Comparative Analysis: The Global Perspective

The Fiscal Treatment of Charitable Contributions in the UK

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Introduction

In addition to the fiscal privileges enjoyed by charities themselves, there are considerable tax incentives given to individuals and companies to make charitable donations.

In his first Budget Speech in July 1997, the new Labour Chancellor of the Exchequer, Gordon Brown, announced that the Government would undertake a Review of Charity Taxation, to be primarily focused on the simplification of the present tax regime affecting charities, and on the question whether charities might be relieved from the burden of paying irrecoverable Value Added Tax (VAT). Charities and other interested parties were invited to submit their views by 1 December 1997, and the Government then proposed to publish a Consultation Document in the Spring of 1998. During the first phase of open consultation, nearly 3,000 responses on a wide range of subjects were received from charities, their representative groups, businesses and individuals. Approximately a year behind schedule, the Government issued a Consultation

Document[1] in March 1999 containing points for consideration and invited comments by 31 August 1999.

The contents of the Consultation Document revealed that, during the course of the Review, the Government's thinking underwent a shift in emphasis, as it abandoned the idea of providing any significant new tax reliefs for charities and decided to focus instead on making the tax system 'more modern, flexible and simple' for donors and charities. The Treasury put forward a number of proposals for change to the existing tax incentives in order to encourage people to give to charity, and also to simplify the current regime.

The Consultation Document generated 500 responses to this second phase of consultation from a wide range of individuals and organisations.[2] Finally, in November 1999, in his Pre-Budget Report, Gordon Brown announced a package of measures called *Getting Britain Giving in the 21st Century*, designed to simplify tax relief and boost giving to charity. It is estimated that the full effect of the package will be a cost to the Exchequer of some £400 million after 5 years.[3] All changes came into effect in April 2000.

A broad overview of the reliefs, incorporating the year 2000 changes now follows. These are considered under separate headings for individual donors and corporate donors. There is a complex mixture of reliefs on income tax payable at source, reliefs reclaimed by charities after gifts are made, and reliefs which are paid back to donors.

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1 HM Treasury, *Review of Charity Taxation*, March 1999.

2 See Inland Revenue, *Review of Charity Taxation: Summary of Responses to the Government's Consultation Document*, October 1999.

3 HM Treasury, *Financial Statement and Budget Report*, March 2000.

1. Individuals

Gift Aid

The original Gift Aid scheme was introduced in 1990. It enabled individuals and companies to give single gifts of money to charity tax effectively, but it required a minimum amount to be given.

Now, tax relief applies to any donation whether large or small, regular or one-off, provided that, as before, the charity can demonstrate an audit trail back to the donor.[4]

There is no legal document involved, although donors have to make a declaration to the charity that they want their gifts to be treated as Gift Aid donations.[5] As well as in writing, donors can now join the new Gift Aid scheme by phone[6] or Internet, without having to fill in and sign a paper form (the charity will then send a written record back to the donor). Donors can make a single declaration to cover a series of (prospective or retrospective) donations. A model Gift Aid declaration is available on the Inland Revenue website.[7] There is no maximum limit for donations, and there is now[8] no minimum limit either. Charities can of course set their own minimum limit to cover the costs associated with reclaiming tax.[9]

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4 Finance Act 1990, s.25 as amended and Finance Act 2000, s.39.

5 Finance Act 1990, s.25(3) as amended and Donations to Charity by Individuals (Appropriate Declarations) Regulations 2000, SI 2000/2074.

6 In the 2001 Red Nose Day appeal, Comic Relief secured Gift Aid Declarations from about 80% of those who made donations by phone. Red Nose Day is a UK-wide fundraising event organised by Comic Relief every two years which culminates in a night of comedy and documentary films on television. It is the biggest television fundraising event in the UK calendar. (source: www.givingcampaign.org.uk)

7 www.inlandrevenue.gov.uk

8 Finance Act 2000, s.39(3)(a).

9 For example on the Barnardo's website (www.barnardos.org) there is the statement: 'Because of the administration costs of setting up the declaration form, we ask that you only request to Gift Aid your donation if it is £10 or more.'

Subject to transitional measures, tax relief for donations under Deeds of Covenant will in future come within the new Gift Aid scheme and there will be no separate relief for these donations.[10]

Gift Aid works in a similar way to the old Deed of Covenant. The amount paid by the donor is treated as a 'net' amount after deduction of basic rate income tax,[11] which the charity can claim back from the Inland Revenue. For donors who pay tax at the basic rate that is the end of the matter. Donors who pay tax at the higher rate can claim higher rate tax relief in their Self-Assessment tax return. The charity still only reclaims tax at the basic rate.

Example

Basic rate taxpayer		
donation	1,000.00	
charity reclaims b.r.t @ 22% (22/78 x 1000)		282.00
total worth to charity		1,282.00

Higher rate taxpayer	
charity reclaims as above	282.00
donor claims h.r.t. relief @18% (difference between h.r.t (40%) and b.r.t) on total worth to charity	230.76
so cost to donor	769.24

There are rules limiting the amount of benefits that donors can receive in return for their Gift Aid donations. For example, for donations of more than £1000 in any one year,

10 Finance Act 2000, s.41.

11 Income and Corporation Taxes Act 1988, ss.348 and 349, Finance Act 1990, s.25 as amended.

benefits worth up to 2.5% of the donation are ignored, provided that the total benefits received from the particular charity in the year do not exceed £250.[12] Membership subscriptions to a charity can be paid through Gift Aid, provided that any benefits received do not exceed the prescribed limits. Under statute, the benefits of entry to view the premises of certain heritage and wildlife conservation charities are ignored.[13]

Payroll Giving

Payroll Giving, also known as Give As You Earn, can be used by employees (and pensioners in employers' occupational pension schemes) to give to charity.[14] Employees can authorise their employer to deduct charitable donations from their pay. There is no minimum limit for donations, and there is now[15] no maximum annual limit either. Because donations are deducted before Pay As You Earn tax is calculated, the employee gets all of the tax relief for the donation at his or her top rate of tax (similar to the US-style of relief). The employer passes on employees' donations to an agency charity (approved by the Inland Revenue) which in turn distributes them to the charities chosen by the employees. Unlike for Deeds of Covenant and Gift Aid, there is no need for the charities to make repayment claims to the Inland Revenue.

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[12] Finance Act 1990, s.25(2)(e) and s.25(5A-G).

[13] Finance Act 1990, s.25(5E-G).

[14] Income and Corporation Taxes Act 1988, s.202, Charitable Deductions (Approved Schemes) Regulations 1986, SI 1986/2211 as amended.

[15] Finance Act 2000, s.38(5)(b).

From April 2000 for three years, the Government is providing a 10% supplement on donations through Payroll Giving from public expenditure.[16] It has also embarked upon a promotional campaign to increase awareness of the scheme and improve take-up.

Example

Authorised monthly deduction	Value to charity incl. 10% supplement (till 2003)	Cost to basic rate taxpayer (saves income tax at 22%)	Cost to higher rate taxpayer (saves income tax at 40%)
10.00	11.00	7.80	6.00
100.00	110.00	78.00	60.00

New Tax Relief for Gifts of Shares

From April 2000, gifts of quoted shares and securities to charity are encouraged by the introduction of a new income tax relief.[17] The tax relief is given for the full market value of the gift in addition to any existing capital gains tax relief. The relief applies to gifts or sales at less than market value.

The deduction from income for the tax year is the market value at the date of the gift, plus any transfer costs less any disposal proceeds or other money or the value of any benefits received in connection with the gift. Relief is claimed at the donor's highest rate of tax.

Example

Donor owns 5000 shares in quoted company and gives them to charity. On date of gift these are valued at £10 each. Donor is charged a broker's fee of £50 for handing the transfer. As a token of its gratitude, charity gives donor a book worth £50.

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16 Finance Act 2000, s.38 and Charitable Deductions (Approved Schemes) (Amendment No.2) Regulations 2000, SI 2000/2083.

Deduction donor can make:	
value of shares	50,000
plus brokers fee	50
	50,050
less value of benefit received	50
	50,000

Another option is to sell the shares and give the proceeds to charity via Gift Aid. This will affect both the value of the gift to the charity and the cost to the donor.

Example 1

A higher rate taxpayer has shares worth £100,000. If they are sold, that would make a net gain of £25,000 after all reliefs and allowances, and a liability to capital gains tax.

Option 1 – Sell and Gift Aid

1 - Sell	
gross proceeds of sale	100,000
less capital gains charge (25,000 @40%)	10,000
net proceeds after tax	90,000
2 – Gift Aid	
donation	90,000
charity reclaims b.r.t @ 22% (22/78 x 90,000)	25,384
total worth to charity	115,384
donor claims h.r.t. relief @18% (difference between h.r.t (40%) and b.r.t) on total worth to charity	20,769
so cost to donor	
value of shares	100,000
less relief	20,769
	79,231

[17] Income and Corporation Taxes Act 1988, s.587B.

Option 2 – Give shares to charity

Charity gets shares worth	100,000
Donor gets tax relief on value at h.r.t.	40,000
Cost to donor	60,000

Example 2

A basic rate taxpayer has shares worth £780, which came free as part of a demutualisation. There are no other capital gains in the year.

Option 1 – Sell and Gift Aid

1 - Sell	
Gross proceeds of sale	780.00
Less capital gains charge	nil
Net proceeds	780.00
2 – Gift Aid	
Donation	780.00
charity reclaims b.r.t @ 22% (22/78 x 780.00)	220.00
total worth to charity	1000.00
cost to donor	780.00

Option 2 – Give shares to charity

Charity gets shares worth	780.00
Donor gets tax relief on value at b.r.t	171.60
Cost to donor	608.40

Inheritance Tax and Capital Gains Tax

In addition to the reliefs from income tax for giving, there are reliefs from Inheritance Tax[18] and Capital Gains Tax[19] for gifts to charity. Bequests, legacies and lifetime gifts to charity - whether in cash or in assets - are generally exempt from Inheritance Tax. Gifts of assets to charity do not give rise to chargeable gains for the purposes of Capital Gains Tax.

2. Companies And Other Businesses

The top 400 corporate donors gave £238 million in cash donations in 1998/99, with a further £176 declared for other forms of support, giving a total community contribution figure of £414 million.[20]

Cash Gifts

Companies can get full tax relief for gifts of cash to charity.

Some charitable giving by businesses (for example, sponsorship payments) can be treated as allowable expenses of the business (if made wholly and exclusively for the purposes of the trade) and deducted when computing the profits of the business for tax purposes.[21]

Businesses can also get tax relief for gifts of cash under Gift Aid.[22] For companies, the full payment is now made to the charity and the company deducts the amount when working out its profits for corporation tax purposes. Tax is not deducted from the

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[18] Inheritance Tax Act 1984, s.23.
[19] Taxation of Chargeable Gains Act 1992, s.257.
[20] Smyth, J, *The Guide to UK Company Giving*, 3rd ed. 2000, London: Directory of Social Change, p.22.
[21] Income and Corporation Taxes Act 1988, s.577(9).

payment and the charity does not claim back any tax on the gift. No declaration is required.

Donated Goods and Staff Secondment

Gifts of equipment or trading stock to charity qualify for relief.[23] Businesses can also get tax relief for all of the payroll costs of employees who are seconded to a charity.[24]

New Tax Relief for Gifts of Shares

From April 2000, companies can get corporation tax relief for gifts of quoted shares and securities to charity.[25] The relief is in addition to relief from corporation tax on capital gains on gifts to charity of shares, securities and other assets.

3. Gifts to Foreign Charities

The definition of 'charity' for tax purposes is 'any body of persons or trust established for charitable purposes only'.[26] It was held in *Camille and Henry Dreyfus Foundation inc. v Inland Revenue Commissioners*[27] that 'established' means established in the United Kingdom, since only bodies and trusts established in the UK are subject to the jurisdiction of the courts of the UK. Gifts to foreign charities are not therefore eligible for

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22 Income and Corporation Taxes Act 1988, s.339, as amended.
23 Income and Corporation Taxes Act 1988, s.83A.
24 Income and Corporation Taxes Act 1988, s.86.
25 Income and Corporation Taxes Act 1988, s.587B.
26 See, for example, Income and Corporation Taxes Act 1988, s.506(1).
27 [1956] AC 39.
28 Income and Corporation Taxes Act 1988, s.660(3).

the reliefs previously described. It should, however, be noted that the activities of a charity established in the UK need not be confined to the UK.

4. The Demise of the Deed of Covenants

The Deed of Covenant scheme has existed for many years as a tax effective method of giving to charity. Not only could the charity recover basic rate tax paid by the covenantor, but the covenantor could also obtain repayment of any higher rate tax paid in relation to the covenanted sum. Any income which was paid to a charity under a deed of covenant which could last for more than three years was regarded as income of the charity, not the donor, provided it was pure income profit in the hands of the recipient charity.[28] The scheme involved the donor entering into a legally enforceable commitment - in a deed - to make regular fixed donations to a charity for a period exceeding three years. There was no minimum or maximum limit on the amount that could be given. The scheme could be quite complex. For example, the deed had to comply with a number of formalities of general law, and there were some tax rules, which had been developed by the courts in judicial decisions and supplemented in statute, that could be difficult to understand and apply.

The removal of Deeds of Covenant[29] as a mechanism for tax effective giving, together with the new Gift Aid scheme makes a significant contribution to simplifying and modernising tax effective methods of giving to charity. Deeds of Covenant have been

[29] Deeds of Covenant will be valid in law only, and not for tax purposes. Donations made under Deeds executed on or after 6 April 2000 will need to be supported by a Gift Aid declaration in order to be tax effective. As a transitional measure, donors will not be required to make a Gift Aid declaration in respect of payments made under a Deed already in existence before 6 April 2000.

important to charities in encouraging regular, committed giving. However, in the debate about the so-called 'democracy of giving'[30] the Government has argued that Deeds of Covenant are outdated and anachronistic and inaccessible to many donors. It is said that Deeds reduce consumer choice and fail to reflect skewed patterns of giving. Studies of patterns of giving in the UK illustrate that many more people (51%) give small amounts of money (less than £50 per year) than give large amounts, even though small numbers of people (4%) account for as much as 50% of donated income to the sector.[31] In addition only 10% of the population currently give on a regular basis. In contrast to Deeds, the new Gift Aid scheme is readily accessible to low and high value givers alike, and is amenable to both regular and one-off donations. It should therefore be more responsive to current patterns of giving. In addition, charities may market the Gift Aid scheme in ways which encourage regular, committed giving in a similar way to Deeds.

5. Take-up Rates

Research published in July 2001[32] by the Charities Aid Foundation (CAF) and the National Council for Voluntary Organisations (NCVO) and funded by the Inland Revenue, reveals that the changes introduced in 2000 are well targeted and beginning to

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30 In the Budget speech in 1999, Gordon Brown announced: 'Instead of charity seen in the old way, the rich bestowing favours on the poor, I want a democracy of giving, where all those who can, help all those who can't.' Chancellor of Exchequer's Budget Statement , 9 March 1999. See also, Michels, JR, 'UK Charity Law: Is it Creating a True Democracy of Giving? [2001]*Vanderbilt Journal of Transnational Law* 169.

31 NCVO, *Getting Britain Giving in the 21st Century. An NCVO briefing on the potential implications of the package of measures announced by the Chancellor in the Pre-Budget report to boost charitable giving*, February 2000.

32 CAF, Inland Revenue, NCVO, *Research Briefing. Charity Tax Review*, July 2001.

make an impact. However, greater promotion is now needed if they are to realise their full potential.

The research reveals, only one year into the new tax reliefs, that there has been an important early impact on the public's understanding of the tax benefits of giving to charity, their use of tax effective giving schemes, and their levels of giving through these methods. The use of Gift Aid has increased from 1% to 7% of the population, but whilst awareness of tax effective giving has grown by nearly 5% since 2000, still only just over half of the population are aware of tax effective giving schemes.

In the year 2000, charitable donations totalled £5.76 billion, with average monthly donations standing at £10.35. This represents a return in real terms to the 1993 levels, after the fallow years of the mid-1990s. However, this recovery is almost entirely down to current donors giving more, as the percentage of the population donating to charity has crept up by less than 3% since 1997. It was hoped that the increases in fiscal incentives for giving would not only attract a wider range of donors, but would also encourage more people to give more. In fact, by March 2001, 5% of people surveyed said that the tax reliefs made them give more to charity, and a quarter of those said they had topped up their gift by 25%.[33] Targeted surveys of (already) tax effective donors indicated a similar response: over one-quarter (26%) said they had given more since the tax changes.[34] However, whilst there is some evidence that the size of gifts made through Gift Aid has begun to increase, the same research suggests that most of this increase amounts to giving converted from non tax effective methods, rather than new giving.

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33 Ibid.

34 Ibid.

In relation to Payroll Giving, in May 2001 the Inland Revenue reported that £55 million was donated to charities through Payroll Giving in the year to April 2001 compared with £29 million[35] in the previous year.[36]

Whilst there is little data so far concerning the take-up of tax effective giving of stocks and shares, the CAF/ NCVO Research of July 2001[37] reported that 'early signs are that this [the new relief] is popular and significant.' Up to 15% of the adult population in the UK now own shares of various kinds.[38] Share offers in the utilities, the trend towards demutualisation, and plans to encourage employee share ownership, all mean that there is a larger population of share owners.

The uptake of the tax benefits on giving however is still only a drop in the ocean of the potential. The percentage of the population giving to charity is now only 67.5% whereas in 1995 it was 70.3%. Charitable giving remains below 1% of average earnings in the UK, so there is clearly scope for greater generosity, particularly amongst the affluent members of society.

The amount of money given to charity in the UK is now on the rise again after a long period of decline. But there is still a lot more to be done. Charities need to find ways of engaging fresh interest from donors, as well as making sure that they promote tax efficient giving at every available opportunity.

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35 This sum excludes the special one-off donations to the Children's Promise appeal at the time of the millennium.

36 Inland Revenue, *Growing Success Of Payroll Giving*, Press Release Number 80, 8 May 2001.

37 CAF, Inland Revenue, NCVO, *Research Briefing. Charity Tax Review*, July 2001.

38 NCVO, *Getting Britain Giving in the 21st Century. An NCVO briefing on the potential implications of the package of measures announced by the Chancellor in the Pre-Budget report to boost charitable giving*, February 2000.

6. The Giving Campaign

The launch in July 2001 of a £1.3 million independent national campaign to get the UK to give an additional £500 million to charity by 2004 may well help. The prime aim of the Giving Campaign[39] is to make the public and charities aware of the new tax regime launched in the 2000 Budget. The campaign's long-term goal - one which the organisers readily admit will take more than three years to achieve - is to encourage a culture of giving where planned donations are commonplace and young people grow up with the idea of giving both money and time to charitable causes. The campaign is funded by £1 million from the government and around £300,000 provided by the NCVO and the CAF and their 20 charity partners.

In addition to leaflets aimed at charities and financial advisers, the campaign also includes an information and advice website aimed at promoting tax efficient donations. The campaign, launched with the aid of the Financial Secretary to the Treasury, Paul Boateng has big names behind it, including the former Labour party head of fundraising, Amanda Delew, as campaign director, and Oxfam chair Joel Joffe, as chair of the campaign. The campaign's success or failure remains to be seen.

7. US-Style Reliefs for the UK?

Interestingly, for an American audience, only a small number of respondents to the Consultation[40] during the Review of Charity Taxation wanted to see a US-style relief for

[39] See its website: www.givingcampaign.org.uk

[40] These were mainly charities appealing to affluent donors.

donations in the UK.[41] The key issue was whether moving to such a relief, where all of the tax relief goes to the donor, would encourage more people to give to charity, and would encourage them to increase the amount that they give. During the consultation stage, conflicting responses were received on whether a US-style relief would achieve these objectives. Most charities feared that switching the basic rate tax relief from the charity to the donor would adversely affect their income, because donors would not increase the amount of their donations sufficiently to compensate for the switch.

Moving to a US-style relief across the board would in any event not be universally practicable in the UK because, as income tax is deducted cumulatively from source on wages (under Pay As You Earn), far fewer people receive an annual tax return in the UK.[42] An alternative might be to consider the introduction of a US-style system as an <u>additional</u> option, alongside Gift Aid and Payroll Giving, for people who receive a Self Assessment tax return – such as the self-employed and higher rate taxpayers.[43] The general response to that idea was that a US-style relief running in parallel with the existing reliefs would add unwelcome complication to the tax system.

28 August 2001

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41 See Inland Revenue, *Review of Charity Taxation: Summary of Responses to the Government's Consultation Document*, October 1999.

42 For the vast majority of employees who receive income from employment or from occupational pensions the tax due on that income is calculated by the employer and the appropriate amount deducted before the employee is paid. This system, known as Pay As You Earn (PAYE), ensures that the majority of these individuals do not usually need to complete an annual tax return or make any direct payment to the Inland Revenue. However, in 1996–97, the UK began a move towards greater self-assessment, with about 8 million tax returns being issued in that first year, covering almost 20% of the adult population. Inland Revenue, *Self Assessment: New Tax Returns Go Out*, Press Release 49/97, 3 April 1997.

43 See Michels, JR, 'UK Charity Law: Is it Creating a True Democracy of Giving? [2001]*Vanderbilt Journal of Transnational Law* 169, who advocates this approach.