The research provides very important new insights into donors’ potential reactions. A straightforward ‘one-size-fits-all’ solution to the challenges currently facing the Gift Aid scheme may not be feasible. It could also be argued that the only alternative to the current system that is presented in the research and likely to benefit charities is the 67p match for higher-rate taxpayers. There may also be a case for further refinement of the scenarios for change; there is therefore a fairly strong argument to opt for no change and continue to promote the current system.

Overview
The research provides very important new insights into donors’ potential reactions to some suggested changes in Gift Aid which would affect the price of giving and the balance of tax relief between donor and charity. Donor responses might also be incorporating the apparent simplicity of some options.

Care needs to be taken in drawing conclusions from the research. It is not based on a general population sample and cannot fully estimate the significance of major changes for donors. The results predict rather small benefits for charities from many of the scenarios for change; there is therefore a fairly strong argument to opt for no change and continue to promote the current system.

A straightforward ‘one-size-fits-all’ solution to the challenges currently facing the Gift Aid scheme may not be feasible. It could also be argued that the only alternative to the system presented in the research and likely to benefit charities is the 67p match for higher-rate taxpayers. There may also be a case for further research focusing specifically on options for the simplification, transaction costs and accessibility of Gift Aid.

Government has invited a robust debate on the research and the options for transforming Gift Aid, and this paper is intended as an introduction to such a debate on Gift Aid or even disposal of it altogether in line with other spending cuts.

Short and long-term effects
The introduction of a ‘composite-rate’ approach would separate the amount of tax relief reclaimable from real tax rates, meaning that donors and charities might not be able to maximize benefits when tax rates change in the future. For example, the increase in the top rate of tax to 50% for those on incomes of over £150,000 would offer these taxpayers a higher incentive to donate to charity under the current donor rebate system. Donors would not benefit from the 67p composite-rate approach.

Another point is that the way in which donors react in the short term to income tax changes is not always a predictor of how they will react in the longer term. US research indicates that long-term adjustments to changes in the tax code differ from short-term effects.

About CGAP
The ESRC Centre for Charitable Giving and Philanthropy (CGAP) is the first academic coordinating “hub” for charitable giving. CGAP’s coordinating body board includes the Charity Bank, the Office for Civil Society, the Scottish Government and Carnegie UK Trust.

For further information on CGAP, visit www.cgap.org.uk

Commentary on recent research and debate about reforming Gift Aid
December 2009

Tom McKenzie and Cathy Pharoah

The purpose of this note is to provide a commentary on recent debate and new research1 on the reform of the Gift Aid scheme through alternative options for donors. The note is intended to stimulate thinking, through focussing mainly on the research and its findings, and help charities and others come to a view on the way forward for Gift Aid.

It does not provide a detailed description of the research, which is available as a report. The note sets out the background to the research, outlines its approach and conclusions, and makes some comments both on specific and general aspects of the study, which represents an extremely important and substantive contribution to research on tax incentives for charitable giving in the UK.

Background
Charitable gifts made by individual donors through Gift Aid are worth around £3.4 billion net of tax, just under one-third of all gifts. They attract a further 67p net of tax from higher-rate taxpayers. Gift Aid induces donor contributions, which is predicted to raise around £530 million net of tax for charities. In effect the rich would be taxed to give to the charities favoured by the less well-off. While such an outcome may be attractive in some ways, it would carry political-economic consequences.

3. The total value to the charity of a Gift Aided donation (the price of giving) would increase by around 1p in real terms compared with the current system.
4. Assuming the composite rate of Gift Aid is 67p for those on £50,000.
5. The tax rate of a Gift Aid donation that would be necessary to maintain the same amount of tax reliev for taxpayers with a taxable income between £20,000 and £25,000.
6. The status of the tax payment under the composite-rate approach is currently under discussion between Treasury, HMRC and the Office for National Statistics. The risk to charities would be that it would then be easier for the government of the day to decrease the rate of Gift Aid or even dispose of it altogether in line with other spending cuts.

To give to the charities favoured by the less well-off. While such an outcome may be attractive in some ways, it would carry political-economic consequences.

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To give to the charities favoured by the less well-off. While such an outcome may be attractive in some ways, it would carry political-economic consequences.
The full report of the research is available online. In summary, the research compared the possible impacts on the value of individual donations of two basic options:

(a) Estimating the impacts of reform
Reduction makes donating more expensive for the higher-rate taxpayer with potentially damaging consequences.

At present, higher-rate taxpayers can reclaim 25p in tax credit for every pound that they donate to charity. Not all of them do, as it has been proposed that this 25p is to be recouped. In addition, the 25p Gift Aid is the charity already receives.

In other words, the total value of the charity’s pound donation from a higher-rate taxpayer would increase by £0.3125 per pound donated. On the face of it, this may seem like a good deal for charities but the downside is that this system actually makes it more expensive for a higher-rate taxpayer to donate. At present, the higher-rate taxpayer only need donate £0.85 per charity pound, whereas under the proposed reduction policy, the higher-rate taxpayer would have to donate £0.97 per pound in order to contribute £1 to the charity. Under the proposed reduction policy, the higher-rate taxpayer would have to donate £0.97 per pound in order for the charity to receive one pound (£0.97 donation plus £0.02 Gift Aid). Under the proposed reduction policy, the higher-rate taxpayer would have to donate £0.97 per pound in order for the charity to receive one pound (£0.97 donation plus £0.02 Gift Aid).

There is evidence in the report that wealthier donors are more sensitive to price and we do not know the exact impact of this because of the difficulties of estimating their true significance within overall giving.

(b) General aspects
Single-issue focus

The research was aimed primarily at exploring the reactions to changes in tax relief and the impact of this might be.

Higher-rate taxpayers might switch systems from donating with Gift Aid to payroll giving.

Under both the reduction policy and the composite rate, it would be cheaper for higher-rate taxpayers to donate via payroll giving, where they only need forgo £0.3125 in net pay for every pound that they donate to charity. In removing the higher-rate tax rebate to donors, government would have to offer a new system that either reduces the £0.85 Gift Aid per pound donated for the ‘profit’ of donating to remain at £0.85 per charity pound for the higher-rate taxpayer. Only then could the higher-rate taxpayer donate £0.85 per charity pound (85p donation plus £0.20 Gift Aid). The current price of donating for higher-rate taxpayers is £0.85 per charity pound as outlined above. The new price of donating would be between £0.87 and £0.89, representing a fall in price for basic-rate taxpayers but a rise in price for higher-rate taxpayers. As argued above, we do not know what the precise impact of this might be.

Distortion to current tax system

The research found that more than half of current higher-rate tax reclaimers who already use payroll giving.

The report highlights important differences in the responsiveness of donors to different forms of tax relief. In economics terms it should not matter whether the tax relief on donations is administrated as a payment to the charity or a payment to the donor as long as the price of donating is held constant. However, it was calculated that higher-rate taxpayers would in practice reduce their donations to a lesser extent in response to withdrawing the donor rebate than they would increase them in response to an equivalent increase in the rate of Gift Aid. This was true for both those who claim their blue rebate and those who do not. Basic-rate taxpayers also responded positively to the proposed higher rate of Gift Aid.

These findings would suggest that the Gift Aid system offers a stronger incentive to donate than the corresponding system of donor rebates. It is not clear, however, that any increase coming from the proposed composite rate approach to Gift Aid would prove a stronger attraction to the wealthier donor than a rebate, and produce more a general increase in giving. Overall, Figures 5 and 6 of the research report show that the benefits to charities of donations from donors currently reclaiming tax relief would only increase by £0.3125 per pound if a 35p match was offered, and would actually fall by 9p per pound at the 35p composite rate.

The estimated benefits of tax changes may not be sufficient to justify the risks involved.

Table 19 in the report estimates the changes in charity income from donations and relief, as well as the change in cost to the Exchequer, for proposed composite rates of 30p and 35p, and the 35p match for higher-rate taxpayers. The estimates allow for expected switching of donors to payroll giving. Results show how the value of donations and relief to charities would rise by between 3 per cent (for the 30p composite rate) and 10 per cent (for the 35p composite rate). While this would suggest that the 35p composite rate is preferable for charities, Exchequer costs would rise by 24 per cent. These predicted benefits are neither small nor even if the Exchequer costs were borne by donors. It is clear that they would outweigh the long-term risks to the charity sector associated with changing the relief system. Caution is also necessary since these estimates are based on survey responses to hypothetical scenarios and some strong assumptions about the structure of the donating population.

Commentary

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Commentary

(a) Estimating the impacts of reform
Reduction makes donating more expensive for the higher-rate taxpayer with potentially damaging consequences. At present, higher-rate taxpayers can reclaim 25p in tax relief for every pound that they donate to charity. Not all of them do, as it has been proposed that this 25p is to be reduced to the charity instead, with the additional 25p going to the charity already received. In other words, the total value to the charity of a pound donation from a higher-rate taxpayer would increase by 25p (i.e. 50p Gift Aid). On the face of it, this may seem as good a deal for charities as the current system, but in reality it does not seem to be as good as it first appears. The current system actually makes it more expensive for a higher-rate taxpayer to donate. At present, the higher-rate taxpayer only need donate £0.65 (85p donation minus 20p rebate) in order for the charity to receive one pound (£0.65 donation plus 35p Gift Aid). Under the proposed redirection policy, the higher-rate taxpayer would have to donate £0.67 (85p donation and no rebate) in order for the charity to receive one pound (£0.67 donation plus 35p Gift Aid). There is evidence in the report that wealthier donors are more sensitive to price and we do not know the exact impact of this because of the difficulties of estimating their true significance within overall giving.

Composite rate would make donating more expensive for higher-rate taxpayers but cheaper for basic-rate taxpayers. Under the composite rate, the basic rate of Gift Aid would rise for both basic and higher-rate taxpayers to a level of between 25p and 50p per charity pound donated, with the higher-rate taxpayers losing their rebate. The current price of donating for basic-rate taxpayers is £0.65 (85p donation and no rebate) per charity pound, £0.85 (85p donation plus 20p Gift Aid). The current price of donating for higher-rate taxpayers is £0.67 per charity pound as outlined above. The new price of donating would be between £0.67 and £0.85, representing a fall in price for basic-rate taxpayers but a rise for higher-rate taxpayers. As argued above, we do not know what the precise impact of this might be.

People appear to be more sensitive to changes in Gift Aid than to donor rebates. The report highlights important differences in the responsiveness of donors to different forms of tax relief. In economic terms it should not matter whether the tax relief is donated as a payment to the charity or a payment to the donor as long as the price of donating is held constant. However, it was calculated that higher-rate taxpayers would in practice reduce their donations to a lesser extent in response to withdrawing the donor rebate than they would increase them in response to an equivalent reduction in the rate of Gift Aid. This was true both among those who claim their rebate and those who do not. Basic-rate taxpayers also responded positively to the proposed higher rate of Gift Aid.

The estimated benefits of tax changes may not be sufficient to justify the risks involved. Table 19 in the report estimates the changes in charity income from donations and relief, as we did in the change in cost to the Exchequer, for proposed composite rates of 30p and 35p, and the 50p match for higher-rate taxpayers. The estimates allow for expected switching of donors to payroll giving. Results show the value of donations and relief to charities would rise by between 3 per cent (for the 30p composite rate) and 10 per cent (for the 35p composite rate). While this might suggest that the 30p composite rate is preferable for charities, Exchequer costs would go up by 24 per cent. These predicted benefits are neither small and, even if they were, it is not clear that they would outweigh the long-term risks to the charity sector associated with changing the relief system. Caution is also necessary since these estimates are based on survey responses to hypothetical scenarios and some strong assumptions about the structure of the donating population.

(b) General aspects
Single-issue focus
The research was aimed primarily at evaluating the incentive power of Gift Aid and not at accessibility, transaction costs or the impact of changes to personal income tax rates on charities. It was a study of donors, exploring donors’ psychological and economic reactions to changes in tax relief, and whether total amounts given to charities would rise by between 3 per cent (for the 30p composite rate) and 10 per cent (for the 35p composite rate). While this might suggest that the 30p composite rate is preferable for charities, Exchequer costs would go up by 24 per cent. These predicted benefits are neither small and, even if they were, it is not clear that they would outweigh the long-term risks to the charity sector associated with changing the relief system. Caution is also necessary since these estimates are based on survey responses to hypothetical scenarios and some strong assumptions about the structure of the donating population.

Transaction costs: processing Gift Aid requires resources which come at a cost to both charities and donors: the costs of reclaiming tax reliefs are often left to the charities.

Incentive power: low take-up of Gift Aid and donor tax rebates raises questions about the extent to which they are effective options for incentivising more donors to give more, and to increase value to charities.

Impact of tax changes: the reduction to personal income tax rates effective from 2009 reduced the value of Gift Aid to charities, and its transitional tax relief rate available to compensate for this by government calls to an end in 2011, potentially leaving a gap in charity funding.

An extensive consultation process has been carried out, which has led to some modifications aimed at streamlining the scheme and a package of donor awareness-raising and charity training measures.

Ideas for more ‘cost-in-line’ reform of the way in which Gift Aid worked were also put forward in the consultation process, and a number of options for donors were explored in recent research published by HMRC and HM Treasury.

Scopes of the research (in brief)
The full report of the research is available online. In summary, the research compared the possible impacts on the value of individual donations of four basic options:

- ‘Re-direction’ – an option under which income tax relief on charitable giving is currently reined by higher-rate taxpayers, a ‘rebate’, is paid back to charities; or
- ‘Composite rate’ – an option under which higher-rate tax relief would be abolished and its place charities could simply re-claim a larger ‘composite’ rate of tax relief, set at a value between standard and higher-rate tax relief.

Using these two options, the research constructed seven different scenarios for giving and tested their likely effects on levels of giving and cost of tax relief to the Exchequer.

Findings of the research (in brief)
Main findings from the research are that:

- across the scenarios examined for changing Gift Aid, the majority of donors reported that they would continue to donate at the same rate, provided their contribution was processed; a small but sizeable minority of donors preferred a Gift Aid system in which a ‘rebate’ on donations carries claimed by themselves; it is possible that a new scenario produced very different results from donors in relation to changes to the value of cash donations, gross donations, and the costs of tax relief to the Exchequer; any change would likely to have winners and losers, and different charitable causes would experience negative or positive effects.

- the various Gift Aid options put forward have implications for accessibility, transaction costs and the impact of future tax changes, but alternative solutions for these issues per se were not studied, and would benefit from being assessed on their own merits.

- there is evidence within the report that wealthier donors are more sensitive to price and we do not know the exact impact of this because of the difficulties of estimating their true significance within overall giving.

- it was calculated that higher-rate taxpayers would in practice reduce their donations to a lesser extent in response to withdrawing the donor rebate than they would increase them in response to an equivalent reduction in the rate of Gift Aid. This was true both among those who claim their rebate and those who do not. Basic-rate taxpayers also responded positively to the proposed higher rate of Gift Aid.

- the estimated benefits of tax changes may not be sufficient to justify the risks involved.

- the research was aimed primarily at evaluating the incentive power of Gift Aid and not at accessibility, transaction costs or the impact of changes to personal income tax rates on charities. It was a study of donors, exploring donors’ psychological and economic reactions to changes in tax relief, and whether total amounts given to charities would rise by between 3 per cent (for the 30p composite rate) and 10 per cent (for the 35p composite rate). While this might suggest that the 30p composite rate is preferable for charities, Exchequer costs would go up by 24 per cent. These predicted benefits are neither small and, even if they were, it is not clear that they would outweigh the long-term risks to the charity sector associated with changing the relief system. Caution is also necessary since these estimates are based on survey responses to hypothetical scenarios and some strong assumptions about the structure of the donating population.
An extensive consultation process has been carried out, which has led to some modifications aimed at simplifying the scheme and a package of donor awareness-raising and charity training measures.

Ideas for more 'cost-in-kind' reform of the way in which Gift Aid was also put forward in the consultation process, and a number of options for donors were explored in recent research published by HMRC and HM Treasury.

Commentary
(a) Estimating the impacts of reform

Reduction makes donating more expensive for the higher-rate taxpayer with potentially damaging consequences.

At present, higher-rate taxpayers can reclaim 25p in tax credit for every pound that they donate to charity. Not all of them do, it is thought, because it was proposed that the 25p be redirected to the charity instead: in addition to the 25p Gift Aid the charity already receives. In other words, the total value to the charity of a pound donation from a higher-rate taxpayer would increase to £1.50 (one pound donation plus 50p Gift Aid). On the face of it, this may seem like a good deal for charities but the downside of the system actually makes it more expensive for a higher-rate taxpayer to donate. At present, the higher-rate taxpayer only need donate £0.50 (50p donation minus 25p rebate) in order for the charity to receive a pound (50p donation plus 25p Gift Aid). Under the proposed redirection policy, the higher-rate taxpayer would have to donate £0.75 (50p donation and no rebate) in order for the charity to receive a pound (75p donation plus 25p Gift Aid).

There is evidence in the report that wealthier donors are more sensitive to price and we do not know the exact impact of this because of the difficulties of estimating their true significance within overall giving.

Composite rate would make donating more expensive for higher-rate taxpayers but cheaper for basic-rate taxpayers.

Under the composite rate, the rate of Gift Aid would rise for both basic-rate and higher-rate taxpayers to a total amount of between 25p and 50p per pound donated, with the higher-rate taxpayers losing their rebate. The current price of donating for basic-rate taxpayers is £0.60 (60p donation and no rebate) per charity pound, which is 60p per charity pound as outlined above. The new price of donating would be between £0.60 and £0.65, representing a fall in price for basic-rate taxpayers but a rise in price for higher-rate taxpayers. As argued above, we do not know what the precise impact of this might be.

Higher-rate taxpayers might switch systems from donating with Gift Aid to payroll giving.

Under both the redirection policy and the composite rate, it would be cheaper for higher-rate taxpayers to donate via payroll giving, where they only need forgo 60p in net income instead of paying 25p in tax credit for every pound that they donate to charity. In reordering the tax relief to donors, government would have to offer a total of £0.70 Gift Aid per pound donated for the 'price' of donating to remain at 60p per pound for the higher-rate taxpayer. Only then could the higher-rate taxpayer donate £0.50 (50p donation and no rebate) for the charity to receive one pound (50p donation plus 40p Gift Aid). There is evidence in the report that more than half of current higher-rate tax reclaimers who already use payroll giving would actually fully pay it if 40p Gift Aid were available.
From tax relief to government spending

A ‘composite rate’ approach runs the risk of converting donor tax relief into government tax revenue. The status of the tax payment under the composite-rate approach is currently under discussion between Treasury, HMRC and the Office for National Statistics. The risk to charities would be that it would then be easier for the government of the day to decrease the rate of Gift Aid or even dispose of it altogether in line with other spending cuts.

Overview

The research provides very important new insights into donors’ potential reactions to some suggested changes in Gift Aid which would affect the price of giving and the balance of tax relief between donor and charity. Donor responses might also be interpreted as incorporating the apparent simplicity of some options.

Care needs to be taken in drawing conclusions from the research. It is not based on a general population sample and cannot fully estimate the significance of major assumptions. The price of donating for both basic-rate and higher-rate taxpayers who donate would effectively be subsidising the donations of basic-rate taxpayers, making the tax system more progressive. In effect the rich would be taxed to the current system that is presented in the research and likely to benefit charities and continue to promote the current system. Charities would not benefit from this with composite-rate approach.

About CGAP

The ESRC Centre for Charitable Giving and Philanthropy (CGAP) is the first academic research centre in the UK dedicated to research on charitable giving and philanthropy. Three main research strands focus on individual and business giving, social redistribution and charitable activity, and the institutions of giving. CGAP is a consortium comprising Cass Business School, University of Edinburgh Business School, University of Kent, University of Southampton, University of Strathclyde Business School and NCVO.

CGAP’s coordinating ‘hub’ is based at Cass Business School. CGAP is funded by the ESRC, the Office for Civil Society, the Scottish Government and Carnegie UK Trust. For further information on CGAP, visit www.cgap.org.uk

About the authors

Tom McKenzie is a research officer specialising in economic analysis. At CGAP he focuses on patterns of giving in the UK using national household survey data. Tom graduated with a degree in economics from the University of Bonn and taught personnel economics at the University of Cologne before joining Cass Business School in 2009.

Cathy Pharoah is professor of charity funding at Cass Business School and co-director of CGAP Hub. Research work includes an annual report on charity funding, supported by the Pears Foundation, as well as the Charity Market Monitor published by CaritasData, an annual update on the finances of the UK’s major fundraising charities. Cathy has published many other reports on aspects of charity funding. She is treasurer of the Voluntary Sector Studies Network (VSSN), and a member of the editorial board of Voluntary Sector Review.

The purpose of this note is to provide a commentary on recent debate and new research1 on reforming the Gift Aid scheme through alternative options for donors. The note is intended to stimulate thinking, through focussing mainly on the research and its findings, and help charities and others come to a view on the way forward for Gift Aid.

It does not provide a detailed description of the research, which is available as a report. The note sets out the background to the research, outlines its approach and conclusions, and makes some comments both on specific and general aspects of the study, which represents an extremely important and substantive contribution to research on tax incentives for charitable giving in the UK.

Background

Charitable gifts made by individual donors through Gift Aid are worth around £3.4 billion per year. They attract a further 67p per pound donated, which lies between 67p and 25p. The ’price of donating’ of this tax relief varies between these two limits for donations below £10,000.

1 The extent to which the sample represents the population assumptions is presented on p12.
taxpayers who donate would effectively be subsidising the donations of basic-rate taxpayers, meaning that donors and charities might not be in a position to give to the charities favoured by the less well-off. While such an outcome may be attractive in some ways, it would carry political-economic consequences.

Short and long-term effects

The introduction of a ‘composite-rate’ approach would separate the amount of tax relief reclaimable from real tax rates, meaning that donors and charities might not be able to maximise benefits when tax rates change in the future. For example, the increase in the top rate of tax to 50% for those on incomes of over £150,000 would offer these taxpayers a higher incentive to donate to charity under the current donor rebate system. Charities would not benefit from this higher composite-rate approach.

Another point is that the way in which donors react in the short term to income tax relief may affect the price of giving and accessibility of Gift Aid. Taxpayers who donate might be left with less disposable income, which may reduce charitable giving.

Care needs to be taken in drawing conclusions from the research. It is not based on a general population sample and cannot fully estimate the significance of major expenditure changes. The risk to access and sustain the current donor rebate system is that it would then be easier for the government of the day to decrease the rate of Gift Aid or even dispose of it altogether in line with other spending caps.

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For further information on CGAP, visit www.cgap.org.uk

Commentary on recent research and debate about reforming Gift Aid

The purpose of this note is to provide a commentary on recent debates and new research on reforming the Gift Aid scheme through alternative options for donors. The note is intended to stimulate thinking, through focussing mainly on the research and its findings, and help charities and others come to a view on the way forward for Gift Aid.

It does not provide a detailed description of the research, which is available as a report. The note sets out the background to the research, outlines its approach and conclusions, and makes some comments both on specific and general aspects of the study, which represents an extremely important and substantive contribution to research on tax incentives for charitable giving in the UK.

Background

Charitable gifts made by individual donors through Gift Aid are worth around £3 4 billion net of tax, just under one-third of all giving. They attract a further 67p net of income tax relief on giving which is paid back to charities by government. Though Gift Aid is a popular, popular and widely understood way for the government to encourage giving, there are a number of significant current challenges to the effectiveness and impact of the scheme. Some of the information on Gift Aid published by the government in 2009. The main challenges are:

1. Accessibility/take-up: Gift Aid is not fully efficient, as it is used only for just one-third of donations for one-third of donations, though potentially the majority of donors and gifts would be eligible.

CGAP Briefing Note

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