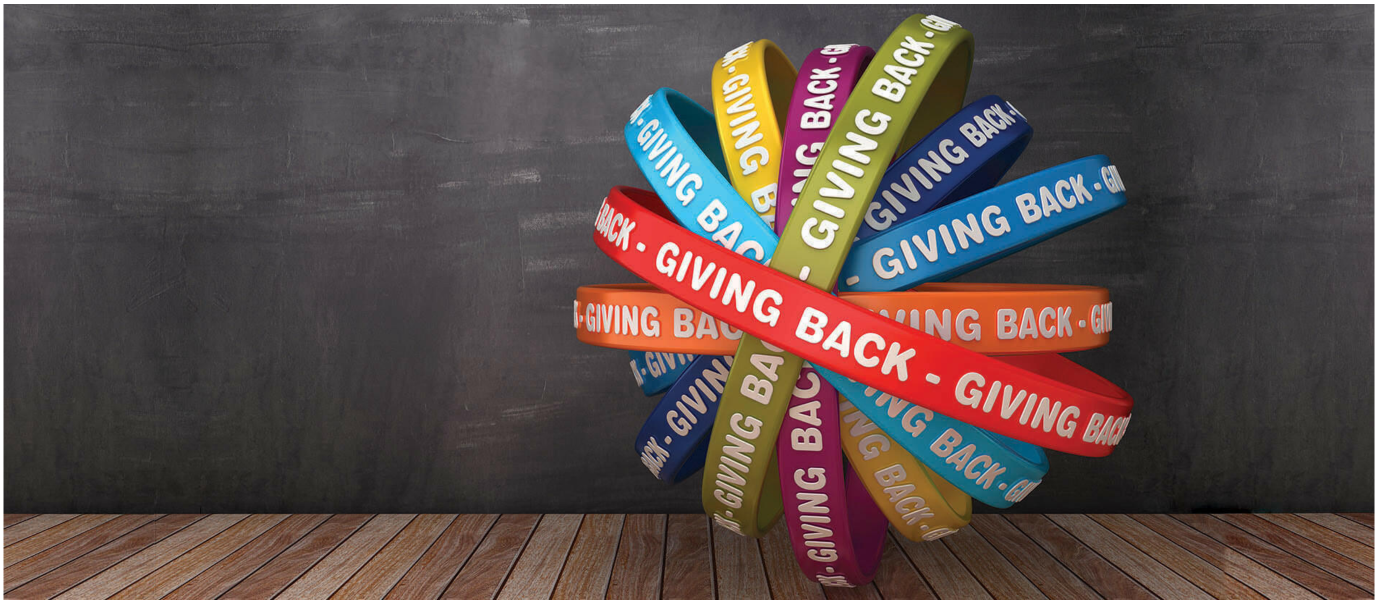
Charitable giving and tax: dispelling the myths

Personal tax | Inheritance tax and trusts



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We consider how to manage the tax implications of charitable giving and how to maximise the benefits to both donors and recipients.

Key Points

What is the issue?

Only a quarter (26%) of high net worth individuals (HNWIs) say that an adviser has raised the topic of charitable giving with them in the past, yet two in five believe it is important to discuss the topic with advisers.

What does it mean to me?

Tax advisers can bring a wealth of essential knowledge to a client's charitable giving that will directly impact the finances of both the charity and the taxpayer, making it very much their subject area.

What can I take away?

Donor advised funds are the UK's fastest growing philanthropic giving vehicles. Acting as a one-stop shop for a HNWI's giving needs, donor advised funds enable them to make charitable contributions and then recommend for the fund to be invested or make grants to organisations that they suggest over time.

Only a quarter (26%) of high net worth individuals (HNWIs) say that an adviser has raised the topic of charitable giving with them in the past, yet two in five believe it is important to discuss the topic with advisers. A similar number say they would like an adviser to suggest ways to help them make the most of their giving. The figures were obtained by a survey of 506 HNWIs with over £1 million of investable assets (conducted by Savanta on behalf of Charities Aid Foundation (CAF) in 2023).

So why aren't more advisers talking to their clients about charitable giving? *It's too personal. It's not my area. I need to be a philanthropy expert.* These are all reasons I've heard in conversations with a range of financial advisers, including tax specialists. But they are all myths.

Tax incentives for charitable giving have long played a crucial role in encouraging individuals and businesses to support charitable causes and also can ensure more money goes to charities. It should therefore be an imperative that tax advisers have this conversation with every one of their clients. Misconceptions often cloud the understanding of these incentives, as well as the role of the adviser, leading to missed opportunities for donors and their advisers alike.

As Christmas approaches – the time when donating to charity is at its peak – this article aims to debunk the most prevalent myths around charitable giving and tax in the UK, shedding light on how both advisers and donors can benefit from these conversations.

It’s too personal

People donate to charity for all sorts of reasons but often it’s sparked by someone they know or something they’ve experienced themselves; it can be an extremely personal act. Tax is never going to be the driving force in this decision but that doesn’t mean it’s not a tax adviser’s place to discuss the topic. In the survey by Savanta on behalf of CAF, only 13% of HNWIs said it would not be appropriate for an adviser to raise a topic like charitable giving, so don’t shy away from the topic thinking it is inappropriate.

Starting a conversation about charitable giving demonstrates to a client that you’re interested in the bigger picture, presenting them with all the options, and provides an opportunity to get to know your client better and discover what really drives them.

Philanthropy is often a family affair, providing advisers with much more tangible access to the next generation or other family members. The much talked about Great Wealth Transfer is happening, with £5.5 trillion expected to be transferred over the next 30 years, and research by Cerulli suggests 87% of next generation HNWIs do not intend to retain their parents’ advisers. A conversation around philanthropy provides an opportunity to change that.

It’s not my area

Ultimately, every donor wants charities to be able to make the most of their donations. And where there are tax incentives and regulations, there’s a role for tax advisers. Through knowledge of schemes such as Gift Aid, where charities can claim back a percentage of the tax paid on each donation, tax advisers can add financial value to charitable donations not just for the client, but for the charity as well.

Tax expertise also comes into play regarding the timing of a donation. HNWI giving is often, and should be, strategic. However, it can also be emotional and impulsive; for example, if a donor hears about a charity that needs urgent help or wants to respond to a major disaster. Without having had a conversation with their adviser about philanthropy in the past, they may not stop to consider that the timing and amount of the donation could have major tax implications.

I recall hearing a story from an adviser about a client who had recently made a capital gain on the sale of his business, which also meant he no longer had an income. When his wife passed away in the following year, he wanted to donate to a charity in her memory. He noted the amount on his draft tax return, but later changed his mind and doubled the donation, forgetting to update his tax return before submitting it. He immediately realised his mistake but the law does not accept amendments. None of the tax relief carried back to the previous year when he was still earning, so he ultimately had to pay an additional £200,000 to HMRC.

Tax advisers can bring a wealth of essential knowledge to a client’s charitable giving that will directly impact the finances of both the charity and the client, making it very much their subject area.

I need to be a philanthropy expert

I often hear advisers say they don’t discuss philanthropy with their clients because they are not philanthropy experts. As I have noted, a good adviser should know the tax regulations and benefits relating to charitable giving. I also believe that tax advisers should know the tax implications of different giving vehicles, though I’m not sure all do (which is why I’ve also included a useful guide). However, I wouldn’t expect my tax adviser to be able to recommend the best homelessness charities or tell me if a particular charity is legitimate.

What I would expect is for an adviser to be able to signpost a client to a philanthropy expert who could. This is added value to the client that again deepens the client-adviser relationship. Giving money away on your own is difficult and time consuming. Philanthropy advisers – whether independent, in-house at a private bank or through an organisation such as the CAF – regularly work in partnership with a HNWI’s team of advisers to provide the expertise needed for a giving strategy that achieves the desired impact. They are able to provide advice, as well as carrying out the administrative tasks such as due diligence and payment processing.

It is also worth noting that there is growing demand for philanthropy training for advisers to be introduced. In January 2023, the Law Family Commission on Civil Society recommended that training on philanthropy and impact investing should be included in FCA-approved curricula for advisers.

Guide to giving

Gift Aid

Gift Aid is a scheme available to UK charities and Community Amateur Sports Clubs (CASCs) which means that they can claim back basic rate income tax from HMRC on donations: an extra 25p for every £1 donated under Gift Aid. Each time an eligible taxpayer donates but forgets to tick the Gift Aid box, the charity misses out – collectively to the tune of £500 million each year.

A charity can claim Gift Aid when you make a monetary donation from your own funds and have paid UK income and/or capital gains tax during that tax year. The amount of tax you pay needs to be at least equal to the value of Gift Aid that the charity or community amateur sports clubs (CASC) will claim on your donation(s).

Tax relief at higher and additional rate must be claimed by the donor, usually on the self assessment tax return.

Helping donors understand the arithmetic is a valuable exercise. An additional rate taxpayer can give £100 to a charity with a net cost to the donor of £55. However, the donor needs to transfer £80 to the charity, which reclaims £20 in basic rate income tax. The donor claims the balance of £25 on the self assessment tax return. Not everyone understands that both the donor and the charity claim tax refunds. Donors who do understand the arithmetic will realise that they can afford to give a larger amount, as they will receive a personal refund.

If circumstances change and the taxpayer no longer pays enough tax, it’s important to tell all the charities supported. If you don’t and they continue claiming Gift Aid, the donor will need to pay any difference back to HMRC.

Non-cash donations

In the UK, you can donate cash, shares or property to charity and all three have different tax implications. For example, donating shares might be most tax-effective for the client, but the charity won't be able to claim the Gift Aid and could ultimately receive less money.

Again, helping donors understand that they receive both income tax and capital gains tax relief might mean that they would wish to supplement the gift of shares with a cash gift to pass on part of the tax benefit to the charity. HMRC's guidance is helpful (see tinyurl.com/bdfwcfww).

Executors or trustees of a will sometimes transfer property to a charity where there is a built-in capital gain arising in the holding period after the death. The charity then sells the property and uses the proceeds for its charitable purposes. The Charities Act 2022 ss 117-121 requires that the charity obtains a valuer's report before selling the property, so it is important to build this into any disposal timetable.

It is important to consider a client's personal circumstances and motivations before recommending which method is not only best for them, but also most practical for the charity.

Donor advised funds

Donor advised funds are the UK's fastest growing philanthropic giving vehicles. The fund is a registered charity, which gives money to other charities, rather than spending directly on charitable purposes. Acting as a one-stop shop for a HNWI's giving needs, donor advised funds enable them to make charitable contributions and then recommend for the fund to be invested or make grants to organisations that they suggest over time. Donor advised funds offer several advantages over setting up your own charitable foundation: namely, cost savings, flexibility and ease of administrative, fiduciary and reporting requirements.

When an individual gives a donation into a donor advised fund, it goes across the charitable threshold. The fund is not a bank account; the individual can't withdraw money from it as it has now been given away; and tax relief has been received on that money. Therefore, it is subject to charitable regulation and can now only be used for charitable purposes.

Gift Aid should be applicable on cash gifts to a donor advised fund. As considered above, individuals who pay tax above the basic rate can reclaim the difference between the rate they pay and the basic rate of tax via their personal tax returns.

One other possible advantage of some donor advised funds is that they can give money to overseas charities which are not registered in the UK. An individual cannot get tax relief on donations overseas, whereas a fund can spend money outside the UK, provided it qualifies under the UK’s charitable rules.

Legacy giving

Tax advantages can make a significant difference to the beneficiaries of an estate. A gift to a UK charity in a will is free from inheritance tax, meaning that the money is ‘removed’ from the value of a donor’s estate before tax is calculated. In addition to the donation being tax free, charitable gifts can reduce the amount of inheritance tax paid on the rest of the estate. If 10% or more of the estate is gifted to charity, then the rate of inheritance tax paid on the rest of the estate is reduced from 40% to 36%.

Gifts in wills can therefore make a significant difference to the causes that donors care about the most, whilst having a positive impact on the remainder of their estate. Donors should take legal advice on how best to build charitable donations into their will; the options are direct gifts or using trustees to make donations from a fund allocated under the will.

Payroll giving

With payroll giving, donations are taken from gross pay before income tax is deducted. The charities you care about get a regular income and it costs you less. The result is that all the tax relief is given to the individual through the PAYE system – and not to the charity through Gift Aid.

To donate £1, you pay 80p if you’re a basic rate taxpayer, 60p if you’re a higher rate taxpayer or 55p if you’re an additional rate taxpayer. The tax relief you get is different if you live in Scotland.

CAF Give As You Earn, the UK's biggest payroll scheme, facilitates over £63 million of donations to charities each year, giving charities a regular income and reducing administration and fundraising costs. Donations made to charity through payroll giving aren't eligible for Gift Aid because they're taken from your wages before tax.

Dual UK and US taxpayers

Dual citizenship can complicate charitable giving and an adviser with knowledge of this area can be incredibly attractive to many HNWIs. Twenty years ago, CAF launched the CAF American Donor Fund (CADF), a DAF specifically for dual UK and US taxpayers, enabling donors to claim eligible dual tax relief on their global giving.