loan was not an approved charitable investment or loan.

Under [section 543 of the Income Tax Act 2007](#), a charity's entitlement to tax relief may be restricted if it makes such an investment or loan, as it is non-charitable expenditure.

The tribunal determined that that test to be applied to decide whether an investment or loan is an approved charitable investment or loan in this context, in accordance with [section 558 of the Income Tax Act 2007](#), is whether **an officer of HMRC is satisfied** on a claim that the investment or loan was made for the benefit of the charity and not for the avoidance of tax (Type 12).

Having considered the explanation by the charity of the arrangements, the tribunal decided that "a much more likely explanation of these transactions" is that it was agreed between Gladstar and the charity that the money should flow in a circle, from Gladstar to the charity and then back to Gladstar, so as to produce two tax deductions for Gladstar; the first for the donation to the charity, and the second for the interest paid on the loan.

It further concluded that these arrangements were exactly the type of arrangements that the substantial donor legislation (not then in force) was put in place to prevent!



Although the tribunal itself considered it possible that the loan **was** made for the benefit of the charity, and concluded that the HMRC officer in question had taken into account irrelevant matters and failed to take into account relevant matters in coming to a decision that the loan was not an approved charitable investment or loan, it decided that even if the HMRC officer had not done so, it was inevitable that they would have come to the same conclusion. The refusal by the HMRC officer to accept the loan as an approved charitable investment was reasonable.

Power to appoint trustees of allotments vested in Parish Council

This [decision](#) may be useful to any charity lawyer forced to consider the appointment of trustees in relation to charities managed by local authorities such as parish councils – in what is described by the judge as a “technical and relatively obscure corner of charity law”.

The dispute involved Rettendon Parish Council, which claimed that it was sole corporate trustee of two allotment charities originally allotted for the benefit of the local inhabitants under the Inclosure Act 1845, with power to appoint trustees of such charities for a term of 4 years if it decided to do so, in accordance with [section 300 \(3\) and \(4\) of the Charities Act 2011](#) and [section 302 of the Charities Act 2011](#).

A number of trustees so appointed by Rettendon Parish Council, however, claimed that following their appointment in this way by the parish council, they were then able to appoint further trustees in accordance with [section 36 Trustee Act 1925](#).

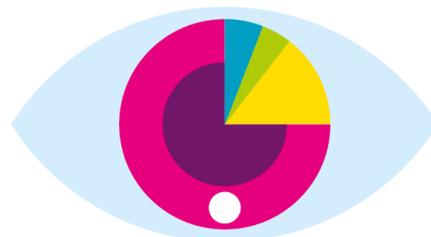
The Court decided that the once-in-time effect of sections 5 and 6 of the [Local Government Act 1894](#) (the “1894 Act”) was to transfer all property held by overseers and churchwardens (including that subject to a trust) to the parish council and all powers, duties and liabilities of the overseers and churchwardens in respect of all such property, and village greens and allotments, to the parish council – which necessarily had the effect of appointing the parish council trustee.

Section 14 (2) of the 1894 Act then permitted the parish council to appoint trustees in its place subject to a maximum term of 4 years. And, following the repeal of the 1894 Act, section 300 of the Charities Act 2011 now confers a power on the parish council to appoint trustees in its place.

Noting that the only power to appoint trustees under section 14 of the 1894 Act vested in the parish council, the Court concluded that the power to appoint trustees for four years could not possibly be construed as a power to be exercised only once and, on the expiry of a four-year term, the parish council alone had the power to appoint for a further four years.

Any inconsistency between the provisions of the Trustee Act 1925 and the Charities Act 2011 had to be resolved in favour of the latter as where Parliament has specifically vested in a parish council the power to appoint trustees to parochial charities, for a series of fixed terms, “it would be absurd to think that Parliament intended to confer on the trustees once appointed the power to extend their term and to appoint others pursuant to the general power provided in section 36 of the 1925 Act”.

So, Rettendon Parish Council alone had the power, in accordance with section 300(3) and (4) of the Charities Act 2011, to appoint others to be trustees of the charities, provided any such appointment was limited to a period of four years – and has the power to appoint further trustees, whether at the end of the relevant four year term or to fill any vacancies in the interim.



Appointment of Interim Manager quashed following challenge by charity

In this [decision](#), the Sikh Channel Community Broadcasting Company Limited successfully challenged the appointment of an Interim Manager by the Charity Commission.

Under [section 76 of the Charities Act 2011](#), in order for an Interim Manager to be appointed:

- there must have been misconduct or mismanagement in the administration of the charity; or
- it must be necessary or desirable to take action to protect the property of the charity or to secure proper application for the purposes of the charity of that property or of property coming to the charity.

The Panel determined that although there had been mismanagement of the charity, on the basis that it had received information showing that the current trustees:

- accepted there had been mismanagement
- indicated a willingness to receive guidance from the Commission and
- would have responded positively to being asked to agree an Action Plan about matters of regulatory concern

They would not, themselves, have exercised their discretion to appoint an Interim Manager.

Interesting, they stated it was, in particular:

“most regrettable that the Charity Commission did not use its power under s. 76(3)(b) of the Charities Act 2011 to appoint new trustees, perhaps finding suitable persons from within the Sikh community. Such a step would strengthen the trustee board – something which we recognise would be of great benefit to the Charity – and the Charity itself would then remain sensitive to the cultural needs of its beneficiaries.”

Therefore, in considering the Charity Commission’s decision “afresh”, as it is required to do under [section 319 Charities Act 2011](#), the Panel decided to allow the charity’s appeal against the Charity Commission’s order to appoint the Interim Manager.

Application to rectify Gift Aid claim unsuccessful

A recent [decision](#) highlights the need for higher rate taxpayers to make sure any claims for Gift Aid are accurately included in their tax returns.

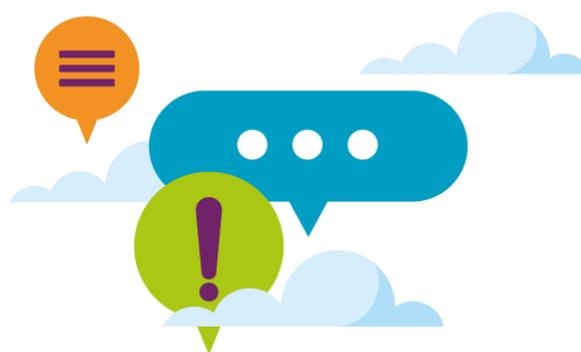
The claimant in question had inadvertently included the figure of £400,000 in his tax return for 2016/17 rather than the correct figure of £800,000.

This error led to HMRC issuing closure notices stating the claimant was liable for a further £215,000 in additional tax, penalties and interest for the tax years 2016/17 and 2018/19 – which figure included the tax liability on the whole £800,000 donation.

Therefore, the claimant sought to rectify his return to avoid this considerable liability.

The Court, however, was not persuaded that a tax return is in principle a unilateral instrument to which the equitable jurisdiction of rectification could be applied.

In addition, it considered that an error arising from carelessness in circumstances where the claimant signed a declaration saying that the tax return was to the best of his knowledge correct and complete was not one that ought to engage either the court’s sympathy or the exercise of its discretion.



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