



TAX EFFECTIVE PHILANTHROPY

UK Tax Reliefs on Charitable Donations

The provision of financial support for charitable causes is something which many people in the UK regard as a moral imperative, whatever the means at their disposal. Whether it is a small one-off annual contribution to Comic Relief, regular contributions for causes which people have particular empathy with or significant donations of cash or other assets, planning for donations to charity is a consideration for many of us. UK tax law contains a number of tax reliefs available to donors to charity. It is important to ensure that the reliefs available are fully utilised and not lost by donating at the wrong time, giving the wrong amount or, in some cases, donating the wrong asset. This Tax Factsheet provides an overview of the tax reliefs available in the UK and summarises the points which need to be considered in relation to them.

What is a 'charity' under UK tax law?

A charity has to satisfy a number of conditions before meeting the definition of 'charity' for UK tax purposes. It must have been established for charitable purposes only and must be based in the UK, the EU, Iceland, Liechtenstein or Norway. The charity must be registered with the Charity Commission or (in the case of a charity not based in the UK) by another regulator and managed by people who are 'fit and proper'. Although, therefore, tax reliefs are not restricted to UK charities, problems can arise in practice when seeking to claim tax relief on a direct donation to a non-UK charity. A foreign charity, as with a UK charity, must be established only for 'charitable purposes', but the definition to be applied is the English Law definition contained in the Charities Act 2011. If, therefore, the objects of a foreign charity include anything which would fall outside the English definition, it could be argued that the foreign charity fails to meet the necessary

conditions. HMRC tends to scrutinise large donations to non-UK charities to ensure that there are no grounds which might disqualify the donor from receiving tax relief.

Structuring a programme of philanthropy

There is usually a specific charity already in existence which provides support in the area of the donor's charitable interest and structuring the gift is therefore very straightforward. However, some individuals with significant funds to give away prefer to play a more hands on role in determining the exact causes or projects which are to benefit, and in these circumstances there are a couple of options.

One option may be to establish and register a new charity to accept the donation, with the donor playing an active role in administering the charity. For example, the donor might have a specific interest in the education of children in, say, Mali and wish to have oversight of the way funds are invested in school construction projects. There are various choices in terms of the legal form of the charity, with trusts, companies limited by guarantee and, more recently, CIOs (charitable incorporated organisations) all relatively common, but with different governance features and liability consequences for the trustees. This is an area where specific legal advice is essential.

There is another option which has features in common with the establishment of a new charity, but which eliminates the burdens of administration. There are several UK registered charities which effectively act as a donations platform. As an alternative to setting up a new philanthropic organisation, it is possible to set up a 'donor advised fund' under the umbrella of the existing charity platform. Having made the donation, the donor can then work with the charity to determine the ways in which the donor advised fund is invested and/or applied on philanthropic projects in the UK or across the world. The legal responsibilities for administering the fund rest with trustees of the over-arching charity rather than with the donor. Examples of charities which operate donor advised funds are Charities Aid Foundation and Prism the Gift Fund.

Both of the above more bespoke options have the potential to streamline donations via a UK registered charity towards overseas projects, where a direct donation to an overseas charity might not be eligible for relief for the reasons explained above.

Income Tax Relief

Income Tax relief in the UK for donations to charity by individuals is available in a number of ways, described below.

Cash gifts

Relief for cash gifts is given under what is known as Gift Aid, a scheme introduced in 1990. It was introduced with a view to making it easier for donors to claim relief who are basic rate tax payers and who, without Gift Aid, would have had to file a tax return in order to claim income tax relief. Prior to Gift Aid's introduction, a basic rate tax payer making a donation of £100 to a charity would have paid £100 over to the charity, and then would have needed to file a tax return to claim relief against their income and receive a £20 repayment. The administrative burden of HMRC having to process many thousands of tax returns for individuals who would otherwise not need to file a return led to the roll-out of Gift Aid. The scheme operates by permitting the donor to transfer £80 to the charity rather than £100, with the donor certifying to the charity that they will pay tax for the relevant tax year of at least £20. The charity then makes a return to HMRC



reclaiming the basic rate income tax withheld on all donations received from individuals in the previous quarter under Gift Aid. In this way, the donor is left paying only £80 in the first place (rather than paying £100 and receiving £20 back), while the charity receives the full £100 as previously (with £80 from the donor and £20 from HMRC). It should be noted that Gift Aid only results in the donor receiving tax relief at the 20% basic rate. Tax payers who are liable to Income Tax relief at the higher or additional rate and are therefore due to receive tax relief at those rates would need to file a tax return to claim the relief or make arrangements for the relief to be included in a payroll coding.

If an individual makes a donation under Gift Aid but it transpires that they did not in fact pay sufficient tax for the relevant tax year to cover the 20% basic rate tax which they certified and retained on the making of the gift, they are then liable to Income Tax on the shortfall. This is a trap for the unwary and is why careful planning is necessary with the timing of charitable gifts, especially with larger donations.

Usually, tax relief is given in the tax year for which the donation is made. However, there are provisions under Gift Aid which permit a donation to be treated as though it had been made in the previous tax year, as long as a claim to relate back the donation is included in the tax return subsequently filed for the tax year to which the donation is to be related back. It is a requirement that the donation is made and the tax return is filed by 31 January following the end of the tax year. Once a tax return has been filed, it is not permitted to file an amended tax return to include a related back donation, even if the amended return is submitted by the 31 January filing date. This ability to relate back donations can be a useful way of maximising Income Tax relief.

There are conditions which have to be satisfied for a donation to be a qualifying donation under Gift Aid, such as where the donor derives a benefit from the gift or where the gift is conditional upon the charity acquiring an asset from the donor. A detailed consideration of these conditions is beyond the scope of this Factsheet.

Individuals who are UK resident but not UK domiciled and claiming the remittance basis may need to consider carefully the funds which they use when making a cash donation to a UK charity. A transfer of funds in an overseas account to the UK bank account of a charity would result in a taxable remittance if the funds used were composed of foreign income or gains. The issue can be avoided if the charity has a non-UK account to receive the donation. Many of the larger charities do have non-UK accounts, as do some of the umbrella charities which operate donor advised funds. US citizens who are UK resident for tax purposes may wish to make charitable donations in such a way that they qualify for both UK and US tax relief, and this is also possible with pre-planning.

It may be possible for an individual engaged in a business activity to claim a deduction for a gift to charity as an expense in computing business profits. For this to apply, the gift would need to be made wholly and exclusively for the purposes of the business (rather than for charitable sentiments or out of a sense of moral responsibility). This is therefore a difficult test to satisfy and there would need to be a close relationship between the activity of the business and the function of the charity. A donation which qualifies as a business expense is not also eligible for relief under Gift Aid.

Non-cash gifts

Income Tax relief is also available on the value of donations of certain other assets to charity. The assets in question which qualify for relief are as follows:

- Shares or securities which are listed on a recognised stock exchange
- Units in an authorised unit trust
- Shares in an open-ended investment company
- An interest in an offshore fund
- A qualifying interest in land

To qualify, it is necessary for the entire interest in the asset to pass to the charity, presumably to spare the charity from complications which might arise from joint ownership. A qualifying interest in land is a freehold or leasehold interest in UK land only. Income Tax relief is given on the value of the donation (plus the incidental costs in making the donation) for the tax year in which the gift takes place (so there are no 'relate back' provisions as there are with Gift Aid). It is also possible to claim relief if one of the assets listed is sold at undervalue, in which case relief is given on the excess of the value of the asset over the consideration given by the charity to the donor/vendor. As with Gift Aid, there are points of detail beyond the scope of this Factsheet to cover situations where the donor continues to derive some benefit from the asset gifted.

In 2013, the UK government sought to limit the amount of Income Tax relief which could be claimed in respect of tax reliefs which were otherwise not subject to a cap. From 6 April 2013, a number of reliefs were capped at the higher of £50,000 or 25% of adjusted total income, including various loss reliefs and relief for qualifying loan interest. The initial proposal included Income Tax relief on donations to charity within its scope, but following intense lobbying from the charity sector the government had a change of heart and excluded charity donations from the list of reliefs to be capped.

Capital Gains Tax Relief

There is a valuable CGT relief for disposals not at arm's length to a registered charity. The relief applies not just to outright gifts of chargeable assets but also to deliberate sales of chargeable assets for consideration which is less than market value. In the case of an outright gift or a sale where the consideration received does not exceed the base cost of the asset for the donor/vendor, the relief operates by treating the disposal as if it had taken place for consideration equal to the original base cost. If the asset is sold to the charity for a price which is less than the market value of the asset but greater than the vendor's base cost, tax is computed on the excess of the actual amount received above the base cost.

This CGT relief, combined with the Income Tax relief for non-cash gifts described above, might make the disposal at cost of investment portfolio assets standing at a capital gain a tax-effective method of donating to charity.

Inheritance Tax Relief

There is a specific provision in the Inheritance Tax (IHT) rules which exempts transfers of value attributable to property which is given to charities. The definition of 'charity' is the same as that outlined above, so a donation to a charity which is outside the UK and EEA will not qualify for the relief.

In order to encourage inclusion of charitable bequests in a Will, a reduction of 4% in the standard 40% rate of IHT was introduced in 2011 which applies where 10% or more of an estate is left to charity. The rules are quite complex, especially where there is a combination of assets in the estate including some which qualify for reliefs for business or agricultural property. Advice is therefore essential when planning for this reduced rate.

In Summary

The UK's tax legislation includes generous provision for tax reliefs on charitable donations, but the rules are complex and require careful planning to maximise benefit from the reliefs and avoid traps and pitfalls. This is particularly so when large cash donations are under consideration, or donations (or sales deliberately at under value) of assets other than cash, or it is intended to direct financial support to projects overseas.

As Aristotle said:

'To give away money is an easy matter and in any man's power. But to decide to whom to give it and how large and when, and for what purpose and how, is neither in every man's power nor an easy matter.'

2,300 years later, the questions remain substantially the same.



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