

# Tax effective giving

## made simple

Introduction	3
<b>1</b> Payroll giving	4
<b>2</b> Inheritance tax reliefs	5
<b>3</b> Gifts of shares and securities	6
<b>4</b> Gifts of land and buildings	8
<b>5</b> Free or non-commercial renting of property	10
<b>6</b> Gifts or use of other business assets	12
<b>7</b> Gifts of private assets	15
<b>8</b> Anti-avoidance	16
<b>9</b> Conclusion	18
<b>10</b> Further information	19



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## Introduction

Various tax incentives are available to individuals and companies to encourage giving to charity. Gift aid has been covered in a separate made simple guide. This guide outlines the other key methods of making donations to charity tax effectively and incorporates the VAT implications of some of these forms of giving.

There are opportunities for both individuals and companies to structure their giving in such a way that it helps them to save tax and helps the charity to achieve its objectives. What many people do not realise is that the tax relief for giving away shares or property is very generous. Charities should therefore be encouraging this form of giving among their supporters and providing much better information on how it operates.

Even if you are a small charity and do not have an investment portfolio, you can sell the shares and get help to do that through ShareGift, a service set up to help charities. All charities can also access donated goods from businesses through In Kind Direct and there are various other intermediary services.

Some time spent researching what is available and providing guidance to the staff and volunteers in your organisation may be well rewarded.

# 1 Payroll giving

The payroll giving scheme enables employees (and pensioners paid through PAYE) to make regular donations to charity by having their donations deducted from their salary before calculation of their income tax liability. Employees can choose to give regular or variable amounts and can specify which charities benefit. As the donations are deducted from gross pay, higher and additional rate taxpayers receive automatic higher and additional rate tax relief and the recipient charity does not need to reclaim tax as with gift aid.

There are a number of agents authorised to operate payroll giving schemes. The employer must first contact an authorised agent to set up the scheme. The employer then deducts employees' donations from gross pay as part of the PAYE process and pays these over to the agent. The agent must distribute the donations to the employees' chosen charities within 60 days.

Agents' fees may be deducted from the payments to charity, charged to the employer or charged to the beneficiary charities. Any costs the employer incurs in running the scheme are allowable expenses for tax purposes.

# 2 Inheritance tax reliefs

Legacies are an important source of income for many charities. Lifetime and death transfers of property to a charity established in the UK are exempt from inheritance tax. Gifts to charity are deducted from the value of the estate before applying the nil band and calculating the inheritance tax due. There is no limit on how much can be gifted and as a result charitable gifts can be used to entirely eliminate any inheritance tax liability. Many people arrange their affairs so that a part of their wealth passes to charity rather than to the government.

One planning point for donors is that if they intend remembering a charity in their will, it may be better to make lifetime transfers of any assets that would be subject to inheritance tax and leave the tax saved to charity. However, donors are best advised to seek professional advice before setting up wills and lifetime transfers.

The will must name the beneficiary charity. If the charity has ceased to exist, the trustees should ensure that the old charity and its successor are entered in the register of mergers so that the successor charity is entitled to the legacy. However, legacy administrators will have to exercise some care as the wording of certain legacies may specify that the charity still has to exist.

At budget 2011 the government announced that a reduced rate of inheritance tax will apply where 10 per cent or more of a deceased's net estate (after deducting inheritance tax exemptions, reliefs and the nil rate band) is left to charity. In those cases the current 40 per cent rate will be reduced to 36 per cent. The new rate will apply where death occurs on or after 6 April 2012.

# 3

## Gifts of shares and securities

Since April 2000 UK income tax payers and corporation tax payers have been able to obtain tax relief if they give, or sell at undervalue, a ‘qualifying investment’ to a charity.

Qualifying investments include:

- Shares or securities which are listed on a recognised stock exchange such as the London Stock Exchange. See Further Information for HMRC guidance on which stock exchanges are recognised.
- Shares or securities dealt on a designated UK market, for example AIM
- Units in an authorised unit trust
- Shares in an open ended investment company

Up to April 2010, the recipient charity had to be a UK charity. From April 2010, gifts to charities in other EC states, Norway or Iceland may also qualify for relief.

The amount of relief available to the donor is the market value of the disposal, plus any transfer costs, less any payment or benefit received from the charity. For disposals at undervalue, transfer costs are restricted. If a person connected to the donor receives any benefit as a result of the donation, this also reduces the tax relief available. The market value is determined at the date of transfer.

For income tax payers the relief is given as a deduction from gross taxable income for the tax year of the gift. For corporation tax payers, relief is given as a charge on income. Outright gifts are also treated as ‘no gain, no loss’ disposals for capital gains tax purposes.

The charity can ask the donor to dispose of the shares on its behalf, though it must be clear that the donor is doing so as agent of the charity.

It is usually worth considering if alternative approaches are more tax effective:

- The donor sells the investment commercially and gift aids the proceeds
- The donor sells the investment to the charity at undervalue and gift aids the proceeds.

# 4 Gifts of land and buildings

From April 2002, tax relief is also available for the gift, or sale at undervalue, of a qualifying interest in UK land and buildings to charity. The relief operates in broadly the same way as the relief for disposals of qualifying shares and securities.

Qualifying interest means a freehold or leasehold interest. Licences to occupy are excluded.

The donor must dispose of the whole of their interest in the property to qualify for the tax relief. If the donor owns the freehold and grants the charity a lease, this is treated as the whole of the donor's interest in the lease and qualifies for tax relief.

If the property is held jointly or in common, all owners must gift the whole of their interest to the beneficiary charity at the same time.

The donor must first contact the charity to confirm it can accept the gift and obtain a certificate from the charity confirming the disposal. The certificate must:

- Describe the property being gifted
- Specify the date of transfer
- State that the charity has acquired the qualifying interest in land.

There is no prescribed format for the certificate.

The donor can deduct from taxable income the market value of the property including valuation and disposal costs, less any payment or benefit received. An outright gift is also treated as a 'no gain, no loss' disposal for capital gains tax purposes and the charity is exempt from stamp duty land tax. The market value is at the date of disposal and it is advisable to obtain a professional valuation.

Donors can seek confirmation of a valuation from the Valuation Office Agency.

Anti-avoidance legislation blocks relief where the donor, or a person connected to the donor, remains in occupation of the property. However if the occupier pays a full market rent, relief is not blocked.

As with shares and securities, it may sometimes be better for the donor to sell commercially and gift aid the proceeds or sell at undervalue to the charity and gift aid the proceeds.

# 5

## Free or non-commercial renting of property

Charities sometimes obtain the use of premises for free or at a below market rent.

### **Creating a leasehold interest**

If a UK taxpayer owns the freehold of a property and lets a charity use the property for free or at a below market rate, the taxpayer can claim tax relief (as explained in section 4 above), by creating a leasehold interest in the property and granting it to the charity.

The creation of a leasehold interest should also be effective for stamp duty land tax relief and for business rate relief. The granting of a lease on property intended for use for charitable purposes qualifies for relief from stamp duty land tax and if the lease creates a separate rateable interest in the property, that interest will qualify for 80% mandatory rate relief provided the property will be used wholly or mainly for charitable purposes.

### **Non-commercial letting**

Where a landlord lets a property to a charity at a below market rate, the landlord's expenditure on that property would not normally be deductible in its income or corporation tax computations as it is partly incurred for charitable purposes and so fails the 'wholly and exclusively' test. However by concession HMRC accept that such expenses can be deducted up to the level of rent received from the charity.

## **VAT implications**

The free or non-commercial leasing or letting of property can give rise to VAT problems for the landlord.

For VAT purposes, providing the use of property for free is a non-business activity for the landlord. This means the landlord cannot recover VAT on associated costs such as maintenance or renovation of the property.

Where property is let at non-commercial rates the situation is not clear cut. Where the rent is very low (peppercorn and nominal rents) this is likely to be regarded as a non-business activity for the landlord with the above consequences. However, the VAT concept of 'business' does not require the activity to be undertaken with a view to profit, so some non-commercial letting will nevertheless qualify as a business activity for VAT purposes. The cut-off is not clear and may require clarification with HMRC.

# 6

## Gifts or use of other business assets

Businesses sometimes provide support to charities in other ways.

For example:

- Gifting business equipment, trading stock or manufactured goods
- Providing the temporary use of business assets such as the free use of a van
- Secondment of staff
- The provision of free services such as pro bono legal advice.

### **Income or corporation tax implications**

There are several specific income and corporation tax reliefs for gifts of business assets and resources:

- Outright gifts of trading assets within the capital allowances regime are treated as disposals at nil value. This enables the donor business to claim full capital allowances on the donation.
- Outright gifts of trading stock and manufactured goods to a charity are treated as sales at nil value. The business can claim a deduction against its taxable profits for the cost of the donated goods but does not have to deem any income to have been received in respect of the gift.
- Outright gifts of trading stock of medical supplies or medical equipment for humanitarian purposes are also treated as sales at nil value. There is no requirement that the recipient is a charity.
- Where a business temporarily secondments an employee to a charity, the business can deduct any expenses of the secondment (including the employee's salary costs) in its tax computations.

There is no specific relief for a gift of services and any expenses incurred in providing free services to a charity will not be deductible

for the donor, unless the donor can claim the gift was made wholly and exclusively for the purposes of its trade.

## **VAT implications**

Gifting business assets and services can sometimes have adverse VAT consequences for the donor. The basic VAT position is:

- Where a business gives away a business asset on which it recovered VAT, this is a taxable supply of goods by the business and it must account for output VAT on the value of the supply. The value of the supply is essentially the fair value of the gifted asset.
- Where a business provides temporary use of an asset on which it recovered VAT, this is a taxable supply of services by the business and it must again account for output VAT on the value of the supply. The value is determined by reference to the asset's depreciation over the period of use.
- Where a business provides services for free, if any input VAT was incurred directly in providing those services, then there is a taxable supply by the business and it must account for output VAT on the supply. The output VAT is capped at the amount of input VAT that is attributable to and recovered in respect of the free supply.

However, there are a number of exemptions.

- If goods are donated for sale, hire or export by a charity then the supply by the donor is zero-rated. The sale, hire and export of donated goods are also zero-rated activities in the hands of the recipient charity and the VAT on purchases attributable to these activities is recoverable by the charity.
- If a gift of goods is made in the course of the donor's business activities and the cost of the all such gifts to the same person is less than £50 in any 12 months there is no supply for VAT purposes and the donor does not have to account for output VAT

on the gifted goods. This typically applies to gifts of small promotional items.

- Where the value of the supply by the donor is small, HMRC officers will usually adopt a pragmatic approach and regard the supply as de minimis, so the donor can ignore any VAT implications. This would probably cover, for example, the free use of a vehicle or premises for a one off event.
- If a business second an employee to a charity, then even if the charity pays for or contributes to the business's costs of secondment, this is by concession treated as a nil value supply by the seconding business. This is subject to the condition that the placement is not done by the seconding business for financial gain. A similar concession for the placement of disabled workers exists.

If the donor does account for output VAT on the gift the recipient charity can treat this as input VAT. The donor should give the charity a normal VAT invoice overprinted with the statement: 'Tax Certificate. No payment is necessary for these goods. Output tax has been accounted for on the supply.'

# 7

## Gifts of private assets

The specific reliefs for qualifying investments and for property apply equally to gifts of such assets held privately.

Gifts of other assets, such as works of art, to a charity are treated as 'no gain, no loss' disposals for capital gains tax purposes. They are also exempt for inheritance tax purposes and if the gifts come from outside the EC, they are free from VAT on import and from customs duties.

Sales of 'pre-eminent' objects such as outstanding works of art, land and buildings to certain national museums and institutions under a private treaty arrangement may be exempt from inheritance tax, capital gains tax and VAT. The recipient body must be listed in schedule 3 to the Inheritance Tax Act 1984. Bodies which exist wholly or mainly for the purpose of preserving for the public benefit a collection of scientific, historic or artistic interest can be added to the list by Treasury Order. The arrangement is designed to encourage donors to sell to national institutions at below the normal market value. The treaty must require the vendor to share the tax saved with the institution, typically by agreeing a sale price that is less than the market value by 75% of the tax saved by the donor.

Detailed guidance on the scheme is available from the Museums, Libraries and Archives Council website (see Further Information) and donors contemplating selling a pre-eminent object can consult the Council for advice on the public institutions most likely to be interested in acquiring it.

At budget 2011 the government announced its intention to consult on introducing a tax reduction for taxpayers who give a work of art or historical object of national importance to the State.



## Anti-avoidance

The tax reliefs for gifts to charity have, on occasion, been exploited for private gain. The government has introduced various anti-avoidance measures to combat these abuses.

Finance Act 2006 introduced the ‘substantial donor rules’. The legislation deems certain transactions between a charity and its substantial donors to be non-charitable expenditure for the charity. As a result the charity becomes liable to tax on an equivalent amount of income.

A substantial donor to a charity is anyone that provides ‘relievable gifts’ of £25,000 or more in any period of 12 months, or £150,000 or more (£100,000 or more before 23 April 2009) in any period of six years. ‘Relievable gifts’ are donations of cash or property that attract tax reliefs for gift aid, payroll giving etc., but excluding the inheritance tax reliefs.

The substantial donor rules have been widely criticised. They are complex, difficult for charities to implement and, as HMRC acknowledge, capture some entirely innocent transactions.

Finance Act 2011 phases out the substantial donor rules and replaces them with a new anti-avoidance regime – the ‘tainted charity donation rules’. From 1 April 2011, no new substantial donors can be created, though the existing substantial donor rules will continue to apply, with modifications, for existing substantial donors, until April 2013.

The new anti-avoidance rule introduces the concept of a ‘tainted charity donation’. Three conditions must be met for a donation to be a tainted charity donation. Where the conditions are satisfied, the donor loses any tax relief that they would have been entitled to

claim, had the donation not been tainted. If the donation was eligible for gift aid, the donor also becomes liable to repay the gift aid to HMRC. The new rules therefore shift the tax burden from the charity to the donor. However, if the charity was a party to the arrangements and was aware at the time they were entered into that the main purpose was, for the donor, to obtain a tax advantage, then the charity is jointly and severally liable for any repayment of gift aid.

The three conditions are:

- Condition A is that a donation and arrangements entered into between the donor and another party in respect of the donation, are connected to each other.
- Condition B examines the donor's purpose in entering into the arrangement that is within Condition A. If the main purpose, or one of the main purposes of the arrangement, is for the donor (or someone connected to the donor) to receive a financial advantage directly or indirectly from the charity the donation is caught by Condition B.
- Condition C excludes donations from wholly owned charity subsidiaries and linked housing associations

It remains to be seen how the tainted charity donation rules will play out. The shift, in most situations, of the tax burden from the charity to the donor, is to be welcomed. However the rules are extremely complicated and there are concerns their effect on charities will be wider than is generally anticipated.

# 9 Conclusion

Charities that receive donations from individuals may be able to increase the value of those donations by structuring them tax efficiently. Gift aid is the best known tax relief and is a very effective route for increasing the value of cash donations from UK taxpayers. It can be administratively burdensome, but the benefits will usually outweigh the costs.

However, for businesses, other forms of giving may be more interesting to them and frequently companies are interested in a whole package to include corporate events and staff giving. Therefore, charity teams need to be aware of the whole range of tax reliefs and benefits available to companies and their owners.

In particular, dealing with major donors, you will need to be able to understand the donations and other help from their point of view. However, you may also need to explain the law to major donors if there is a potential breach of the substantial donor rules or some other aspect of tax.

Charities should never forget that donations may affect both the charity's and donor's VAT positions. The donor may have to account for output VAT on the gift and donations may restrict a charity's ability to recover VAT on purchases.

Donors to charities will expect the charity to know the rules and be able to explain them right at the beginning. So make sure your guidance and your staff know the rules so that you can make the most of the tax reliefs for giving.

# 10 Further information

***A guide to tax incentives for corporate giving***

joint HM Treasury and Home Office publication  
[www.hmrc.gov.uk/charities/guide\\_tax\\_incentives.pdf](http://www.hmrc.gov.uk/charities/guide_tax_incentives.pdf)

***Guide to tax effective giving***

Institute of Fundraising  
[www.tax-effective-giving.org.uk/index.html](http://www.tax-effective-giving.org.uk/index.html)

***Sharegift website***

[www.sharegift.org](http://www.sharegift.org)

***In Kind Direct***

[www.inkinddirect.org](http://www.inkinddirect.org)

***Valuation Office Agency***

[www.voa.gov.uk](http://www.voa.gov.uk)

***HMRC guidance on substantial donors***

[www.hmrc.gov.uk/charities/guidance-notes/annex2/annex\\_ii.htm#11](http://www.hmrc.gov.uk/charities/guidance-notes/annex2/annex_ii.htm#11)

***HMRC list of recognised stock exchanges***

<http://www.hmrc.gov.uk/fid/rse.htm>

***Museums Libraries and Archives Council website***

[www.mla.gov.uk](http://www.mla.gov.uk)

# made simple guides

**Made Simple guides are aimed at finance professionals working in charities. They cover technical areas such as risk assessment, accounting, tax and VAT treatments and aim to provide practical guidance to busy accountants in charities.**

The content of guides is correct at the time of going to print, but inevitably legal changes, case law and new financial reporting standards will change. You are therefore advised to check any particular actions you plan to take with the appropriate authority before committing yourself. No responsibility is accepted by the authors for reliance placed on the content of this guide.

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