HMRC - CFM95695 - x-Interest: Certain Payments Made To Charaties

CFM95695 Interest restriction: Tax-interest: Certain payments made to charities

TIOPA10/S459

Charities are limited as to the activities they can undertake and cannot, for example, undertake commercial or trading activities. As a result, many charities will undertake more commercially driven activities through a subsidiary company which it funds with an interest-bearing loan.

The charity will bring the interest into account when calculating its profit, which will then be exempted from tax where the income is applied for a charitable purpose. The interest will therefore not be a tax-interest income amount where this exemption applies. By contrast, the subsidiary company will be charged to corporation tax on its profits and will claim a deduction for the interest it pays to the charity, which would ordinarily be included in tax-interest expense.

This would result in tax asymmetry with debits in the company not matched with credits in the charity. This would lead to an increased net tax-interest expense for the group as a whole and a reduction in interest capacity.

Exclusion where payment would qualify for Gift Aid

Paying interest to the charity is a means of the subsidiary returning profits to that charity. The subsidiary would also have the option of making a Gift Aid donation, provided the relevant conditions at CTA10/S191 - S202 are met. This means there is no tax advantage to be gained from choosing to fund a subsidiary by debt because, absent a loan, the subsidiary could simply make a charitable donation to its charity parent equal to its profits and claim relief for this amount.

The rules therefore do not treat interest paid by a company on a loan as being a tax-interest expense amount of the company where:

The creditor is a charity

The company is a wholly owned subsidiary of that charity, and

Any donation made by the company to the charity would attract Gift Aid.

These tests do not concern themselves with whether a gift could legally be made and just look at whether such a gift would qualify for a charitable deduction if it were to be made.