The Charity Law & Practice Review

GIFT AID RELIEF FOR GIFTS IN KIND

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1 Scope of the Article

Gift Aid relief for gifts to charity is currently limited to payments of money. There is every reason in principle why it should extend to gifts of assets in kind. Alleged practical problems of valuation will be found, on analysis, to be a vermilion herring.

There is no reason in principle why the donor should not be able to carry forward Gift Aid relief to future years or, within limits, to carry it backward.

Likewise, there is no reason why the donor should not be able to set his relief off against his capital gains tax liability rather than his income tax liability. This could be particularly appropriate in the case of the gift of a capital asset.

2 The Extension of Fiscal Reliefs

2.1 Increasing Need for Extended Reliefs

It is Government policy to reduce public expenditure wherever the burden can be passed on to charities. This necessitates an increase in the funding of charities by voluntary contributions. In order to induce the private sector to give more, the State must provide an incentive. Tax concessions are one of the most efficient incentives known. In principle, the idea is an excellent one. At a cost of, say, £400 in income tax relief, which the State in effect donates to charity, it secures a further donation by an individual higher rate taxpayer of £600. The higher rate taxpayer may well be very happy to give up £1,000 to a charity of his choice rather than to pay £400 in income tax, over the expenditure of which he will have no control, and be left with £600 in his pocket.

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2.2 History of Reform under the Present Government

Much has admittedly been done since the Conservatives took power in 1979. Gifts to charity had been exempt from capital gains tax since its inception in 1965. Gifts to charities made more than one year before one's death were always exempt from inheritance tax, or capital transfer tax as it was then called. Now all gifts to charity without limit, even ones made by will, are completely exempt. Moreover, the gifts with reservation of benefit provisions, introduced in 1986, do not apply to gifts which qualify for the charitable exemption, so that a donor may in general, subject to certain anti-avoidance rules, make a gift to charity during his lifetime and continue to benefit from it without any inheritance tax being payable.

It is in the area of income tax and corporation tax on income that the most significant reforms have been made. Since 1965, covenanted payments to charity qualified for tax relief only at the basic rate. While covenanted payments made by corporations were in principle fully deductible for corporation tax purposes, in the case of a closely held company they could entail a charge to income tax at the higher rates on shareholders or other participators in the company. One-off payments did not qualify. The payments had to be periodic and capable of occurrence during a period of at least six years and one day.

The reforms effected concerning income tax relief for gifts of *money* have indeed been considerable. Since 1987, covenanted payments have been fully deductible for the purposes of income tax at all rates. Covenanted payments made by closely held corporations can no longer involve their participators in an income tax charge. The minimum period over which the payments must be capable of recurrence has been reduced to three years and one day.[2]

Gift Aid was introduced in 1990. The ceiling of £5,000,000 on total payments deductible by any one taxpayer in a year of assessment was removed in 1991. The minimum amount of a gift which can qualify was reduced in 1993 from £600 to £250 which, in the case of a donor who pays tax at the higher rate, means that the net cost to him of his gift can be as little as £200. While both the Gift Aid and covenanted payment rules are bristling with technicalities and contain their fair share of traps for the unwary, in practice they operate reasonably well and the Inland Revenue do not seem over astute to deny relief on the grounds of pure technicalities.

[2] Hence, most covenants are to pay an annual sum for four years.

3 The Limitations of Gift Aid

3.1 The Basic Rule

The chief limitation on the utility of both covenanted payments and Gift Aid payments is that they must be payments of money. In the case of covenanted payments, this is entirely a matter of historical accident. The Gift Aid legislation to some extent builds on the covenanted payment rules in that it deems a "qualifying donation" to be a covenanted payment.[3] Conversely, the receipt by the charity of the qualifying donation is treated for tax purposes as the receipt of an annual payment equal to the gross amount of the gift, which is deemed to have been paid under deduction of income tax at the basic rate for the relevant year of assessment.[4]

But despite the fact that the Gift Aid rules build upon the covenanted payment rules it is clearly no historic accident that only payments of sums of money qualify. The Gift Aid code has been very carefully thought out. It is quite clear that as a matter of policy it was decided that it would not apply to gifts in kind. Indeed, it contains an anti-avoidance provision aimed at preventing indirect gifts in kind.

3.2 Anti-avoidance: the Supposed Mischief

Suppose a donor wishes to donate a painting worth £1m to a charity. But for the anti-avoidance provision, he could make a Gift Aid payment of £750,000 to the charity on condition that it purchased the picture from him at market value. The charity would then recover £250,000 from the Revenue and purchases the picture from him for £1m. The donor would then use the £250,000 to meet his basic rate of tax liability on the £1m of his income which he had given away. By virtue of the Gift Aid payment, he would escape paying £150,000 income tax, being the difference between the higher and the basic rate on £1m. Thus, the total cost to him of the gift would be £600,000, which is the amount he would have been left with had he made no gift and simply paid £400,000 tax on the £1m income.

3.3 The Provision

In fact, because the qualifying donation is conditional on the acquisition of property by the charity from the donor otherwise by way of a gift, Gift Aid relief is denied, by Finance Act 1990 section 25(2)(f). Nor can the anti-avoidance provision be escaped by making the gift on the "understanding" that it would be used to buy the picture. If it is "associated with or part of an arrangement

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3 See Finance Act 1990 section 25(6).

4 See section 25(10).

involving" the acquisition of the painting by the charity, relief is also denied. Then again, if the donor gives the painting to his wife or a trust, from whom or which the charity buys the painting, the anti-avoidance provision still applies, because the acquisition is from a person "connected" with the donor.

3.4 The Downside

As is commonly the case with anti-avoidance provisions, resourceful donors will be able to obtain advice from specialist tax counsel on how to avoid the anti-avoidance provision, while those who are not adequately advised may find they have unwittingly increased their tax bill. Reverting to the above example, the donor would find himself not only denied Gift Aid relief but also exposed to a charge of capital gains tax on the basis that he had sold the painting for £1m. If he had simply given the painting to the charity there would have been no question of any such liability.

4 The Argument on Difficulty of Valuation

It is prima facie irrational to distinguish between gifts of cash and gifts in kind. The concern of the Inland Revenue is apparently that gifts in kind would be difficult to police and it is the determination of their value which is at the heart of the problem.

Now the valuation of some investments, such as shares in a publicly quoted company, will be easier than others, such as a minority holding in a privately held company. In many cases, the gift will take the form of an object of intrinsic value to a charity, such as a work of art or historic documents. Such objects are notoriously difficult to value. There is in practice a wide spectrum of values which competent experts might reasonably certify as being the market value. On the basis that the charity is being given the object or, at the very least, being sold it at less than its market value, it will have no incentive to argue for a low market value. The donor normally will. The Inland Revenue are perhaps concerned that they lack the resources to obtain independent valuations themselves or to verify valuations obtained by donors.

I find this plea far from convincing. Fiscal legislation requires market valuations of property on many occasions for the purposes of inheritance tax, capital gains tax, income tax, corporation tax, value added tax and stamp duty. I would be perhaps more impressed by the Revenue's argument if they were to forgo levying charges to tax whenever a difficult problem of valuation would be involved! In the case of land, the Inland Revenue can call on the services of the District Valuer. In the case of shares, they have their own Shares Valuation Division. They even seem to cope with valuing works of art. There is no asset capable of being gifted which they do not need to value and do not in fact succeed in valuing.

In principle, Gift Aid relief should be available for all gifts in kind. The Revenue would be adequately protected. They could in any case where they were unhappy with a valuation refuse a claim for relief and force the taxpayer to prove on appeal to independent Commissioners that his valuation was correct, just as happens in the case of any other income tax dispute.

In fact, on a closer examination, one realises that, if the rules are properly structured so as to avoid double relief, a valuation will be required but seldom and possibly never.

5 Avoidance of Double Relief

It would obviously be unfair to put a person who makes a gift in kind in a better position than one who makes a gift in cash. Consider the following scenario. A donor has a painting which he and the charity which is intended to become its owner agree is worth £1m. If the donor were to sell the painting on the open market, it would be necessary to compute for capital gains tax purposes his chargeable gain. That would involve ascertaining his acquisition cost, any allowable expenditure and indexation relief. Let us suppose that the total of these, his base cost, is £250,000. If the donor were to sell the painting for £1m, he would realise a chargeable gain of £750,000 on which he would pay capital gains tax at, let it be assumed, the top rate of 40%, making £300,000. Hence he would end up with only £700,000. If he were to give the asset to charity, then, under existing law, he would be deemed to receive such consideration as results in his realising neither a gain or a loss, namely £250,000. Thus, he would have given up a picture which was itself worth, say, £1m, yet which he could have turned to only £700,000 of net pecuniary advantage by way of sale on the open market. If he were to be allowed Gift Aid relief on the gift of the picture and his capital gains tax position were to remain unchanged, he would actually be better off than someone who had made a cash donation of £1m; for he would have saved both £300,000 capital gains tax and £400,000 income tax, whereas the donor of the cash would have saved only £400,000 income tax.

Justice would be achieved by limiting the amount deductible for Gift Aid purposes to the value of the consideration the donor is deemed to received for capital gains tax purposes, in this case, £250,000. The result would be that the donor would save £300,000 capital gains tax and, assuming him to be a top rate taxpayer, 40% of £250,000, i.e. £100,000 income tax, making a total saving of £400,000. This is precisely the saving which a donor of £1m cash would have achieved.

Not only would this rule produce a just result; *it would also in the vast majority of cases avoid any need to value the object gifted.* Whether the object be worth £950,000 or £1,050,000 would be irrelevant. The donor's tax position would be just the same.

The only real difficulty arises where the asset has fallen in value, so that the donor would in fact realise a loss if it were sold for a market value consideration. Under existing law, the donor of a gift to charity is deemed for capital gains tax purposes to receive such consideration as to secure that neither a gain nor a loss accrues on the disposal. See Taxation of Capital Gains Act 1992 section 257(2)(a).

Now this provision is fundamentally unjust in its treatment of losses. The symmetry of the wording deceptively masks an asymmetry of treatment. While it makes perfect sense to provide that if a person is gifting his capital gain to charity then he should not pay any tax on it, it makes no sense to provide that if on a gift to charity he should happen to realise a loss, that loss shall not be an allowable loss. For, unlike the gain, the loss remains his and is not transferred to the charity. Quite apart from any considerations of Gift Aid relief, section 257 ought to be amended so that the consideration which the donor is deemed to receive (and that which the charity is deemed to give) for the asset is the lower of its market value and the maximum amount of such consideration consistent with the donor not realising a gain on the disposal.[5]

6 Proposed Reforms

6.1 The Ideal

Returning to Gift Aid, if my proposed amendment of section 257 were to be adopted, it would involve a valuation of the property gifted, just as in the case of virtually any other gift.[6] The valuation would in fact be a formality in any case where it was clear that the market value was greater than the donor's base cost. The donor would then become entitled to an income tax deduction equal to his capital gains tax base cost, or, if lower, the market value of the asset gifted. Thus, reverting to the above example, if the donor's base cost were £250,000 but the market value of the asset gifted were only £100,000, he would obtain relief from income tax on £100,000. He would also, however, have available an allowable capital loss of £150,000.[7] The taxpayer is thus in exactly the position where he ought to be, namely as if he had sold the asset on the open market for £100,000 and then donated the cash to the charity.

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5 Again, the well-advised donor can usually circumvent the problem.

6 The general rule is that the donor of a gift is deemed to receive for it a consideration equal to its market value: see Taxation of Chargeable Gains Act 1992 section 17(1).

7 In certain cases, there would be restrictions on the chargeable gains against which the donor could set off his allowable losses. Specialist tax counsel ought to be able to ensure that these restrictions were avoided.

6.2 The Compromise

Such is the ideal reform. If there were an unreasoning reluctance to amend section 257 in the manner indicated, then one could still apply the new Gift Aid rules literally without making any special provision for realised losses. Thus, in the example of the taxpayer who gives a painting in respect of which he has a capital gains tax base cost of £250,000, it would be completely irrelevant what the market value of that asset was. As he would be deemed to receive a consideration equal to that base cost, he would obtain a deduction from his taxable income of that amount. In effect, his capital loss would be relieved not against his capital gains tax liability but against his income tax liability. In the vast majority of cases, the result would no doubt be the same as if section 257 had been amended. His total allowable deduction in either case would be £250,000. If section 257 were amended, this total would be made up of a £150,000 deduction from taxable capital gains and a £100,000 deduction from taxable income; whereas in the latter case it would be entirely a £250,000 deduction from taxable income.

In virtually all cases, taxpayers pay income tax and capital gains tax at the same rate so that the value of the reliefs would be the same. The main case where it would make a difference would be where the taxpayer had taxable income against which to set his Gift Aid relief but did not have sufficient chargeable gains against which to set his allowable losses or vice versa. Personally, this does not concern me in the least. I have long since argued that when Nigel Lawson harmonised the rates of capital gains tax and income tax in 1988, he should have gone one step further and allowed allowable capital losses to be set off against taxable income and income losses to be set off against capital gains, as is the case in, say, the United States.

The enormous advantage of this second method is that it involves no valuation at all.

7 Spreading Reliefs

One feature of Gift Aid is that the tax deduction is obtained in the year in which the payment is made. The taxpayer may wish to give a substantial sum which exceeds his taxable income for a year. He may not even know before the end of the year what his net taxable income for that year will be. In the case of cash gifts, there exist mechanisms which are said to enable a gift to be spread over several years. While these strategies are often implemented in manners which are highly questionable in law, the Inland Revenue appear in general to accept that they are efficient. Where, however, a donor is to donate an object of some considerable value, it is more difficult — I shall not say impossible — to split the object up and to give part of it year by year.

It would be eminently sensible if the taxpayer could choose to carry forward or, within limits, backwards Gift Aid relief which he is not able to utilise in the given year. There is no reason at all in principle why this should not be done. This is routinely done, for example, in the case of trading losses.

8 Changes to Mechanics

Some changes would, of course, be needed in the mechanics of the system. A sum of money can be paid, as it is in effect paid under Gift Aid at present, under deduction of basic rate tax. A gift of an asset in kind must necessarily be made gross. In the case of a gift in kind, therefore, the charity would not be able to recover any tax consequent on the gift being made. The charity would be deemed to have received taxable income equal to the gross amount of the relief obtained by the donor, which would normally be equal to his capital gains tax base cost. The charity would be taxable on that notional income only in the same circumstances as it would on a Gift Aid payment of money. The donor would be entitled to a deduction equal to his capital gains tax base cost in computing his total income for the purpose of calculating his income tax liability at all rates. As the charity will be receiving a gross gift it would not matter against which year's income the donor elected to set his Gift Aid relief.

Equally, a donor of a Gift Aid payment consisting of money should also be able to spread his relief backwards or forwards. Complications might admittedly arise where the taxpayer had made a gift in a given year, the charity immediately reclaimed basic rate tax on the grossed up amount but the taxpayer then elected to set the whole or part of the relief against his liability for subsequent years. The obvious solution is for the taxpayer to be able to elect that his Gift Aid payment of money should be regarded as a gross one. He would increase the amount of his gift accordingly.[8] The charity would, as in the case of a gift in kind, not be able to reclaim any income tax, whereas the donor would obtain relief at both basic and higher rates of tax in the years he has chosen.

Under the present system of the donor making net payments and the charity reclaiming the tax, the charity automatically notifies the Revenue that a payment has been made. Under a gross gift system, whether of a gift in kind or of cash, the Revenue could quite reasonably expect the taxpayer to provide a certificate signed by the recipient charity acknowledging the gift.[9]

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8 With a basic rate of income tax of 25%, his gift will be increased by one third.

9 Compare the position where a person pays "qualifying" interest gross for which he subsequently makes a claim for tax relief. The bank or other lender completes a certificate of interest paid in the year, which the borrower then submits to the Revenue.

9 Relief against Income Tax or Capital Gains Tax?

Gift Aid relief is currently given only against income tax liability. That is no doubt because historically covenanted payments were a means of relieving such liability. There is no reason in principle why Gift Aid relief should not be given, in whole or in part, at the donor's election, against a capital gains tax liability, rather than an income tax liability. With the approximation of the rates of income tax and capital gains tax payable by individuals and corporations as a result of the Finance Act 1988 changes, the two taxes are well on their way to assimilation. Logically, the assimilation should be completed. The distinction between income gains and capital gains is such an artificial one that the sooner this is done the better. Allowing Gift Aid relief against either tax would be a further step in the right direction.

10 Conclusion

There is every reason in principle why relief under Gift Aid should be extended to gifts in kind and not limited to gifts of money.

The supposed problems of valuation are largely illusory. Valuations will in fact be required only where the market value of the asset gifted at the time of the gift is less than the donor's capital gains tax base cost, provided there were also implemented an overdue reform of the capital gains tax rules where a donor of an asset to charity would have realised an allowable loss on the sale of the asset for market value.

Alternatively, valuations can be avoided altogether by allowing any capital loss which may be realised on the gift to be set off against taxable income, as part of the Gift Aid relief.

There is every reason to allow donors to spread forwards or backwards Gift Aid relief. The necessary changes to the mechanics of the Gift Aid relief system would be extremely easy and follow precedents of other allowable deductions.

There is no reason in principle why Gift Aid relief should not be set against capital gains or income profits, at the donor's option.