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Commission requests the UK to end discrimination on charities

Overview

On July 10th 2006, the European Commission sent the United Kingdom a formal request to end discrimination of foreign based charities. The United Kingdom allows tax relief for gifts to charities, but only if they are established in the UK. Charities established in other Member States are excluded from the relief and the Commission considers that this discrimination is contrary to the EC Treaty. The request takes the form of a 'reasoned opinion' under Article 226 of the EC Treaty. If the United Kingdom does not reply satisfactorily to the reasoned opinion within two months the Commission may refer the matter to the European Court of Justice[1]. "The rules of the Internal Market forbid discrimination of charities in other Member States" and "Gifts to bona fide charities in other Member States should get the same tax treatment as gifts made to domestic charities" said EU Taxation and Customs Commissioner László Kovács according to the Commission press release[2]. The European Commission press release is not very clear on which UK tax rules are currently under review. However, in an oral statement, the Commission said that it is in the UK case looking at various tax exemptions for charities and their donors and their potential conflict with the EC-Treaty such as income tax incentives for donors, tax treatment of charities (corporate income tax and capital gains tax) as well as inheritance tax.

Gifts/donations to UK based charities are encouraged by a series of tax exemptions in the field of inheritance tax, income tax, capital gains tax and corporate income tax. However, this favourable tax treatment is only granted if the charity is resident in the United Kingdom. The UK tax scheme does not offer the same relief from taxes for donations and bequests to non-domestic charities. The difference in treatment between gifts made to charities in the United Kingdom and charities in other Member States is now considered by the European Commission to constitute an obstacle to the free movement of capital guaranteed by the EC Treaty[3]. The discrimination is also seen being in conflict with the free movement of persons[4], as workers and self-employed persons moving to the United Kingdom might wish to make gifts to charities established in the Member State where they came from. Finally, the rules are also seen contrary to the freedom of establishment[5], as foreign charities are forced to set up branches in the UK in order to benefit from the favourable tax treatment. In the press release, the European Commission stated that the United Kingdom can ask for assistance of the Member States where the charities are established on the basis of the Mutual Assistance Directive[6] if it wants to check that assets and income of charities in other Member States are only used for charitable purposes.

Other national foundation tax laws under review

The UK foundation tax scheme for charities is not the only one that is under review by European institutions. Last summer, the European Commission announced that it would take Belgium to the European Court of Justice as it was of the opinion that Walloon inheritance and gift tax

[1] The Commission's case reference number is 2005/2281.
[2] See press release IP/06/964 http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/964&format=HTML&aged=0&language=EN&guiLanguage=en
[3] Article 56 EC-Treaty
[4] Article 39 EC-Treaty
[5] Article 43 EC-Treaty
[6] See 77/799/EEC.

discriminate against foreign public benefit organisations[7]. The Walloon inheritance and gift tax rules provide for reduced taxation of donations (legacies and gifts) to Belgian public benefit organisations, which do not apply for donations to foreign public benefit organisations. The Commission considers that this violates the prohibition of discrimination on grounds of nationality and the freedom of establishment[8]. The Commission has for the time being suspended the Walloon case and has not started the procedure before the European Court of Justice as it may wish to take a broader approach and look at other tax incentives for donors, eg. in the field of income tax, too. On April 4th this year, the European Commission sent a letter to the Polish government, stating that the current Polish tax treatment of donations violates both, the EC-Treaty and the European Economic Area (EEA) Agreement with regard to freedom of establishment and free movement of persons and capital because tax deductions to donors are allowed only for donations to domestic public benefit organisations. In September 2006, a new law proposal has been presented, which would extend tax incentives for donations also to public benefit organisations in other European Union states. This year the Netherlands amended its legislation and now allows donations to qualifying foreign charitable organisations to be tax deductible for the donor. However, the criteria for defining a "qualifying foreign charitable organisation" have not yet been established.

Impact for the broader foundation sector

The essence of the infringement procedures against the UK and Belgium of the European Commission which would in principle also apply to other Member States jurisdictions is the following: donations to foreign EU-based public benefit organisations should be treated as donations to resident public benefit organisations. A series of national tax laws do not treat donations to resident and foreign public benefit organisations on an equal footing and they would therefore be in conflict with the EC Treaty. The European Commission could be asked to go to other EU countries to review their legislation in this respect.

The way forward

It is expected that the UK, Poland and Belgium will now adopt their legal regime accordingly. The EFC and its Tax Task Force will continue to monitor the issue and document the impact of such cases on the wider foundation sector in Europe. For more information, please contact the EFC at eu@efc.be . Promoting tax-effective cross-border giving is one of the key objectives of the EFC Tax Task Force, which has developed a series of comparative charts of the different fiscal systems affecting foundations and their donors in the EU. This is intended to benchmark favourable fiscal provisions at the national level, thereby having an impact on those countries revisiting their taxation laws. The charts are available on the EFC website at http://www.efc.be/projects/eu/tax/default.asp . The King Baudouin Foundation set up an online database “Giving in Europe” which provides information about the national legal and fiscal treatment of cross-border gifts, donations and legacies, and serves as an information tool for donors, intermediaries and beneficiaries about the best options for tax-effective cross-border giving, see www.givingineurope.org. Unfortunately, not much has happened at the level of national and European authorities to enhance the situation. The EFC developed a *Model Law* for public benefit foundations to facilitate the review of national-level legislation, where it urges national legislators to treat domestic and foreign organisations equally with regard to gift and inheritance tax as well as income tax[9]. At EU level, a European legal form for foundations could potentially improve the situation of cross-border giving. The EFC adopted some recommendations on a European Foundation Statute in this regard, which are available at www.efc.be/projects/eu/legal/european_statute.asp.

[7] See EFC briefing on the case: http://www.efc.be/content/alert.asp?ContentID=846

[8] Articles 12 and 43 and 48 of the EC-Treaty

[9] The EFC Model Law for public benefit foundations is available at www.efc.be/projects/eu/legal/model_statute.asp