

## Gift Aid Forum – report to Economic Secretary to the Treasury

### ISSUE

1. The Gift Aid Forum addressed the question 'Does Gift Aid need to be reformed and if so how?'

### RECOMMENDATIONS

2. My recommendations to Ministers are:
  - a) **Recommendation 1** : That Government celebrates Gift Aid as a success which enables donors to give to charities and other eligible bodies, a gift and the tax paid in relation to the gift. The donating public must not pick up the message that Gift Aid is broken. The ambition to reform should be balanced with costs, at a time of fiscal consolidation, and the risks of undermining what is already a successful scheme for much of the charities sector. However, small charities are particularly vulnerable at times of economic stress and some find dealing with Gift Aid difficult. Their needs should be a priority.
  - b) **Recommendation 2** : That Government and the charities sector develop a joint programme to promote giving to charities, recognising their contribution to society, for launch in early 2011; noting all of the money that charities receive through the Gift Aid system comes from donors.
  - c) **Recommendation 3** : That the Government explain and promote Gift Aid to taxpayers and charities as part of the general programme to promote charitable giving - along the lines, 'giving is good; giving through Gift Aid gives more'.
  - d) **Recommendation 4 .1** : That the Government should publish a work programme including a timetable for examining and ideally implementing the long list of reforms to the administration of the Gift Aid system set out in the appendix, perhaps under the banner, 'standardise and simplify'.

- e) **Recommendation 4.2** The work programme should give priority to reforms which remove the requirement for mandatory paper declarations, through for example, creating a standard Gift Aid database, ideally available to charities as a free download from the internet. This would remove paper from the system and will be of particular benefit to smaller charities.
- f) **Recommendation 4.3** : The work programme should also give priority to proposals for enabling higher rate taxpayers to redirect the relief on their donations to charities, thereby increasing the value of donors' gifts and their incentives to give.
- g) **Recommendation 4.4** : The work programme should schedule the start of work on arrangements to digitise Gift Aid including enabling charities to submit Gift Aid claims online and donors to make gifts using mobile phones.
- h) **Recommendation 4.5** : The work programme should be published before the next Budget and should be informed by advice from the Office of Tax Simplification, charities, fundraisers and professionals advising them. Ministers should give consideration to commissioning an independent person to bring together this advice.
- i) **Recommendation 4.6** : The work programme should not consider proposals that will cause Gift Aid as a whole to be reclassified as public expenditure.
- j) **Recommendation 4.7** : The Gift Aid Forum should be disbanded.
- k) **Recommendation 5** : Ministers should consult with the tax profession to explore how tax professionals might donate their skills and time to help charities comply with and benefit from the Gift Aid system.
- l) **Recommendation 6** : That Ministers should have regard to the particular needs of small charities in the implementation of these proposals and give them priority when there is less pressure on public expenditure.

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## DISCUSSION

3. In addition to considering reform to Gift Aid in general, the Gift Aid Forum was specifically asked to consider the option of leaving Gift Aid largely unchanged against the options of a composite rate or tiered composite rate.
4. I start by the observation that contrary to some comment in the press, the Gift Aid system is not broken - it should be seen as a success. In 2009/10 charities received over £1,000 million from HMRC, as the tax claimed on around £3,500 million of donations made through the Gift Aid system - that is over £4,500 million of income in total.
5. While Gift Aid can be made better it is instructive to consider what better would look like and what are the costs and risks of reform and how long would any reform take. For the purposes of comparing reforms 'good' is assumed to be - More money for More charities raised at Less cost to charities, donors and HMRC. All monies raised through Gift Aid come from donors - the payments made by HMRC to charities can be regarded as the tax paid by the donor in respect of the gifts donated to charities (a fine point is that the tax reclaimed may not always equal the tax paid in respect of the gift).
6. Against these assumptions the biggest effect on charities' income would be achieved by increasing the overall level of giving through the Gift Aid system. Even a marginal - say a 1% increase in the monies raised through Gift Aid would increase the income to the sector by £45 million. Moreover, it is not unreasonable to argue that increases at this level could be achieved quickly through promotion and advertising without material risk or cost.
7. Also it is essential to increase donor's willingness to give and to give through Gift Aid. There are risks that donors - both large and small - will hear arguments about the mechanics of the Gift Aid system as something other than what they are and become less willing to give or give through Gift Aid.
8. Transitional relief is an exception as it is public expenditure - £105 million in 2009/10 - on charities which is scheduled to expire in April 2011 and would be equivalent to a cut

of over 10% in the income charities received from HMRC through Gift Aid. However this is only around 2% of the cash flowing through Gift Aid.

9. Turning to the composite rate and the tiered composite rate, it is difficult to see how they would bring materially more money into the charities sector unless government pays more. However they will, bring additional risks and costs.
10. In either variant of the composite rate a charity would reclaim the tax paid in respect of a donation at a rate above the current basic rate. This additional cost would be funded either by abolishing higher rate relief (£310 million in 2009/10) or by government support, which I will not consider further as the Gift Aid Forum was asked to look at tax reform not public expenditure. The amount redistributed is small - equivalent to only 7% of the amount charities receive through Gift Aid. There would be forced redistribution within the sector - even assuming, heroically, that donors do not change their behaviour. The tiered composite rate gives donors above the tier tax relief and denies it to those below. This divides the higher rate donor community even though less higher rate relief is claimed than is available to claim.
11. It is also argued that donors are moved to give by the appeal of a specific charity. Some argue that the composite rate and its variants weaken the connection between 'my gift and my charity' as the message will in effect be 'give to my charity and the government will give more to the sector - but not necessarily to my charity'. These arguments over the distribution of additional relief for higher rate taxpayers on gifts made through Gift Aid may disturb the relationship with donors and nudge them in unpredictable directions.
12. The composite rate has attractions as a simplification measure - especially if the rate was also applied to donations from non-taxpayers - but the composite rate would change the arguments underpinning Gift Aid as higher rate taxpayers' tax would be donated by government not by taxpayers. And there is a risk - a certainty if non-taxpayers are included - that some or all Gift Aid would be reclassified as public expenditure, competing for public funds alongside all other claims on the Exchequer. Any benefits would be deferred probably into 2012 or later as both approaches would require legislation and administrative changes both in HMRC and charities.

13. Debates over the composite rate on the Gift Aid Forum exposed some of the reasons why the Forum found it impractical to unite around a single proposition. Proponents saw the composite rate as a mechanism for increasing government support for the sector, or a simplification measure, or a way of equalising the tax treatment of donors. Opponents saw the composite rate as undermining philanthropy especially amongst donors to the arts and education sectors.
14. On balance, I believe the arguments against the composite rate and its variants are far more compelling than those in favour; not least because all the benefit charities receive comes from donors so reforms should be focused on them.
15. I am particularly taken by the argument that Gift Aid is successful because it enables a charity to say to a taxpaying donor - give through Gift Aid and you give more. This message would be strengthened if charities could say to higher rate taxpayers - 'give through Gift Aid and you give more and you could donate your higher rate tax relief as well'. Put more elegantly this is a strong argument. I understand that HMRC have concerns about the difficulties of enabling higher rate taxpayers to redirect their relief to charities but I think it is a reform worth working at because it is focused on where the money comes from - the donors - rather than where it is spent.
16. The Gift Aid Forum process has precipitated many ideas for reforming the way Gift Aid works for charities. It is instructive to note that the relative merits of these ideas are difficult to assess but Gift Aid works well for many donors and charities - large and small. There is clearly a risk that introducing a reform may have the unintended consequence of making the Gift Aid system more complex overall.
17. The Government has set up the Office of Tax Simplification to advise it on making the tax system simpler. It would be consistent with the Chancellor's existing policy if the Office were asked to advise on any programme of reforms that improves the operation of Gift Aid whilst at the same time making the system less complex, as the Government has decided to do.

18. It is also important to seek advice directly from those who operate the Gift Aid system - that is fundraisers and finance directors and their professional advisers.
  
19. The simplification policy also touches on the risk of seeking reform through changing the system rather than the people who work with the system. The Gift Aid Forum heard anecdotal evidence that some small charities find Gift Aid very difficult to operate whereas others take advantage of Gift Aid, comfortably. For example, the Church of England currently has over 10,000 parishes (charities) that reclaim a total of about £80m a year in tax (that is less than £8,000 per typical parish). The Church has been working on tax-effective giving since at least the 1960s, and by 1999 (pre the phasing out of covenants) were collecting tax refunds on 56% of its donor income (collections etc).
  
20. An unsung benefit of Gift Aid is that HMRC processes claims on a 'repay now, check later' basis bringing material cashflow benefits to charities and other claimants. Some of the paperwork and compliance overhead can be attributed to this benefit as HMRC has to ensure that tax has been paid in respect of the gift and fraud on government outflows of around £1 billion a year, is prevented.
  
21. This suggests that reform of Gift Aid is a people issue as well as a systems issue - if more people who are able to take advantage of Gift Aid helped those who cannot - then charities would raise more income through the Gift Aid system. There is an opportunity for Government to call on the professional community to direct its charitable activity towards taking advantage of the Gift Aid system.
  
22. The think-tank ResPublica published some proposals at the beginning of September which at their heart proposed that donors should be able to donate through their mobile phones and charities should be able to claim tax repayments online. At present donors can donate via Gift Aid online but not through their mobile phones and charities must submit their claims in paper form.
  
23. ResPublica's proposals are too new for a full analysis of their deliverability. However, it is clear that implementation requires public expenditure on IT systems procured by HMRC, with all the inherent risks. In addition there is the risk that a narrative that says Gift Aid is broken may undermine the 'bargain' with the current donors and charities and weaken the £4,500 million currently flowing through the system. For example, collecting

donations in a bucket creates an emotional link between the donor and collector which perhaps is not as strong when donating through a mobile phone.

24. That said, ResPublica's proposals are exciting and bring together something for donors - especially young donors - donating by mobile phone - and charities - claiming entirely online. They point to how a successful system can be made even better - when the Government can turn it's attention to new spending.
  
25. Finally, the Gift Aid Forum facilitated a dialogue both within the charities community and between it and government. Many ideas were precipitated and debated and all involved had an opportunity to learn. It was successful as a policy development group. However, the Forum was not constituted in a way that drove it to produce recommendations to government. That is why I eventually offered to produce a report for submission to Ministers under my own name. I have sought to capture the consensus and I hope that all those involved in the Gift Aid Forum can see their ideas reflected within the submission and the appendices. However, I take responsibility for the report and the recommendations.
  
26. The ideas of the Gift Aid Forum need to be weighed against each other and the Government's priorities and HM Treasury's and HMRC's resources. I urge Ministers to commission an individual with influence and independence to offer advice based on consultation within the sector and those that advise it.
  
27. The arguments are analysed more fully in the appendices.

**Peter Fanning**  
**Chief Executive**  
**The Chartered Institute of Taxation**

**Appendices**

28. Appendix 1 : Overview of Gift Aid

29. Appendix 2 : Options for increasing resources received by charities

30. Appendix 3 : Options for reducing the costs to charities, donors and HMRC of operating the Gift Aid system and a long list of potential reforms

31. Appendix 4 : 'Lubricating the mechanism'

## Appendix 1 : OVERVIEW OF GIFT AID

32. HMRC statistics show <sup>1</sup> that in 2009/10 UK charities received over £4,500 million through the Gift Aid system:

- a) £3,600 million was donated by individual UK tax payers to charities
- b) £1,000 million was reclaimed from HMRC by charities under Gift Aid - including transitional relief which expires on 05 April 2011
- c) £300 million was reclaimed by higher rate tax payers from HMRC

33. So for every £1 flowing through the Gift Aid system, approximately 93p goes to charities and 7p goes to donors.

- a) **Recommendation 1** : That Government celebrates Gift Aid as a success which enables donors to give to charities and other eligible bodies, a gift and the tax paid in relation to the gift. The donating public must not pick up the message that Gift Aid is broken. The ambition to reform should be balanced with costs, at a time of fiscal consolidation, and the risks of undermining what is already a successful scheme for much of the charities sector. However, small charities are particularly vulnerable at times of economic stress and some find dealing with Gift Aid difficult. Their needs should be a priority.

34. Almost all of the £1,300 million of relief paid to charities and donors is an example of what will be referred to as tax expenditure. Tax allowances, that is reliefs or tax expenditures do not score as public expenditure and are treated as negative taxation in the national accounts if they meet all the following criteria <sup>2</sup>:

- a) The benefit to individual taxpayers does not exceed the amount of tax paid by them;
- b) It is made as a matter of economic policy; and

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<sup>1</sup> <http://www.hmrc.gov.uk/stats/charities/menu.htm>

<sup>2</sup> [http://www.statistics.gov.uk/downloads/theme\\_economy/concepts\\_sources\\_methods.pdf](http://www.statistics.gov.uk/downloads/theme_economy/concepts_sources_methods.pdf)

- c) The allowance is an integral part of the tax system.
35. For example, in 2009/10 charities claimed £902 million in Gift Aid which scores as tax expenditure in the national accounts and £105 million in transitional relief which scores as public expenditure in the national accounts, although it is part of the Gift Aid system. Transitional relief is due to expire in April 2011 which means a cut of over £100 million a year in government support for the charity sector.
36. The classifications of transactions in the national accounts are made by the Office of National Statistics (ONS) which is the executive office of the UK Statistics Authority, a non-ministerial department which reports directly to Parliament.
37. The voluntary sector also receives sums of money that are not eligible for Gift Aid including grants, trading and legacies. In addition, the sector also receives money that is potentially eligible for Gift Aid but it is donated in ways that currently prevent Gift Aid being claimed; for example donations given through collection tins and one-off donations at events.
38. Charities are not all the same and as well as having different objectives they vary in many other ways.
39. The Charity Commission<sup>3</sup> reports that in 2010 there were:
- a) 162,194 charities with annual income of £52,514 million - which means that Gift Aid donations account for approximately 8.6% of the aggregate income of the charities sector.
  - b) 140,588 charities had income below £500,000 with an aggregate income £5,831 million - that is 86.7% of the sector accounted for 11.1% of the sector's income.
  - c) 1.1% of the sector - under 2,000 charities account for 66.9% of the sector's income, that is £35,126 million and receive.
40. Clearly there are a very large number of small and medium sized charities and a very small number of very large charities.

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<sup>3</sup> The Charity Commission covers England and Wales

41. In addition there are tens of thousands of organisations that have either 'excepted or exempt' status and so are not registered with the Charity Commission but are nevertheless eligible for tax reliefs. Such organisations include churches, Higher Education Establishments, Museums, Galleries. Community Amateur Sports Clubs (CASCS) are also eligible to use Gift Aid but are not charities.
42. Furthermore, the Charity Commission statistics show that in the 5 years to 2009, the total number of charities fell but the annual gross income of the sector rose by over 36% and the number of charities with annual income over £10 million rose by 46%.
43. This pattern is reflected in the survey of the sector by the 'Simplification Group' led by the Charity Tax Group (CTG)<sup>4</sup> and published in July 2010, showed that 46% of the charities that responded had incomes under £99,000 per year while 14% had incomes in excess of £10 million per year.
44. However, only 68,000<sup>5</sup> charities claimed Gift Aid in 2009/10 which is a small proportion of the number eligible to claim Gift Aid and other tax reliefs. However, many charities rely on grants and other sources of income rather than donations so the number of charities eligible to use Gift Aid never equals the number that actually use Gift Aid.
45. Charities are not always run by charity professionals - trustees have a variety of backgrounds from celebrities through to working parents.
46. Charities often focus on a particular sector of society which requires help. Under the Equality Act 2010 UK Charities will, unlike most other sectors, be able to continue to exercise discrimination where the governing document permits benefits to persons who share a 'protected characteristic' such as ethnicity, disability, sexual orientation, religion or belief.' The need to be able to do this demonstrates the inherent variation within the charities sector.

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<sup>4</sup> This survey was put together and distributed by Charity Finance Directors' Group and CTG, the Small Charities Coalition, Stewardship, Churches' Legislation Advisory Service, and the Institute of Fundraising and was designed as a sector-led consultation on the main proposals for Gift Aid simplification outlined in the CTG paper.

<sup>5</sup> <http://www.hmrc.gov.uk/stats/charities/table10-4.pdf>

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47. However, it is instructive that over 70% of all charities' registration applications to the Charity Commission are now voluntarily submitted online, together with over 75% of annual return or update submissions and 98% of people choosing to read their guidance online.<sup>6</sup> This indicates the willingness of the sector to embrace the online world.
48. Not only are donors different, donations to charities come in a variety of forms, demonstrating the breadth of the sector and its income. In addition to donations of money from higher rate, basic rate or nil rate taxpayers, donations include:
- a) Bequests in wills;
  - b) Gifts of shares, land and buildings;
  - c) Donations of surplus business assets;
  - d) Provisions of surplus goods to charity shops, the proceeds of which are often gift aided to charity;
  - e) Donations of time as volunteers – from assistance in charity shops, running major events through to professional advice.

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<sup>6</sup> See [http://www.charitycommission.gov.uk/About\\_us/About\\_the\\_Commission/ccnews31.aspx#doing](http://www.charitycommission.gov.uk/About_us/About_the_Commission/ccnews31.aspx#doing)

49.

**Appendix 2 : OPTIONS FOR INCREASING THE MONEY RECEIVED BY CHARITIES**

50. Noting that through the Gift Aid system, in 2009/10, £3,600 million was donated by UK tax payers to charities, £1,000 million was reclaimed from HMRC by charities under Gift Aid and £300 million was reclaimed by higher rate tax payers from HMRC.

51. Charities would receive more money through the Gift Aid system if:

- a) Donors paid more – donors account for ALL of the resources charities receive through Gift Aid (with the exception of transitional relief which accounts for around 2% of total cash flow through Gift Aid)
- b) More donors sign up for Gift Aid.
- c) More charities claimed Gift Aid - and claimed more Gift Aid through making full advantage of the arrangements.
- d) Tax expenditure on charities was increased – for example, government might increase £900 million of tax expenditure on charities by paying amounts that were not directly related to individual donations or relax the eligibility criteria further.
- e) Tax expenditure on donors was re-distributed to charities – for example, the composite rate and its variants could re-distribute c£300 million of higher rate relief from donors to charities. This assumes 'all other things being equal' which is unlikely as there is evidence that the behaviour of some donors will change and there a material risk that some or all Gift Aid would be reclassified as public expenditure.

52. Although dealt with in the next section any reduction in the costs to charities of administering Gift Aid would also mean they have additional resources available.

53. The pros and cons of each of these options are explored briefly below.

**Donors pay more and pay more through Gift Aid**

54. Donors are the only contributors to charities under Gift Aid.

55. The Gift Aid income received by the charities is equivalent to the basic rate of income tax paid by the donor on the gross gift. The principle is that a taxpayer should not have to pay tax on an asset donated (rather than consumed or used for their own purposes), then the payments made by HMRC through the Gift Aid system generally repay tax that was paid but is not due.
- a) It is instructive to note that there is no consistent link between the rate of tax claimed by the charity and the rate of tax paid by the donor. For example, if a donor has no income but only pays capital gains tax, they can still use Gift Aid – the donor is taxed at 18% and the charity claims at 20%.
56. However, an essential feature of Gift Aid is that a donor makes the decision to give to their chosen charity not a Minister or official. Gift Aid is often seen as being built on the principle that the payment made by HMRC is part of the donation made by the donor.
57. Action supported by government, to encourage giving would have the greatest impact on the money received by charities. However, unless tackled directly, there is a risk that a general rise in donations would result in large charities getting proportionally more and smaller charities proportionally less, simply because of the capacity of larger charities to take advantage of any new initiatives.
58. For example, the Government might develop a campaign to encourage giving generally. Such a campaign might be enhanced by government encouragement to donors to sign up for Gift Aid.
59. Examples of government action to raise more for charities from donors are to:
- a) Promote regular giving through direct debits, by for example providing a higher element of tax relief, payable direct to the charity, against those payments from individuals who sign up to regular direct debits to charity.
- b) Integrate the Gift Aid rules and the payroll giving rules, to make giving through a payroll more attractive (a donation through a payroll is not a donation under Gift Aid, so only the donor obtains relief).

- c) Align the payroll giving deduction for both National Insurance and income tax, providing an additional relief but encouraging more employers to take up the scheme and more employees to contribute.
- d) Local groups and businesses might be encouraged to pool funds that can be used to match individual donations to local charities.
- e) A general marketing campaign might develop the Gift Aid 'brand' drawing on best practice amongst marketing professionals - for example, a 'Thank you - you have given extra'. Campaigns might be timed having regard to the bonus season in the City. The use of creative incentives might be explored - for example, DVLA uses a prize draw to encourage motorists to renew their tax online.
- f) In parallel with a general campaign to promote giving and giving through Gift Aid, HMRC might promote Gift Aid in a way that reduces taxpayer's anxieties of dealing with Gift Aid - for example, 'HMRC says giving is good, giving through Gift Aid is better'.

### **More charities use Gift Aid more**

60. Many charities do not use Gift Aid or do not take full advantage of it.

61. As noted above, around 68,000<sup>7</sup> charities claimed Gift Aid from a potential population of over 162,000<sup>8</sup> charities and nearly 5,800<sup>9</sup> CASC and other bodies who are also eligible to claim Gift Aid. Clearly even a small increase in usage would bring more income into the sector.

62. There is some evidence the either real or perceived difficulties in coping with the administration of Gift Aid accounts for a significant portion of those eligible bodies who do not take advantage of Gift Aid.

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<sup>7</sup> <http://www.hmrc.gov.uk/stats/charities/table10-4.pdf>

<sup>8</sup> Charities Commission

<sup>9</sup> <http://www.hmrc.gov.uk/casc/clubs.pdf>

**Tax expenditure on charities increased**

63. The boundaries of the payments on which charities can claim Gift Aid relief are constantly being explored. For example, HMRC has had to issue guidance on the application of Gift Aid to charitable auctions, and the proceeds from the sale of goods in charitable shops, as they were not covered or conceived as being within the original scope of Gift Aid.

64. Government could increase the scope of donations upon which Gift Aid relief can be claimed, to include, for example :

- a) Donations from non-taxpayers - notwithstanding the accounting issues that are raised,
- b) Donations of goods and services from individuals.

65. Pros include:

- a) More money and resources to charities - possibly
- b) More opportunities to interest and attract donors
- c) A simpler message – public mindset that ‘anything I give to charities gets extra tax relief’
- d) Simpler administration in some circumstances.

66. Cons include:

- a) More complexity – as HMRC would have to police a more complex boundary, raising audit costs and accounting volumes
- b) Greater risk of fraud

c) Possibly a cost to government

d) More employers dealing with the donations system

67. Government could change the basis on which the relief remitted to charities is paid, probably by removing the direct link to individual taxpayers.

68. Pros include:

a) Administrative savings – particularly if charities don't have to record donations or get taxpayers to sign up, so more donations qualify

b) Government can pay to charities what they wish to. For example, transitional relief.

69. Cons include:

a) In some situations, losing the link with donors thereby reducing opportunities to interest and attract them

b) Risks of tax expenditure being reclassified as public expenditure.

c) Risks that future governments may reduce payments

d) Some charities may win and others may lose depending on the formula used by government

e) Cost to government

70. Tax expenditure to charities could be increased by extending Gift Aid to other taxes but this is outside the scope of the Forum's remit and will not be considered further.

#### **Tax expenditure on donors re-distributed to charities - composite rate**

71. Other than direct public expenditure the main option considered for financing a composite rate that enabled charities to claim Gift Aid at a rate above the basic rate was the abolition of higher rate relief on Gift Aid donations. Therefore, the composite rate

and its variants could re-distribute c£300 million of higher rate relief from donors to charities.

72. For example, some estimates show that a pre-tax composite rate of 23% (or 30% post tax, that is on the donations) would redistribute the £300 million in relief on Gift Aided donations paid by HMRC to higher rate taxpayers to charities, leaving the charity sector as a whole broadly neutral. However there would be some redistribution within the sector and this assumes of course that donors do not change their behaviour, which is a heroic and probably unrealistic assumption.
73. An issue for the composite rate would be the arrangements for making and updating the calculation. The rate could be calculated by HM Treasury or HMRC or another body. The rate could be set under arrangements with varying degrees of statutory certainty - that is with greater or lesser discretion given to the rate setters. Each of these options will have their own arguments for and against.
74. However calculated, a composite rate which redistributed higher rate relief would be greater than the current basic rate of 20% and would probably be in excess of 23%.
75. The composite rate at or below the current basic rate of 20% can also be used as a simplification and cost saving measure and this option is explored in the section on administration changes.
76. Legislation would be required as relief for higher rate taxpayers would be removed to fund the composite rate.
77. Pros
- a) More resources for some charities
  - b) Reduction in administration for charities which would no longer need to collect and maintain records on detailing whether individual donations were made under Gift Aid together with the declarations and names and addresses of the donors.
  - c) Reduction in administration costs of higher rate taxpayers and

- d) Reduction in administration for individuals, doing sponsored events in aid of charities, who would no longer need to collect details of whether donations made by third party individuals were made under Gift Aid.
- e) Reduction in administration costs in HMRC

#### 78. Cons

- a) Less money for those charities who have successfully developed major donors; (the composite rate will specifically penalise only those charities whose donors reduce their donations as a result of losing higher rate tax relief).
- b) A risk of an increase in public expenditure if some or all of Gift Aid would be reclassified as public expenditure rather than tax expenditure. Therefore, public expenditure on Gift Aid would be competing with other claims on the public purse at a time of fiscal consolidation.
- c) Breaking of the basic tenet that taxpayers should not pay tax on assets donated. Some or all of Gift Aid would be turned into a form of state grant subject to the will of government and parliament.
- d) Uncertainty as small changes in either composite rate or donor behaviour can have disproportionately larger effect on some charities.
- e) An undermining of private philanthropy as the composite rate financed by abolition of higher rate relief means the state would, in fact, redistribute the gifts made by higher rate taxpayers. This may change behaviour amongst the largest donors who have the greatest choices and the greatest impact on individual charities.

#### **Tax expenditure on donors re-distributed to charities - redirection of higher rate relief**

- 79. An alternative to the composite rate would be to allow higher rate taxpayers to donate their higher rate relief to the charity. This is sometimes referred to as redirection or the 'tick box method'.

80. Legislation would be required as HMRC would have to have the power to act on a higher rate taxpayer's decision to re-direct their relief to a charity.

81. Pros are :

- a) The Warwick/Bristol<sup>10</sup> research indicated that, overall, charities would receive more in gross donations through the redirection of higher rate relief; especially the education and arts sectors due to the higher proportion of gifts from higher-rate tax payers.
- b) It simplifies explaining Gift Aid to higher-rate donors and reduces confusion. This should encourage philanthropy by showing the significant additional value Gift Aid provides to gifts from higher-rate taxpayers.
- c) It saves donors who are higher-rate taxpayers time and effort in completing their tax returns and having to keep records of donations.
- d) It saves HMRC some of the cost of processing tax returns as they will be simpler.

82. Cons are:

- a) Charities will need to get donors to complete a Gift Aid declaration confirming that they are a higher-rate tax payer (and possibly whether they're 40% or 50% taxpayers) - this will take time and also, if the tax rates or bands change significantly may require them to seek new Gift Aid declarations.
- b) It does make the claiming process more complex for charities as they will need to indicate which of their donors are higher-rate tax payers (and possibly at which level). Those charities with databases and systems that can handle change will absorb this additional effort at marginal cost, but charities, especially the smaller

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<sup>10</sup> Warwick/Bristol report page 51

charities less able to manage change will have difficulty handling additional information.

- c) There might be a concern about lower-rate taxpayers (deliberately or accidentally) ticking the higher-rate taxpayer box but the possibility for such fraud/error exists already in the system with non-taxpayers making Gift Aid declarations. There are also risks of higher rate taxpayers double claiming and increased risks of Gift Aid fraud by charities as the amounts at stake are potentially increased.
- d) Donors may not wish to disclose their tax status to charities.

83. The broad conclusion from this discussion is that the basic framework for Gift Aid works and works well. Reform of the framework brings with it risks some of which could undermine the cashflows that so many charities and other bodies depend on. Effort would be spent more productively on promoting philanthropic giving through Gift Aid. This leads to the following recommendations to Ministers.

- a) **Recommendation 2** : That Government and the charities sector develop a joint programme to promote giving to charities, recognising their contribution to society, for launch in early 2011; noting that all of the money charities receive through the Gift Aid system comes from donors.
- b) **Recommendation 3** : That the Government explain and promote Gift Aid to taxpayers and charities as part of the general programme to promote charitable giving - along the lines, 'giving is good; giving through Gift Aid gives more'.

## **OPTIONS FOR REDUCING THE COSTS TO CHARITIES, DONORS AND HMRC OF OPERATING THE GIFT AID SYSTEM**

84. The costs of compliance with the Gift Aid system impacts on donors and charities very differently.
- a) For example, charities with a large number of small donations have a higher administrative burden than charities with a small number of large donations. Similarly, charities with professional finance staff and suitable accounting systems have more capacity to handle the administration of Gift Aid than the larger number of charities run by volunteers. Charities vary across the sector.
  - b) For example, basic rate donors only need to declare their tax status and provide their name and address at the time of making a gift. Higher rate taxpayers who wish to reclaim the additional relief need to maintain records of their gifts which they will rely upon when completing their tax return.
85. HMRC pays out around £1,000 million per year in tax reclaimed by charities. The size and volume of payments is a target for fraud therefore some of HMRC's costs arise from protecting the public purse against theft. HMRC processes claims on a 'repay now, check later' basis bringing material cashflow benefits to charities and other claimants.
86. Any reforms to reduce the costs of operating Gift Aid to charities, donors and HMRC must have regard to the following:
- a) The range of administrative capacity within the charity community – from single volunteers to large scale financial departments - noting again that the Charity Commission reports that 1.1% of the sector, under 2,000 charities account for 66.9% of the sector's income, that is £35,126 million.
  - b) The range of technical capacity available to the charity community – from untrained single volunteers to professionals qualified in tax at the highest level

- c) The range of capacity relating to IT in the charity community – ranging from individual with a low skill base with no access to IT/limited through public libraries to charities with sophisticated, bespoke software supported by teams of IT professionals.
  - d) The diversity of types and sizes of donations – from cash collected in a tin to cheques for several millions of pounds
  - e) The diversity of the donor community – from non-taxpaying individuals to large scale charitable foundations
  - f) The need to ensure that all payments made by HMRC count as tax rather than public expenditure for the purposes of the national accounts
  - g) The need to ensure that all payments made by HMRC are made to charities that are properly entitled to receive them and that payments are not made in respect of fraudulent claims or used for non-charitable purposes.
  - h) HMRC's administrative capacity particularly in the context of the current pressure on public expenditure – even unchanged, the current system will generate a rising volume of transactions which HMRC will have to absorb. Any administrative reforms may impose initial additional burdens on HMRC and some, such as capital expenditure on IT systems will need to be justified against other public expenditure priorities.
87. It goes without saying that an administrative reform that may help one part of the Gift Aid system may impose burdens on another. For example, the extension of Gift Aid to EU bodies increased the risk of fraud which prompted HMRC to introduce the 'Fit and Proper Person' test which is seen by some smaller charities as particularly burdensome. Although it is perhaps too early to judge, HMRC have not seen any evidence of particular burdens to small charities.
88. Before considering specific proposals it is instructive to consider strategies for yielding savings across the Gift Aid system. These include:
- a) Reducing the number of transactions

- b) Reducing the variety of types of transactions
- c) Eliminating errors
- d) Eliminating paper
- e) Eliminating double processing

89. For example, HMRC have intimated that they receive 3,000 Gift Aid claims per week and as it costs HMRC a minimum of £5 to process each Gift Aid claim reducing the absolute number of claims will yield material savings in HMRC. However, if the number of claims received by HMRC were achieved by restricting the number of claims made by a charity to say one a year the charity would lose the current cash flow benefit of being able to submit claims throughout the year.

90. HMRC have intimated that around 5% of the claims are 'in error' including some which are for substantial sums. Clearly errors in large value claims have more impact on the public purse than errors on claims of smaller value. Whilst the new R681 form will reduce some of the errors, an online claims system has greater potential for validation checks thereby enhancing checks whilst reducing HMRC costs.

91. The current system is largely paper-based - donors sign forms confirming that they are UK taxpayers which charities are obliged to store - and some forms are handled by both the charity and HMRC. All of the 3,000 claims HMRC receive each week are made on paper. However, an advantage of paper-based systems is that they are very easy for volunteers to manage and can be adapted quickly and with minimal cost.

92. However, the move to online filing (74% of SA returns for individuals voluntarily filed online) and the use of 'Adobe type intelligent forms' available online indicates that a suitable online version of returns can be attractive and reduce errors, due to in-built automatic checks. They are also cheaper for HMRC to process once the system has been installed and reduce transcription errors by HMRC staff in deciphering hand written paper forms.

93. These examples illustrate the difficulties of change and the trade-offs that will be necessary to deliver material reductions in the costs of operating the Gift Aid systems.

94. Against this background the ideas for reform are set out below.

95. Charity Database

- a) The retention of Gift Aid declarations remains a major problem for charities – especially those who are not in a position to convert paper declarations to electronic copies. The time taken and cost of storage act as major disincentives to using Gift Aid but equally important is the fear of losing declarations and running into problems, including paying back significant sums of claimed Gift Aid following a HMRC Gift Aid inspection.
- b) These problems could be solved by a standard, simple database capable of being used and maintained by charities, including, crucially, small charities. The database would record the details included on the Gift Aid declaration which would then be confirmed to the donor by letter. The written declaration could then be destroyed if the charity so chose. The entry on the database and confirmation that the letter had been sent would be taken as sufficient evidence that the donor had made the Gift Aid declaration.
- c) This could be developed or procured by HMRC, in consultation with the sector. It should be hosted by HMRC or if not possible, available for free download. Whilst it would involve a modest investment by government, this would be very much in line with the existing policy to invest to make gift aid more accessible and simple and improve take up through reduction of the ‘fear factor.’

96. Clear Instructions on Oral Declarations

- a) Clear standard advice on how charities might make use of oral declarations would be helpful, especially to smaller charities.

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- b) For example, rather than retaining a recording of the conversation, confirmation at a Gift Aid audit might be evidenced by showing to HMRC Charities that the electronic recording of the information generates a letter which is then sent to the donor.
- c) This could be integrated into the proposals for a downloadable database for charities mentioned above.

97. Gift Aid Declarations – Addresses

- a) The current rules could be simplified to allow any address through which the donor can be contacted. Currently, insistence on a home address is causing some cases of cancelling of declarations for fear of falling short of the audit requirement.

98. Sponsored Events

- a) The usage of Gift Aid in association with sponsored events is restricted because of the perceived 'hassle' involved in getting correct details from lots of individual donors making small donations.
- b) A light touch approach could be applied to sponsorship declarations and guidance to emphasize that providing initial, surname, house number and postcode is obtained from / on behalf of the donor, plus the box ticked, that is sufficient for gift aid purposed.

99. Charity Auctions

- a) The rule that the donor is aware, at the time he/she makes a successful bid that the item could be purchased separately and for what price be withdrawn. This rule is restrictive and in any event almost impossible to police. It also devalues the event. Instead of concentrating on the joint objectives of doing more for the charity's beneficiaries and having fun, the charity has to start being 'commercial' and start talking about market values etc.
- b) This would also mean that the guidance in this area could be written in a more positive light. The guidance should also be made more visible as the Gift Aid

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Simplification Survey demonstrated that many organisations are not aware that Gift Aid can be claimed on auction income, despite the fact that they have held auctions.

- c) A more radical development would be to waive the rules altogether and allow Gift Aid on auction income. The rationale for this would be that the whole ethos behind the event and the auction element is about giving more money to the charity rather than buying or selling goods as in a commercial auction. The 'value' of the gift and the purchasing is therefore incidental to the main objective.
- d) In the meantime consideration could be given to a de minimis relaxation for smaller charities where, for example house contents are donated and the aggregate amounts raised at auction are small.

100. Relaxation of 'money' rule

- a) It would be simpler and more logical if Gift Aid applied to money and money equivalents – postage stamps, donated goods, donated expenses etc.
- b) For example, the current rules for “claiming gift aid when goods are sold by, and the proceeds gifted to, charities” are complex and exclude those charities that cannot afford the up front investment in systems. Also those using volunteer staff working short shifts would not be able to train all the customer facing staff to carry out the necessary procedures in an error free way.
- c) A minor change to legislation would bring a large simplification. To prevent abuse to the system Government and the Sector could work together on proposing simple rules for valuing items.

101. Split Payments

- a) Where a charity separates that part of a subscription that simply gives the basic rights of membership from any part that relates to the provision of services or facilities the membership element can be treated as a gift. Clarification on how this might work with Gift Aid would be helpful.

102. Benefits

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- a) To encourage major gift giving it would be useful if the current benefit limitation rules could be reviewed, either by amending the rules governing Split Payments or by revising the Aggregate Value Test;
- b) To remove confusion and costly clarification processes, the rules governing benefit valuation could be further strengthened.

103. Gift Aid from Couples

- a) The Gift Aid Survey identified problems in claiming donations from couples. This was especially identified by charities receiving membership fees from parents, but is also an issue for churches receiving donations.
- b) It would be helpful, if one member of the couple is a taxpayer for the Gift Aid to be claimed for the couple rather than as present, having to split the donations/gift aid.

104. Gift Aid Claims Online

- a) For those charities that are now getting used to dealing with PAYE online, it makes sense to allow them to make Gift Aid claims online as well.

105. Payroll Giving

- a) Currently outside the Gift Aid system, Payroll Giving might be reformed to bring it within the Gift Aid system. However, care must be taken to avoid gifts being made without tax being paid otherwise any tax reclaimed would be public expenditure.

106. Standard tools

- a) For example, intelligent claim forms such as HMRC R68 and HMRC approved arrangements for maintaining the donor records of micro and small charities <sup>11</sup>, etc.

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<sup>11</sup> CTG's proposal for a standard database for donor records that would be approved by HMRC and made available free over the web

107. The digital age - SMS and mobile phones.
- a) ResPublica<sup>12</sup> have offered some proposals to develop arrangements for giving to charities using mobile phones and enabling charities to make claims to HMRC online.
  - b) It would be helpful to establish the arrangements for doing so, so that charities and their partners in the mobile phone and IT industry can develop systems to take advantage of Gift Aid.
108. These proposals all have costs and benefits which are difficult to assess. In addition, it would be helpful if any reforms were consistent with other reforms within the tax system. However, they are largely technical and arguably less contentious or divisive than reforms which have a direct impact on the income of charities. Therefore this leads to the following recommendations to Ministers:
- a) **Recommendation 4.1** : That the Government should publish a work programme including a timetable for examining and ideally implementing the long list of reforms to the administration of the Gift Aid system set out in this appendix.
  - b) **Recommendation 4.2** The work programme should give priority to reforms which remove the requirement for mandatory paper declarations, through for example, creating a standard Gift Aid database. This removes paper from the system and will be of particular benefit to smaller charities.
  - c) **Recommendation 4.3** : The work programme should also give priority to proposals for enabling higher rate taxpayers to redirect the relief on their donations to charities, thereby increasing the value of donors' gifts and their incentives to give.
  - d) **Recommendation 4.4** : The work programme should schedule the start of work on arrangements to digitise Gift Aid including enabling charities to submit Gift Aid claims online and donors to make gifts using mobile phones.
  - e) **Recommendation 4.5** : The work programme should be published by the end of 2010 and should be informed by advice from the Office of Tax Simplification,

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<sup>12</sup> <http://www.respublica.org.uk/sites/www.respublica.org.uk/files/Digital%20Giving.pdf>

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charities, fundraisers and professionals advising them. Ministers should give consideration to commissioning an independent person to bring together this advice.

- f) **Recommendation 4.6** : The work programme should not consider proposals that will cause Gift Aid as a whole to be reclassified as public expenditure.
  
- g) **Recommendation 4.7** : The Gift Aid Forum should be disbanded.

#### Appendix 4 : LUBRICATING THE MECHANISM

109. It is instructive to note that Gift Aid payments have grown from £11 million in 1990/91 to £902 million in 2009/10. It is difficult to conclude that this growth is evidence of a system that is failing.

110. It is perhaps inevitable that attention becomes focused on the 'squeaking and rubbing' within the system because that is what causes irritation to those involved. There is a natural temptation to re-design the system in response. Underpinning the previous brief discussion is the assumption that the components of Gift Aid have been designed for a reason and changing the way things work incurs risks which are not always immediately apparent. Examples are the reduction in the basic rate of income tax in 2008 precipitated transitional relief which costs £100 million and the extension of Gift Aid to EU bodies in 2010 precipitated the 'Fit and Proper Person Test' which has attendant challenges.

111. Another way of looking at the Gift Aid system is that it works really well and would work more smoothly with a little lubrication.

112. A lubricant is people - especially those who are trained and experienced in providing tax services. Gift Aid is not complex to those whose profession is to deal with the tax system. The tax agent community already donates time and skill to supporting the unrepresented to handle their tax affairs. HMRC support or work with the tax charities - TaxAid supports those in tax debt; and Tax Volunteers provides tax aid for older people. Indeed, Tax Volunteers includes around 700 CIOT members who provide support pro bono. HMRC also encourages its staff to donate their time. Similarly while there is evidence that smaller charities find difficulties with Gift Aid there is also evidence that many do not. For example, Churches within the Church of England have been particularly successful in mobilising their volunteers to take advantage of Gift Aid and its predecessors - but it has taken time.

113. Further work might be done to encourage tax professionals both within and outside government to donate their time and skills to support charities, especially the smaller charities, to take advantage of Gift Aid. This leads to the following recommendations to Ministers:

- a) **Recommendation 5** : Ministers should consult with the tax profession to explore how tax professionals might donate their skills and time to help charities comply with and benefit from the Gift Aid system.
  
- b) **Recommendation 6** : That Ministers should have regard to the particular needs of small charities in the implementation of these proposals and give them priority when there is less pressure on public expenditure.