MACFARLANES

A GUIDE TO TAX EFFICIENT GIVING IN THE UK

WHAT TO GIVE

1. MONEY

By individuals

Gifts of money to UK charities can benefit from Gift Aid. Under the Gift Aid scheme, qualifying charities are entitled to reclaim the basic rate income tax which has been or will be paid by the donor in respect of that gift. This equates to a 25 per cent uplift on the value of the gift.

If the donor is a higher and/or additional rate taxpayer, he can also reclaim relief from higher and additional rate income tax or capital gains tax on the total received by the charity (i.e. what he gave plus the basic rate tax refund).

For example, if a donor who pays the top rate of income tax makes a gift of £10,000 under the Gift Aid scheme, the charity will receive a further £2,500 and the donor will be entitled to reclaim £3,125 against his income or capital gains tax liability for that year (or in certain cases against his liability for the previous year if claimed before the relevant tax return is submitted).

By companies

The corporate Gift Aid scheme largely mirrors the rules for gifts by individuals except that the relief is attributed entirely to the donor company, rather than being split between the donor and the charity.

2. QUALIFYING INVESTMENTS (INCLUDING LISTED SECURITIES AND UK PROPERTY)

Gifts (or sales at an undervalue) of certain investments directly to UK charities will qualify for a particularly generous relief. Such investments include, listed shares and securities (including shares listed on AIM), units in an authorised unit trust, shares in an OEIC, an interest in an offshore fund and UK property.

Relief from income tax or (in the case of a company) corporation tax is given on the value passed to the charity by the transaction. For an individual this reduces their total income tax liability, so a top rate income tax payer will secure 45 per cent tax relief on the value passed to the charity.

For example, if a donor who pays the top rate of income tax makes a gift of £10,000 worth of shares, the donor will be entitled to reclaim £4,500 against his income tax liability for that year.

Gifts to charity are also not subject to capital gains tax. The donor would not therefore be required to pay capital gains tax on the donation and, assuming that the shares are standing at a capital gain, this represents a potential saving of up to 28 per cent.

3. CHATTELS

Gifts of chattels (such as art) to charities do not currently benefit from particularly generous tax treatment because, although the gift itself will not be subject to capital gains tax, there are no provisions allowing a donor to set off the value of the gift against his personal UK tax liability (as is the case for gifts of “qualifying investments” – discussed in 2 above). There are, however, a number of limited circumstances where other reliefs may be available.

Cultural Gifts Scheme[1]

The Cultural Gifts Scheme (the “Scheme”) introduced in 2013 offers taxpayers the potential to reduce their liabilities to income tax, capital gains tax or corporation tax by making gifts of pre-eminent objects to the nation.

The operation of the Scheme is seemingly straightforward: a taxpayer has an object that qualifies under the scheme, a value is agreed with the Arts Council Panel and the object is transferred to an “eligible institution” for public display.

Objects will be eligible if they are “pre-eminent for national, scientific, historic or artistic interest”, of great importance to a region or if they were once part of an historic building open to the public. This includes artwork, archives, books or even scientific specimens. Objects associated with an historic building only qualify if the building is in the ownership of particular prescribed charitable bodies, such as the National Trust.

Individuals can set 30 per cent of the value of qualifying gifts against their liability for income tax or capital gains tax. If the offer exceeds an individual’s tax liability in any one year, the tax reduction can be spread over up to five years.

Corporate donors will be able to set 20 per cent of a gift’s value against corporation tax but cannot spread it over more than one year.

Acceptance in lieu of inheritance tax

On death, works of art and important heritage objects may be offered to the nation in return for relief against the inheritance tax liability due on the deceased’s estate. This scheme is discussed in more detail in the section on making gifts on death below.

Conditional exemption

If chattels are of pre-eminent quality because of their national, scientific, historic or artistic interest, there is also the option to defer inheritance tax by providing for the chattels to be on public display for parts of the year. This conditional exemption offers the possibility of retaining assets in family hands while avoiding inheritance tax charges on death.

In return HMRC will ask the owner to give undertakings that the chattel will be properly looked after and that reasonable access will be given to the public to view it. The public access requirements can be quite tough to comply with and access for at least 28 days a year will generally be required. As an alternative, owners of artworks may be able to fulfil the public access obligation by lending their collection to a museum or art gallery for part of the year.

HOW TO GIVE

1. GIFTS BY NON-DOMS

Non-UK domiciled individuals who are taxed in the UK on the remittance basis will typically want to use non-UK income or gains to make charitable gifts (rather than using up their clean capital, or income or gains which have already been taxed in the UK). There is a tension here as, if the individual brings non-UK income or gains to the UK, tax will be triggered by the remittance.

It is possible to make a gift which qualifies for tax relief (Gift Aid) without triggering a remittance tax charge by making the gift to a non-UK bank account of the relevant UK charity. The money can then be brought into the UK, or otherwise used by the charity, without there being a remittance by the donor.

Setting up an offshore philanthropic entity

If there is no need to obtain UK tax relief on donations an attractive option may be to set up a philanthropic structure in a low tax jurisdiction outside of the UK. This option allows for far greater flexibility in relation to the structure, management and administration of the philanthropic entity. It also avoids restrictions on the causes which the entity may support. Funding an award to encourage entrepreneurship for example may not qualify as a charitable purpose under UK law, but could be funded by a more flexible offshore vehicle.

Note that if the donor is deemed domiciled in the UK for inheritance tax purposes it would generally not be appropriate to set up the entity as a trust as this could give rise to an immediate 20 per cent charge to inheritance tax.

2. GIFTS BY US CITIZENS

Obtaining charitable tax reliefs becomes more complicated where the donor is subject to tax not only in the UK but also in another jurisdiction. The classic example of this is that of a US passport holder living in the UK. He will be subject to US taxes as a US citizen, notwithstanding that he is resident in the UK, and also subject to UK taxes by virtue of his residence here.

The (rather complicated) trick for achieving tax relief in both jurisdictions is via a specific type of dual UK/US qualifying charity. For donations of cash and certain other assets, several providers offer a dual qualifying donor advised fund. Gifts of money can be channelled through this account in order to obtain dual UK/US tax relief. For more complicated charitable transactions, it may be necessary to set up a bespoke UK/US dual qualified charity, but this can be an expensive task as it would require specialist advice in both jurisdictions.

3. GIFTS TO NON-UK CHARITIES

Gifts to charities registered in other EU states, or in Norway or Iceland, may now qualify for UK tax relief if the charity has registered with HMRC.

For gifts to non-EU charities, the solution is to make the gift indirectly, via a UK charity which is able and willing to give the money to the non-EU charity. A UK charity can make a payment to a non-UK body provided that the UK charity takes adequate steps to ensure that the money will be used for purposes which are charitable, as a matter of UK law, and provided that those purposes fall within the objects for which the UK charity was established.

4. GIFTS ON DEATH

Gifts directly to charity under a testator's will are not subject to inheritance tax, resulting in a tax saving of 40 per cent. It is however sometimes possible to dramatically increase this tax saving by making the gift by way of a deed of variation (known as a "double dip").

A beneficiary under a will is entitled by way of a deed of variation to redirect his legacy to someone else and if the redirection is done within two years of the testator's death, a statutory fiction operates so that the gift is treated as if it had been made by the testator himself.

The essence of the double dip is that a legacy is redirected to a charity in such a way as to secure a reduction in two taxes at once – the variation is advantageous not only for inheritance tax (payable on the deceased's estate) but also for income tax (payable by the person making the variation). The combined tax benefit can be worth over 90 per cent of the value of the redirected legacy, although the achievable tax saving very much depends on the circumstances.

Double dips are however quite tricky to implement and you can expect HMRC to pounce on any mistakes that are made.

Relief where 10 per cent or more of an estate is left to charity[1]
Since 6 April 2012 a reduced rate of inheritance tax has applied where 10 per cent or more of a deceased's taxable estate is left to charity. Under the current headline inheritance tax rate of 40 per cent, a reduced rate of 36 per cent will be applied to the balance of the estate not passing to charity.

Acceptance in lieu of inheritance tax
On death, works of art and important heritage objects may be offered to the nation (in practice to a suitable public museum) in return for relief against the inheritance tax liability due from the deceased's estate. This scheme offers a better result than if the assets were sold on the open market as, under the terms of the scheme, 25 per cent of the inheritance tax that would have been payable on the asset is available to reduce the tax liability on the deceased's estate (so in essence inheritance tax is charged at 30 per cent on the value of the asset rather than the standard rate of 40 per cent).

A similar, but less generous, scheme also exists for buildings and land of historic, architectural or scientific interest which are offered to the nation.

5. SETTING UP A NEW CHARITY

When a high level of flexibility in charitable giving is required, or where very substantial sums are involved, it may make sense to set up a new grant making charity for an individual's, or their family's, own use.

Any UK charity with an income over £5,000 and any charitable incorporated organisation must be registered with the UK Charity Commission and will be subject to a certain level of bureaucracy, such as the requirement to produce an annual report and annual return. It will also be subject to regulation by the Charity Commission and HMRC.

This option is therefore most appropriate if the charity is intended to receive non-cash gifts, such as if the donor wishes to gift property to the charity (so as to obtain qualifying investment relief) or if the donor wishes to make grants which would not qualify for charity tax reliefs if made directly to the recipient (for example because they are to an individual or an organisation which is not a UK registered charity).

TRAPS FOR THE UNWARY

1. TAINTED CHARITABLE DONATION RULES

Donors who wish to enter into commercial transactions or arrangements with UK charities should ensure that they are not caught by the punitive "Tainted Charity Donation Rules".

These rules are intended to counteract schemes whereby donors who make donations to charities also enter into transactions with the donee charity which confer some advantage on the donor.

In brief, the Tainted Charity Donation Rules will apply if:

- the donor or a connected person enters into arrangements with a charity and it is reasonable to assume that the donations and the arrangements would not have been entered into independently of each other; and

- one of the purposes which the donor or a connected person entered into the arrangements was to obtain a financial advantage directly or indirectly from the charity that received the donation or a connected charity.

2. THE FIT AND PROPER PERSONS TEST

The Finance Act 2010 dramatically increased HMRC's role in the regulation of charities by providing it with power to withdraw tax relief from any charity unless the charity's "managers" are "fit and proper persons". Both UK charities and donors should be aware of these requirements and ensure that their rights to charity related tax reliefs are not put at risk.

With both "managers" and "fit and proper persons" left undefined by the legislation, HMRC has a wide discretion to decide on the extent of its new role. Its first set of guidance published in April 2010 seemed to grant them carte blanche to retrospectively withdraw tax reliefs whenever anyone connected to the finances or control of a charity was judged not to be "fit and proper". However, after coming under considerable pressure, HMRC has now relaxed its position. In particular, it has confirmed that it will assume that all "managers" of a charity are "fit and proper persons" unless there is information to suggest otherwise. Provided that proper consideration is given to the suitability of their trustees and other senior employees, charities may assume that they meet the prescribed conditions at all times.

[1] For more information in relation to this relief, see the article "Inheritance Tax Reduction Where 10 Per Cent Or More of an Estate Passes to Charity on Death" in issue 1 of our "Philanthropy Update" publication.

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